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Litigating Variable Compensation and Incentive Payment Cases in Oregon: Is it a commission or a bonus, and when is the obligation to payment absolute?

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Introduction and Purpose:

Over the last 10 years, my office has litigated numerous employment law cases where the recovery of significant amounts of earned compensation hinged on the determination of its classification: Whether the compensation at issue was commission, wages, incentive payments, variable compensation, bonus, or something else. On behalf of those clients, we have been fortunate to secure comprehensive victories, often securing 100% of damages sought, plus penalties, plus reimbursement of attorneys fees. Two notable cases involved significant wins on appeal; one in the Oregon Court of Appeals, and one at the 9th Circuit Court of Appeals. Our firm prides itself in mathematical competency—with one partner who was a CPA in a past life, an associate with tax/and accounting expertise, and your present author, who has gotten a lot of mileage out of a certificate from business school titled "Financial Analysis and Valuation for Lawyers." Understanding the math and accounting aspects of these cases allows us to litigate these cases at a depth that has resulted in what I believe are new insights that should prove helpful for both companies drafting incentive compensation plans and for salespeople or executives who are negotiating their compensation or asking whether they should be paid wages that their employer is denying them.

One of the dynamics that makes this area so technical is how the contract principles which lawyers are comfortable intersect with—and are sometimes contradicted by—standard accounting principles (often called generally accepted accounting principles, or "GAAP"). But although the subject matter can be technical, there are also strong notions of equity that create critical fairness issues in the litigation context. Specifically this: if a sales employee has done everything that was asked of them, and their employer got paid by their client, is it a windfall for the employer to keep the money and not pay the employee? Sometimes the answer is yes, sometimes it's no, but the question creates tension that drives powerful narratives and case themes in a trial setting.

The following article has two sections. The first offers examples of specific terms in actual compensation agreements that resulted in litigation. The second part of the article analyzes key Oregon cases that are critical for dissecting compensation classification.

The purpose of this article is to discuss the law and share information with colleagues. Corrections and comments and conversations over coffee are most welcome. **No part of this article is intended to be legal advice**, and as I hope is clear from the discussion, the complexities in this area of law are rich and many, and employers and employees alike should seek actually intelligent, and not merely artificially intelligent, legal representation before wading into the deep waters of variable compensation litigation.

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Part I. Examples of Variable Compensation Clauses:

It's my opinion that many employers are exposing themselves to massive drafting issues in their incentive payment agreements. On the other hand, however, executives and high-level sales staff are leaving hundreds of thousands of dollars—and in some cases we've handled, millions of dollars—on the table, if they are to quit or be terminated without pressing their claim for wages. The following are provisions from various agreements which are offered as tangible, real-world examples of variable compensation clauses. After these clauses is an analysis of the legal principles that are used by courts to interpret them:

1. **Patrick Johnson v. Floor Solutions LLC**[1]

In the *Johnson* case, the CEO/Employee's agreement provided the following provision:

> *Commission Provisions: Commissions are not considered earned until the job is closed and paid in full. Employees must be actively employed on the date the commission is earned to be eligible for payment. However, management has the discretion to pay a percentage of a commission based on how much of a job requires the involvement of others to complete. The job must still be closed and paid in full to be eligible for payment.*

In this agreement, the employer has attempted to define the point in time at which the wages were to be earned. The first sentence establishes the timing: when the job, which in this case was flooring construction, was completed and paid in full. A critical complexity of this case to note that the construction industry can involve long time-horizons, and the progress and completion of a job is not something the salesperson has control over. It might take five years to finish a building, and flooring is often installed towards the end of that project. It's not uncommon in the flooring sales world for payment from the customer to be triggered only when the project is completed, and even then only after a retention period (think: waiting period) is complete.

Although the first sentence in the above example provision purports to establish an earning definition, the second sentence then appears to change the definition established in the first sentence. The second sentence requires the employee to be actively employed to be eligible for payment. The contract thereby creates the possibility for a salesperson to do everything asked of them and yet go unpaid for their services. This is because under this contract term, it is possible that the salesperson might successfully get a foot in the door with the customer, build the relationship, get an opportunity to bid, bid, win the bid, manage the project, watch and wait for the project be completed, wait for most of the retention period—but, if the salesperson quits or is fired before the actual payment is made, then the employer, as far as was argued in this case, could claim that the payment wasn't earned under the contract's terms.

In this case, Mr. Johnson had been terminated shortly before significant commissions were "due" (a term I, and some court opinions, use to mean the date when payment must occur). Litigation had

[1] *Floor Sols., LLC v. Johnson*, 322 Or. App. 417, 520 P.3d 902 (Ct. App. 2022).

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commenced after Floor Solutions sued Mr. Johnson for breach of restrictive covenants under his employment contract. Floor Solutions sought a temporary restraining order ("TRO") in state court, and on behalf of Mr. Johnson, our firm and Mr. Johnson defeated the TRO by arguing the non-payment of wages was a prior material breach precluding relief for the employer. *See* Docket; Feb 5, 2020: 19CV53363. Mr. Johnson ultimately prevailed on his claims after a full arbitration hearing through the Arbitration Services of Portland. He was awarded the full amount of his prayer, plus attorneys fees, a statutory penalty, interest, and costs. The award was confirmed on appeal. Floor Solutions, LLC v. Johnson, 322 Or. App. 417, 520 P.3d 902 (Or. App. 2022). The above quoted contract provision was critical to the dispute. Also important were the *Martin*[2] and *Thompson*[3] cases (which are discussed below), which were heavily argued over and relied on by both parties' counsels.

Additionally, on a related but different part of Mr. Johnson's claim, the contract provision governing compensation titled "variable compensation" was at issue. The defense presented the argument that it was a contractually unlocked bonus rather than obligatory commission wages. The contract was substantially similar to the provisions below:

> *Variable Compensation. You are entitled to seventy percent (70%) of the bonus pool:*
>
> - *EBITDAM < $1mm = 0%.*
> - *EBITDAM $1m – $1.5M = 30%*
> - *EBITDAM > $1.5m = 40%*
>
> *In addition to the bonus entitlement, if the Company generates more than $1,000,000 in EBITDAM, you will be entitled to an additional $25,000.00. The Bonus pool EBITDAM is measured from August 1 to July 31 (The Measurement Period) commencing on August 1, 2014. EBITDAM is equal to Income plus interest, taxes, depreciation, amortization and any management fee charged by Holding Company or any other non-arms length entity. The Variable Compensation will be paid as soon as practicable and in any case, no later than 6 months following the end of the Measurement Period.*

Important terms in the paragraph include: "entitled," "bonus pool," the EBITDAM formula/metrics used for calculation, "Measurement Period," and "*The Variable Compensation will be paid as soon as practicable and in any case*…" Keep these terms in mind, as the *Thompson*, *Martin*, and *Larsson*[4] cases are discussed below in the case law section. There is an aesthetic and word association battle involved here, but even more importantly in my opinion, a conflation of definitions, and muddling of "rate of pay" and earning definitions.

2. *Alex Larsson v. DXC Technology Inc*: Interpreting Complex Incentive Compensation

[2] *Martin v. DHL*, 235 Or. App. 503, 234 P.3d 997 (Or. Ct. App. 2010).
[3] *Thompson v. Burr*, 260 Or. 329, 490 P.2d 157 (1971).
[4] *Larsson v. DXC Tech. Servs., LLC*, 2023 U.S. App. LEXIS 31514 (9th Cir. Nov. 29, 2023) (nonprecedential memorandum opinion not for publication).

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Agreements

In *Larsson v. DXC Technology*, a case I litigated on behalf of Mr. Larsson, the District Court judge ruled in favor of the defendant employer on cross motions for summary judgment. However, after appealing to the 9th Circuit Court of Appeals, the District Court's ruling in favor of the employer was reversed and Mr. Larsson prevailed. The facts before the court were narrow. Mr. Larsson—who by all accounts, was an incredible salesperson—wasn't terminated, but had resigned shortly after the end of Fiscal Quarter 3. His compensation documents called his compensation "incentive payments" in some places, "commissions" in other places, and used the term "bonus" never—but nevertheless the defense argued that the compensation at issue was a "bonus." The defendants took the position that because Mr. Larsson's claim for was for a "bonus," it was contractual, and therefore earnable only upon satisfaction of the following condition precedent:

> *Incentive Payment and Timing: Company will pay Incentive Payments within ninety (90) days following the end of the fiscal year or the quarter in which such payment was calculated by Company, so long as there are no unforeseen or extraordinary events or circumstances which effect Company's ability to calculate or make payment. If there are unforeseen or extraordinary events, Company will pay these Incentive Payments as soon as reasonably possible. However, for metrics which are part of Company's financial reporting, no payment will be made until Company has announced its earnings for the quarter and any relevant SEC filings have been completed.*
>
> *If a Participant's employment terminates for any reason the employee is no longer a Participant and will not be entitled to any further Incentive Payments unless otherwise stated in the Agreement subject to Applicable Law. No claim or entitlement to compensation or damages shall arise from non-payment of an Incentive Payment resulting from termination of the Participant's employment for any reason whatsoever.*

The drafting issue, and problem for the defendant, was that the employee's 'incentive payments,' to use the neutral term, were calculated quarterly. This created a paradox. To explain this paradox: if Mr. Larsson completed Fiscal Quarter 1, and was due $86,000 in wages, he would need to wait until the end of Fiscal Quarter 2, according to the contract, to earn the Q1 pay. But what about his Q2 pay? The defense position was that he would then need to wait until the end of Q3 to get his Q2 pay—but what about his Q3 pay? From the defense: repeat *ad infinitum*. In this case, Mr. Larsson had worked through the end of the applicable fiscal quarter and then resigned his employment in good standing. The employer did not pay his wages and pointed to the contract that purported to require him to work through the end of Q2 to receive his Q1 pay.

On behalf of Mr. Larsson, we argued successfully that the wages at issue were commission wages, relying heavily on *Martin v. DHL* (discussed below in Part II), a case whose holding was contested.

3. **Terms relating to complex mathematical formulas that boiled down to a percentage, or rate of pay.**

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This section aims to unravel some terms in the examples below that are useful for the *Martin* analysis in Section II. The question that will be under the microscope is the degree of connection between the act of selling and the resulting compensation. Is there any connection, is it correlated, or is it effectively a mathematical rate? In the *Larsson* case, the employer elected a complicated formula that muddled the issue. In the following compensation formula, despite the complexity, we were able to prove, through some wonderful mathematical analysis from my partner, that the Total Contract Value ("TCV") and Annual Booked Revenue ("ABR") formulas at issue boiled down to the numbers of 1% and 3.5%, respectively. This was a critical factor in establishing that Mr. Larsson's wage was a commission.

- TCV AND ABR
  - "Total Contract Value" (TCV) is the total anticipated US dollar value of a Contract Award as determined consistent with the DXC Bookings policy in the current fiscal year resulting from an Opportunity to which the SICP Participant is assigned in the Plan Assignment Agreement and for the Offerings described in the Plan Assignment Agreement. Only the net incremental value of the contract is included in TCV.
  - "Annual Booked Revenue (ABR)" is the total expected revenue per the Bid Model in the 1st twelve full fiscal months commencing on the final validated Salesforce.com close date. It is the expected revenue based on the reportable contract revenue as determined in the Company's discretion and as stated and validated in Salesforce.com.

- TCV Pay Curve
  - Annual Incentive Payment Calculation Guidelines
  - TCV Incentive Payments are calculated as follows:
  - TCV Incentive Payment is based upon achievement percentage of Quota
  - Percentage of achievement is not rounded, but the exact percentage will be applied against the annual TCV OTI.
    - TCV achievement > 100% achievement of Quota: o ((Annual achievement percentage of Quota – 100%) x 130%)) + 100%
    - FY20 DXC SICP Plan 4 v1 27 DXC Confidential Information
    - Acceleration only applies to achievement >100%. The percentage of achievement above 100% is multiplied by 130% if the accelerator is applicable.
    - Cap at 500% of annual TCV OTI

- *ABR Payout Curve*
  - Participants will be eligible for an accelerated upside opportunity of a 130% multiplier for achievement over 100% and a 500% ABR OTI Cap, as explained below.
  - Annual Incentive Payment Calculation Guidelines
  - ABR Incentive Payments are calculated as follows:
    - ABR Incentive Payment is based upon achievement percentage of Quota
    - Percentage of achievement is not rounded, but the exact percentage will be applied against the annual ABR OTI.
    - ABR achievement > 100% achievement of Quota: o ((Annual achievement percentage of Quota – 100%) x 130%)) + 100%

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- Acceleration only applies to achievement >100%. The percentage of achievement above 100% is multiplied by 130% if the accelerator is applicable.
- Cap at 500% of annual ABR OTI

The employer's first argument was that the above formula wasn't like a commission because the rate was variable (e.g., it can change). To simplify, the rate increased by 30% once the quota number was reached. This was not a successful argument. Is a commission any less a commission because the employee gets 5% on sales 1-10, and 7% if he sells more than 10? Common sense and the courts say no. The second argument from the employer was that it wasn't a commission because a commission earns in lockstep, but this formula used the word quota. The next section discusses why the above language was not a 'quota,' as the term is ordinarily used.

4. Is it a Quota or is it a Quota?

The word quota has a meaning, and that meaning typically establishes a quantity that is a gate, or a threshold. If a quota is achieved, something happens. In compensation agreements, a quota is sometimes established to create a floor for the compensation. When that is the case, and if that is how the term is used in the contract, then that can be a factor that points towards classification as a bonus instead of a commission. However, even if the term quota is invoked, if it is used as a mere accelerator of the worker's earning rate, then effectively it isn't performing the gatekeeping function typically established by a quota.

> *"Quota" is the annual target objective for each metric assigned to the SICP Participant in their individually assigned Plan Mechanic. Each applicable Quota component is set forth in the Plan Assignment Agreement and, to the extent permitted under Applicable Law, can be varied or amended by Sales Leaders in any respect and at any time during the Plan Assignment Period with or without the consent of the Participant where the Sales Leader considers that the Quota does not sufficiently incentivize the Participant or for any other reason the Sales Leader deems necessary or appropriate in his or her sole discretion. The Quota may be pro-rated to reflect a Plan Assignment Period shorter than a full fiscal year. Quota assignments are not final until approved by the Vice President, Global Sales Operations and Vice President, Global Sales.*

In the applicable case, the term quota didn't operate as a floor, a gate, or a threshold. It wasn't an unlocking concept. Instead, the effect of the quota in the case was simply that the employee's rate would increase, as discussed above. The analysis in the case law section will discuss the importance of the term quota, and offer insight into why drafters of contract might be using the term quota in spite of their being no requirement for the employee to meet the quota in order to be paid the compensation. If a drafter is attempting to actually establish a quota, or a requirement that a certain number of sales be met, before a payment is made, it should not act as a numerator in an incentive payment calculation.

5. The Case of a Financial Analyst vs. a Stock Advisory Company:

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In a case that resolved just prior to actually filing the complaint, a financial analyst and a stock advisory firm took different positions on the compensation agreement. The parties entered into a complicated risk sharing/incentive payment agreement. Unlike other compensation models highlighted above, this case arguably didn't involve sales. The financial analyst was not client-facing, nor was he selling stocks. Instead, the analyst was doing complicated fiscal analysis and market research. The firm used this for stock selection and client sales. Nonetheless, the employee was incentivized and compensated on company growth as outlined below:

> *The qualification / measurement period: Annual / calendar year (December 31st) with the bonus paid in January of the following year. Growth in the Firm's AUM materializes in two distinct ways; the first is positive net flows (net of existing and new client/termination money); the second is market return. The amount available to staff will be based on the growth in AUM due to market gain. Stated differently, staff will neither be penalized nor rewarded for firm attrition or new money invested. There is a separate and distinct bonus already available for bringing in new clients. So, in order to qualify there has to be a gain in AUM due to a positive market return. So, in the case of a negative market return, but the weighted avg. gross of fee alpha is at least positive 1% (min threshold), there would be no bonus. Determination of the max amount of bonus available:*

- *Step 1: Calculate 1% (approx. average billing rate of client portfolios) of the growth in billable firm AUM due to market return.*
- *Step 2: 65% of the total amount calculated in step 1*
    - *Example: Billable growth in AUM at year end = $10m*
        - *Growth in AUM due to net flows= $6m*
        - *Growth in AUM due to market= $4m*
        - *1% of $4m = $40,000*
        - *65% of $40,000 = $26,000 (max amount available to professional staff)*
        - *35% of $40,000 = $14,000 (firm decision - SG&A, profit, capex, working capital)*

> *Determination of bonus: The bonus will be based on the weighted average of our actual model portfolio results vs. the weighted average of the policy benchmark (aka weighted average Alpha) gross of fees (think reasonableness). Measurement is easy and already calculated in our composite performance. For now we will exclude the results of the Enhanced Index Models as they are passive in nature (very little to no ability to generate alpha due to security selection) and represent a small part of overall billable firm AUM. The minimum gross of fees Alpha required to qualify is 1% (if our average fee is 1%, and we attain policy benchmark net of fees, we have accomplished the required return objective, which should be rewarded).*

Specific terms that should pop out to counsel include: "Bonus", "Measurement Period", "qualification", and "Calculate 1%". The absence of other terms should also pop out to counsel: Where are "discretion," "conditional," "earned," or other similar terms? Do the terms and the formula contradict

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in their application of the legal terms *earned* and *due?* It appears likely that they do, and this creates significant liability issues, which will be analyzed in the cases discussed below.

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Part II. The law and fundamentals of variable compensation and risk sharing compensation models.

There are an infinite number of different ways to compensate an employee for their labor, but almost all methods of compensation can be broken down into two broad categories: (1) time-based or (2) performance-based. For time-based compensation, the two most common subsets are hourly and salary. For performance-based compensation, there are commission and piecemeal bonus arrangements. These different categories and subsets create difficult analysis for the courts, who are often asked to determine both when an employee is entitled to pay, and how much they are entitled to. In Oregon, different courts have used different terms, analyses, and determinations to resolve these issues. Some of the disparity seen in the case law is the result of the litigants and how the complaints were framed. Other differences are the result of whether the claims were brought after the enactment of the Oregon wage statute.[5] This section argues that using defined terminology, and borrowing concepts from the foreign land of accounting, would give courts the tools, and practitioners the knowledge, needed to bring order to the multibillion-dollar wage and hour practices (i.e., bring clarity and reduce legal claims).

1. General Compensation Rules and Holdings:

Oregon courts agree that earned wages are absolute: once wages are earned, the employee is entitled to payment of such wages. If an employer has counterclaims or offsets, those claims are separate and distinct from the employees' right to payment of the wages earned. The employer must seek redress for their claims or offsets in a separate action and must not reduce the employee's earned wages no matter how legitimate the claim or offset.

2. *Schulstad*: Earned wages are absolute.

In *Schulstad v. Hudson Oil Co.*, the plaintiff/employee supervised four service/gas stations for his employer.[6] The employee was promised salary compensation for his services.[7] The employee had a written contract that required him to handle receipts properly.[8] The employee, however, did not properly handle cash receipts—in the approximately 22 day period employee that acted as supervisor, the four locations had revenue of $20,000, and employee's accounts were short $2,397.93.[9] The employer refused to pay the employee his wages because the employer's claim was larger than the employee's wages earned.[10] The employee sued for wages, and the employer sued for the shortage.[11] The trial court determined that both parties had proven their claims; nevertheless, the court required the employer to pay full wages earned in addition to attorney's fees and penalty wages.[12]

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[5] OR. REV. STAT. Ch. 652.
[6] 55 Or. App. 323, 325 (1981).
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*
[11] *Id.*
[12] *Id.* at 325-26.

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The *Schulstad* opinion provides the following analysis and determinations, the entirety of which is helpful for the analysis in this section:

> Defendant first contends that no wages were due and owing. The terms "due and owing" and "earned" are nowhere defined in the statute. Defendant argues that the terms contain a qualitative element -- that the plaintiff must do more than work the days involved to "earn" his pay. It urges us to permit an employer to withhold wages for any work the employer has determined to be inadequately performed. If followed, this interpretation would defeat the central purpose of the wage collection statutes. As recognized by the [Oregon] Supreme Court, that purpose is the protection of employes:
>
> "This policy of the statute is to aid an employe in the prompt collection of compensation due him and to discourage an employer from using a position of economic superiority as a lever to dissuade an employe from promptly collecting his agreed compensation." *State ex rel Nilsen v. Ore. Motor Ass'n.*, 248 Or. 133, 138, 432 P.2d 512, 515 (1967).
>
> There might seldom be prompt payment of termination wages if an employer, on some basis besides time worked, was allowed to decide that the wages were not earned. **We do not suggest that an employer may not condition the payment of wages on an event other than time worked as part of the employment contract.** *See Walker v. American Optical Corp.*, 265 Or. 327, 509 P.2d 439 (1973). However, the employment contract entered into between plaintiff and defendant here does not contain a condition for payment of wages. We, therefore, find that the plaintiff earned his wages by working the days agreed upon and conclude that he has a valid claim against his employer for those wages.[13]

The court introduces the terms "earned" vs. "due and owing", but only comments that the terms are not defined in the Oregon wage claim statute. The employer argued that the terms imply a "qualitative" element, but the court rejected that conclusion, and explained that employers withholding wages for inadequate job performance would create system that is contrary to the policy of the wage statute. This all follows logically.

But then comes the final quoted paragraph with its second sentence (bolded above) contradicting the first. Citing to the *Walker* case, the court affirms an employer's ability to establish conditions precedent to payment for something "other than time worked." The court doesn't explain what it was about the wage structure in *Walker* that permitted the use of a condition precedent to wages. And, interestingly, the *Schulstad* court did not cite *Thompson v. Burr*, which came before *Walker*.

3. *Thompson v. Burr*: Employer's condition precedent requiring active employment on X date was not enforceable because of Employer's bad faith termination.

In *Thompson v. Burr*, the employer offered employees a "bonus"[14] of 10% of the employees' annual

[13] 55 Or. App. at 326.
[14] Term used by the employer and adopted by the court.

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earnings. The plaintiff-employee's testimony was that the only requirement for the bonus was to be employed on December 31st of the relevant year, but payment wasn't actually due until April of the next year.[15] However, there was a document that the employer had all his employees sign after a separate lawsuit from a different employee, and in that document plaintiff signed his understanding was that he had to work through April to get paid the bonus.[16] The employer fired the employee shortly before April, in part because he was going to testify on behalf of another employee in a manner that would hurt the employer.[17] The court determined that the employer was obligated to pay the "bonus" to the employees because "bonus payments were not a mere 'gratuity,' to be paid to qualified employees, or withheld from them, at defendant's whim or caprice, but that it was an offer to make a bonus payment to any employee who 'stayed on the job' and qualified for such payments, so as to become a binding unilateral contract upon such an acceptance by such an employee and in consideration of his continued employment."[18] The *Thompson* court concluded that the termination was not in good faith,[19] and that because the bonus arrangement was a matter of contract, that defendant's bad faith termination would not release employer of its obligation to make the payment.[20]

4. *Walker v. American Optical*: Employer's condition precedent requiring active employment was upheld, where employee was terminated, with no evidence of bad faith, shortly before the active employment requirement calendar date.

In *Walker*, the employer presented to the employee a "sales incentive plan" (the "Agreement").[21] Under the Agreement, the employee was eligible for bonus payments every six months.[22] The Agreement provided, however, that the employee must be on the payroll at the time the bonus payment was distributed to employees.[23] The Employee in *Walker* resigned at the end of December of the relevant year, which meant he worked through the second half bonus period.[24] He hit the required quota, and was eligible for a

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[15] 260 Or. 329 at 330-31.
[16] 260 Or. at 331. Note that the employee in *Thompson* had received the bonus payment in prior years. *Id*. However, in a separate lawsuit against the employer in *Thompson*, another employee sued to collect his bonus as he worked through the end of the year, but left before April. *Id.* The employer in Thompson took the position that employees were required to be employed in April when the payment was due. *Id.* During the separate lawsuit, the employer made Thompson sign a document saying that his understanding was that he had to be employed through April. *Id.* at 331-32.
[17] *Id.* at 331-32.
[18] *Id.* at 334.
[19] The employee in *Thompson* was fired on March 12th, after it appeared that he would give unfavorable testimony against the employer in a separate action filed by a different employee over entitlement to the bonus payment. 260 Or. at 332. Because he was fired in March, the employee in *Thompson* wasn't employed in April, and the employer claimed the bonus was not earned, and refused to pay out. *Id.*
[20] *Id.* at 334-35.
[21] 265 Or. 327, 329, 507 P.2d 407 (1973). Further, note the parties do not use, or make any argument pertaining to, the unique nature of commissions. *See id generally.*
[22] *Id.*
[23] *Id.*
[24] *Id.* at 329-30.

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bonus, which would be paid in April to all staff who earned one.[25] Because he was not on the payroll in April, the Employer denied him payment.[26]

In arriving at its conclusion, the *Walker* court distinguished *Thompson* as follows: "In that case it appeared that the employee would have "stayed on the job" until April of the following year, but for his discharge, and that the employer did not have "good and sufficient cause" to discharge him. In this case, however, the employee was not discharged, but voluntarily quit his job."[27]

The employee in *Walker* also argued, and the court also rejected the argument that payroll was a liquidated damages clause in disguise.[28] Citing 5 Corbin on Contracts, the court provided,

> [a]n agent's right to compensation can be made expressly conditional upon the rendition of a specified performance by him. If the performance is not rendered, his right to the compensation never arises. Such a provision is not regarded as one that fixes a penalty for breach of duty; neither is it a provision for liquidated damages. It is not impossible that in an extreme case the court might be convinced that a provision seeming to create a condition precedent to a primary right is put in that form as a camouflage for a penalty clause; but the writer has seen no case of this sort.[29]

The Court opined that an employer has a legitimate business interest in retaining employees through economic incentives, but did not cite any prior case law, or offer any analysis to support the proposition.[30]

The final argument from the employee, and the larger part of the court's analysis, was that the clause requiring active employment at the time the wages were distributed were void because they were in conflict with ORS 652.120.[31] The statute requires employers to establish a regular payday and pay employees "wages due and owing to them." The court's analysis was light, but it noted its early holding and declared that the wages were not "due and owing".[32] Unfortunately, an opportunity was missed to establish the difference between earned wages as discussed in *Schulstad*, and wages that are "due and owing."

5. <u>Conclusions from *Walker* and *Thomson v. Burr*:</u>

It is important to note what *Walker* and *Thompson* do not address. First, neither case uses the term 'commission,' and the compensation at issue did not resemble commission wages in any way. In both cases, the compensation calculation was ten percent of the employees total pay for the prior year. In *Thompson*, the employee didn't even have to hit any threshold or quota. However, in *Walker*, the employee

[25] *Id.* at 330.
[26] *Id.*
[27] *Id.* at 330-31.
[28] *Id.* at 331-32.
[29] 265 Or. at 332.
[30] *Id.* at 332.
[31] *Id.* at 332-33.
[32] *Id.* at 333.

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did have to hit a sales goal. The distinction will be critical in *Martin*, but seemingly wasn't at issue in these foundational cases. Oddly, *Martin* mentions Walker only once, and doesn't discuss *Thompson* at all. At the post-*Walker* stage, it is important to note that there is barely any discussion or determination on key terms in ORS 652 and maybe more importantly, no discussion at all on bonus wages versus commission wages.

6. *Martin v. DHL*: "Commissions" defined, and a legal rule on when commissions are earned.

In *Martin v. DHL*, the payments at issue were labelled commissions in the employer's sales-incentive program documents.[33] Despite employer's own documentation labelling the payments as commissions, the employer argued the payments were legally a bonus, which was not payable until a condition precedent was met.[34] The condition precedent was the requirement that the employee be employed through the end of the quarter (sound familiar?).[35] Accordingly, the employer argued that the bonus payment was only earned when the condition precedent was met.[36]

The sales incentive plan in *Martin* paid employees a pro-rated monthly advance against the quarterly incentive payment.[37] The employee's agreement required him to meet a quota, in order to earn the quarterly payment, and therefore, the employers' agreement allowed it to offset advances against future earnings.[38] The Court in *Martin* did not describe the formula used to calculate the quarterly incentive payment.[39]

Plaintiff argued the payments were commissions, and Defendant argued that the payments were bonuses "that served the purpose of giving sales managers an incentive to reach quarterly goals and that plaintiff could not claim entitlement to the payment until it could be determined whether he met that quarterly goal."[40] Without citing any authority, the court opined that "[t]he label that attaches to the payments is relevant only insofar as it reflects a functional difference that has legal consequences."[41] This rule, which runs through several cases, creates the opportunity for litigants and the traps for drafting attorneys. You can call it what you want, but if it walks and talks like a duck then the court's going to call it a duck.

Again, without citing any authority, the court explained, "a commission is logically regarded as to

[33] 235 Or. App. 503, 505, 234 P.3d 997 (Or. Ct. App. 2010).
[34] *Id.*
[35] *Id.* at 505-06.
[36] *Id.* at 505.
[37] *Id.* at 511.
[38] *Id.* at 512. Example: Employee has a quarterly quota of $30 revenue, and get's paid 50% of any revenue sale over quota. Month 1 he sells $12. Month 2 he sells $12. Month three he sells $0. Employee would get $2 ($4 minus $2) paid out in advance, but since month three was a flop with zero sales, he did not "meet" the quota and, therefore, the $2 will be treated against future earnings.
[39] *Id.* This is an oversight by the appellate court given the analysis that follows. With the emphasis being on "keyed" you would think that the court would include in the record how the mechanics of the sales program worked.
[40] *Id.* at 510.
[41] *Id.* at 511.

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have been earned at the time of the transaction to which it is keyed. A bonus, on the other hand, is a payment provided to an employee or partner in compensation for performance (either individual or enterprise) above and beyond what is usually expected."[42] Finally, the court provided, "There is nothing about a bonus which necessarily ties it to particular transaction."[43] With this, the court in *Martin* created and laid out the consequences of a payment being designated as a "commission" or a "bonus."

So what is a bonus and what is a commission? The court answered, "The ordinary and legal definitions of 'commission' denote a payment that is a regular part of a salesperson's compensation, keyed to particular transactions."[44] To support that definition, it cited to Webster's dictionary in the footnote.[45] But the actual text of the Websters' definition didn't use the same words—it provided, "a fee paid to an agent or employee for transacting a piece of business or performing a service * * * *esp:* a percentage of the money received in a sale or other transaction paid to the agent responsible for the business."[46] In my opinion, the courts use of the term "keyed" is unfortunate. It sounds nice, but is more artful than useful. Moreover, the Webster's definition that the court notes, but does not adopt verbatim, contains the notion of a percentage—a mathematical term that can be useful for drafters and courts alike.

But the *Martin* court ultimately pronounced not just a definition, but a three factor test for determining whether compensation is a commission or a bonus:

2) Whether the payment was tied to achieving a specific goal;
3) whether the payment was for performance "above and beyond what is usually expected"; and
4) whether the compensation is "a regular part of a salesperson's compensation, keyed to particular transactions."[47]

For the first factor, presumably, the court's intention was that the more compensation was tied to the employee achieving a specific goal, the more akin to a bonus it is. The application of this factor, however, is confusing. A commission rate is tied to achieving a goal: selling. A bonus of $100,000 is also tied to achieving a specific goal. The second factor makes sense. In a typical commission, a salesperson is getting the commission percentage rate for all sales, not just upon hitting some prolonged threshold or quota.

Using its formulated test, the court then concluded that the payment at issue in *Martin* was a bonus, and not a commission.[48] The court concluded that the payment at issue was "not tied to particular transactions."[49] One way to interpret "tied to particular transactions" is the percentage concept that is contained in the Webster's dictionary. If a salesperson is entitled to 5% commissions in sales, we have a

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[42] *Id.*
[43] *Id.*
[44] *Id.*
[45] *Id.* at n.1.
[46] *Id.*
[47] *Martin,* 235 Or. App. at 511 (citing WEBSTER'S THIRD NEW INT'L DICTIONARY at 252).
[48] *Id.* at 515.
[49] *Id.* at 511.

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perfect connection or "keying," as the salesperson will be entitled to $5 for every $100 sold. However, the court in *Martin* did not engage in any analysis of the mechanics of payment in Martin's employment agreement. The court did, however, dissect the timing of when the payments were due.[50] The court noted that in *Martin*, the monthly payments were only an advance and the employee, according to the employers' plan, didn't earn the payments until the quarter concluded and a determination of quota was determinable.[51] The court concluded, "Plaintiff's progress toward achieving the goal was *measured* on a monthly basis, and plaintiff was advanced a payment based on a projection of how that monthly progress would translate into a quarterly total, but the advance was unambiguously contingent. Only the quarterly total was relevant to the final determination of payment. It follows that payments were not keyed to particular transactions and remained unearned until the quarter ended."[52]

7. <u>*Alex Larsson v. DXC Technology, Inc.*: Illusory conditions precedent are not enforceable.</u>

To refresh the reader's memory: in [Larsson v. DXC Technology](), a case I litigated for plaintiff, our client, Mr. Larsson, initially lost on cross motions for summary judgment.[53] However, after appealing to the 9th Circuit Court of Appeals, the case was reversed in a non-precedential opinion.

Revisiting the *Larsson* case with the discussion of the *Martin* test in mind, as well as *Thompson*'s holding, recall that Mr. Larsson's case involved a compensation contract, which was titled "Incentive Payment Agreement." Despite the title, the employees and managers referred to the wages at issue as commissions, and some of the reports the salespeople received from the employer also showed projections that titled the wages "commissions." The contract had two key terms that the Defendant argued were conditions precedent. The first term required that the employee be actively employed at the end of the fiscal quarter, following the fiscal quarter at issue for the compensation. For example, if Mr. Larsson completed Fiscal Quarter 1, and was due $86,000 in wages, he would need to wait until the end of Fiscal Quarter 2, according to the contract, to earn his pay. The paradox that was created by the contract drafting, is that he would then need to wait until the end of Q3 to get his Q2 pay—*ad infinitum*. In Mr. Larsson's case, he worked through the end of the applicable fiscal quarter, then resigned his employment in good standing. The employer did not pay his wages and pointed to the contract that purported to require him to work through the end of Q2 to receive his Q1 pay.

The 9th Circuit agreed that *Martin* was determinative of whether the Incentive Payment Agreement was a commission or bonus. The court analyzed the factors in *Martin* against the contract in *Larsson*, and the facts at issue. The 9th Circuit honed in on two key factual issues that were complex to prove. First, Mr. Larsson proved that there was no quota at issue in the contract. The contract used the term 'quota,' but did not actually require that a certain level be hit in order for the incentive to be paid. Instead, the contract established that the incentive rate would increase if the quota was met. Critically, Larsson was able to show, through complex excel formulas and forensic accounting, that even if Mr. Larsson had sold only $1,

[50] *Id.* at 511-12.
[51] *Id.* at 511.
[52] *Id.* at 512. (emphasis in original).
[53] 2023 U.S. App. LEXIS 31514 (9th Cir. Nov. 29, 2023) (not for publication) (affirming summary judgment on unpaid wage claims arising under Oregon law).

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he would receive some nominal incentive payment. This fact dovetails nicely into the factors in *Martin*, and looks much more like an ordinary commission than the convoluted and delayed compensation at issue in *Walker* and *Thompson*.

Part III. Making the Law Make Sense

1. Earned vs. Due, and Other Terminology Needed.

The terms "earned" and "due and owing" are useful terms in wage law, and regardless of their specific inclusion in the statute, Oregon courts should use them as a framework for analyzing wage claim cases. I propose that the term "earned" be used to mean when the right to compensation at issue vests with the employee. That is; when the wages are "earned" the wages become a property right of the employee, and cannot be taken away by an unrelated contingency. Even though the compensation has not physically or digitally transferred to the employee, the employee owns the property right at the time of "earning" or vesting. This is the concept at play in *Schulstad*. The employee in that case worked for the time period at issue, and earned/vested in the wages. Therefore, the employer wrongfully used its 'economically superior' position when it withheld property that was no longer the employer's as a purported setoff against a claim that the employer had against the employee. *Schulstad*'s use of the term "economic superiority" comes from the legislative history of the wage statute, but terms like "trustee" or "escrow" are perhaps more accurate. This is because before wages vest in the employee, the employer holds the cash—and the status quo favors the employer. The rub for the employee is that the employer possesses the wages in the gap between the time the wages are earned, and when they are due. The wage law cases then, are similar to self-help concepts found in other nooks of law; the employee must recover that which is rightfully theirs.

2. Are "rate" and the implicit concepts of numerator and denominator the missing terms Oregon case law needs?

To preserve the guaranteed nature of wages, it seems an employee's rate of pay is, and should continue to be, the key that unlocks the earning of wages. Rate of pay is a concept that is easy to understand in time-based compensation models, but is perhaps less intuitive in production-based compensation models. In mathematics, a "rate" is a ratio that compares two quantities with different units. It expresses how one quantity changes concerning another. For example, speed (miles per hour) and density (people per square mile) are common types of rates. Consider the following examples of common compensation rates:

- Hourly rate – Wages paid per hour worked (e.g., $20 per hour).
- Salary rate – Fixed annual compensation divided over a period (e.g., $60,000 per year).
- Piece rate – Payment based on the number of units produced or tasks completed (e.g., $0.50 per assembled item).
- Commission rate – Compensation as a percentage of sales or revenue generated (e.g., 10% of total sales).

If the courts identify and isolate the rate of pay as part of the legal analysis for wage entitlement, it will bring clarity and consistency to compensation arrangements in Oregon. The framework is already in

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place, but the language used by the courts is non-uniform. *Nielsen*[54] establishes the guiding policy—that prompt payment is the purpose of the statute; *Schulstad* incorporates that policy, and at least for time base compensation structures—opines that quality of the work cannot offset an employee's wages; *Walker and Bur*r bring in notions of the employer's ability to terminate employment and of conditions precedent, while *Martin v. DHL* finally, but without precision, differentiates between a commission and a bonus.

The courts or the legislature should formalize and improve the holding in *Martin* and adopt a formal, legal presumption that wages are earned in accordance with the rate of pay established in the employees' compensation agreement. The concept of rate interlaces neatly with the realistic concerns of the parties involved in the typical compensation negotiation. When rate is established, it's often the basis of what the employee relies on in weighing one job over another.

Further, a formal, legal presumption of wage earnings in lockstep with rate is congruent with the holding in *Martin*—that is, compensation "keyed to particular transactions." The court in *Martin* was presented with the issue of whether the incentive pay plan was a bonus or commission. Had it analyzed the plan based on rate of pay, it may have been determined that the payment structure in that case was in fact a commission which would have created the clarity this area of law needs.

Moreover, by incorporating the term "rate," and identifying the stated rate to the employee, the law can flesh out what this commentator perceives as a drafting error in many employment commission contracts. That error comes about when a rate is stated, but the employer attempts to subsequently include additional conditions precedent. For example, if the employee's contract says that the employee will be paid $2,000 for every car sold, we have a rate, and a condition precedent already established. If you sell a car (the input) then that unlocks the earning of the $2,000 (output). If there are other conditions (inputs) in the contract, then there are complications, maybe even contradictions—and if they are buried in the fine print, it creates problems. Employers might be tempted to put such additional conditions somewhere other than front and center. They should carefully consider the sequences of choosing that option. If the employee's expectations based on the offer letter is: "I sell X, I get Y," then they are being set up for disappointment when the rate/formula is more complicated than that, and their pay is less than expected. That can result in costly and time-consuming litigation.

By contrast, bonuses make more sense if they aren't advertised using rate language. Instead of a rate for each sale, there should be a clearly established goal that must be met. The bonus is not part of the employee's regular compensation and is more of a reward upon completion. It should be clearly labelled as discretionary. But the employer must face on reality on this: recruitment and hiring will suffer if the compensation terms clearly establish this framework; yet, undesirable litigation will decrease.

Part IV. No Silver Bullet.

If the proposal in the prior Part III is adopted, then a salesperson will presumptively earn/accrue their commission wages when they make the sale. A host of questions follows. By "make the sale," what

[54] *Nielsen v. Baldrige*, 173 Or. 555 (1944).

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do we mean? When the customer and the salesperson high five on the front nine? When they toast champagne on the back nine? When the contract is signed at the clubhouse after the golf game? When the contract is effective? When the customer pays? When the customer pays *and* the job is fully performed? When the customer pays, the job is done, *and* a retention period of 10 years expires, *and* the employer has flipped a coin that lands on heads 7 times in a row?

Although some salespersons are sophisticated in financial, contracting, and accounting terms, many are not. The Oregon Legislature and courts display a pattern of protecting employees from the potential imbalance of power and sophistication that is presumed to be greater for the employer and presumed less prominent for the employee. Law regarding Non-Competition Agreements, Severance Agreements, and of course, the wage statutes are all examples of this.

If Wall Street can get duped by the smartest guys in the room, it's not hard to imagine accounting nuances duping salespeople who are eager to accept a job. Although in a perfect world new hires would have the agreements reviewed by an attorney or CPA, that's typically not how things go.

The legislature, not the courts, would be the most appropriate body to step in and put bumpers up on how far an employer can go in drafting complex compensation agreements. But it's also worth asking how far an employer *wants* to go. At what point is the simple sales compensation agreement and the risk-sharing nature of it so complex that it's more akin to phantom equity shares? Could we just say "revenue," and disburse it when appropriate?

In the meantime, when courts are presented with a complex accounting structure that defines the earning of wages, they will, and should continue to, apply the benefit of the doubt to the non-drafting party. Unlike mergers and acquisitions and leveraged buy-outs, employment agreements are a high volume/frequency, and if sales compensation agreements require as much legal review and sophistication as merger instruments, that is far from ideal. Moreover, whether an employee is transitioning from another job, or from unemployment to employment, the time for review is typically shorter than for a corporation's arms-length asset purchase or merger negotiation.

By taking the fundamental concept in *Schulstad*, and enhancing the holding in *Martin* with better terms and clearer language, the law can strike a balance of ensuring prompt payment and preventing employer abuse of economic superiority, while still allowing freedom of contract principles so that parties can intelligently balance incentives and shared risk. Finally, note that this is better for the employer as well; there will be more clarity, less lawsuits, and each party can rest assured that they get what they bargained for.

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