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SALES REPRESENTATIVE AND DISTRIBUTORSHIP CONTRACTS IN WASHINGTON

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A number of Washington statutes and areas of case law touch upon different aspects of sales representative and distributorship arrangements. Similar to other jurisdictions in the United States, Washington's law of contracts is based on common law principles, which are in turn supplemented by statute.

Freedom of Contract

Washington permits the parties to a contract significant leeway in establishing the terms of their agreement. One notable exception, however, is the Washington sales representative statute described below.

Washington courts abide by the objective theory of contract interpretation and construction. The objective theory directs courts to give the terms of a contract their reasonable meaning in light of the outward manifestation of the parties' intent.

Compared to many other jurisdictions in the United States, Washington is relatively more willing to consider extrinsic evidence in attempting to ascertain the parties' intent. Commonly referred to as the "context rule," Washington courts will consider extrinsic evidence in interpreting the words of a contract, regardless of whether a particular provision is ambiguous. The context rule is a departure from what Washington courts describe as the "plain meaning rule," which requires that, unless a particular term is ambiguous, courts determine the meaning of a contract based on the contract's language alone. A number of judicial opinions have described the purpose of the context rule as "leading courts to discover the intent of the parties based on their real meeting of the minds, as opposed to insufficient written expression of their intent." *Tjart v. Smith Barney, Inc.*, 107 Wn. App. 885, 895, 28 P.3d 823 (2001) (citing *Olympia Police Guild v. City of Olympia*, 60 Wn. App. 556, 805 P.2d 245 (1991)).

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Pursuant to the context rule, courts commonly consider evidence of such factors as: (i) the subject matter and purpose of the contract; (ii) circumstances surrounding the contract's formation; (iii) the acts of the parties subsequent to creating the contract; (iv) the reasonableness of the respective interpretations advocated by the parties; and (v) usage of trade and course of dealing. However, notwithstanding the leeway that the context rule offers courts in interpreting contracts, Washington courts will only consider such evidence to supplement language that is already in the agreement. Even under Washington's context rule, extrinsic evidence cannot be used to contradict the otherwise unambiguous provisions of a contract.

Washington Sales Representative Statute

Although Washington generally allows parties to draft the specific terms of their contractual relationship as the parties deem appropriate, Washington law imposes a number of non-waivable requirements on contracts between manufacturers and sales representatives. The Washington statute will apply whenever: (i) a "principal" manufactures, produces, imports, or distributes a product for sale to customers who purchase the product for resale; (ii) the principal uses a sales representative to solicit orders for the product; and (iii) the principal compensates the sales representative in whole or in part on commission. Additionally, the sales representative must not place orders for its own account for resale, purchase for its own account for resale, or sell or take orders for direct sale of products to the ultimate customer. The Washington statute can also apply to contracts between distributors and sales representatives.

If the above conditions are satisfied, the Washington statute imposes a number of requirements on parties entering into such an arrangement. First, an agreement to solicit wholesale orders within the state must be in writing and must set forth the method by which the sales representative's commission is to be computed and paid. Second, during the course of the contract, the principal must pay the sales representative any earned commission, as well as all other amounts earned and payable under the contract, no later than thirty (30) days after receipt of payment by the principal for products sold on the principal's behalf by the sales representative. Third, upon termination of the contract, the principal must pay the sales representative all commissions due within thirty (30) days after receipt of payment by the principal for products sold on the principal's behalf, including any earned commissions not due when the contract is terminated.

In addition to the above three requirements, the Washington statute also provides that any principal that is not otherwise a resident of Washington and that enters into an agreement subject to the statute is deemed to be doing business in Washington for purposes of Washington courts exercising jurisdiction. Moreover, the statute indicates that any provisions in a contract that purports to establish a venue for an action arising out of the contract in a state other than Washington is void.

The above requirements apply to contracts involving sales representatives, not to contracts between manufacturers and distributors. Nonetheless, Washington also regulates certain types of arrangements between manufacturers and distributors. For example, a Washington statute imposes a number of requirements on agreements between manufacturers and distributors of spirits, wine, and beer products.

Unlike certain jurisdictions outside the U.S., Washington does not impose any compensation payment requirements solely arising due to the termination of a sales representative or distributor.

Other Issues

Washington law touches upon various other issues that are likely to arise in a typical sales representative or distributorship arrangement. First, sales representative and distributorship agreements commonly include noncompetition provisions. To be enforceable under Washington law, noncompetition agreements must be reasonable in duration, geographic area, and the scope of prohibited activity. The reasonableness of such factors can vary significantly depending on the nature of the parties' relationship.

Second, arrangements between manufacturers, distributors, and sales representatives can, in certain instances, qualify as franchises or business opportunities under Washington law. Washington's Franchise Investment Protection Act defines a "franchise" as any agreement by which:

- (i) A person is granted the right to engage in the business of offering, selling, or distributing goods or services under a "marketing plan" prescribed or suggested in substantial part by the franchisor;
- (ii) The operation of the business is substantially associated with a trademark or other commercial symbol designating, owned by, or licensed by the franchisor; and
- (iii) The person pays, agrees to pay, or is required to pay a franchise fee.

The Franchise Investment Protection Act also defines a "marketing plan" as any plan or system concerning an aspect of conducting business. Common attributes of such a plan or system include: (i) price specifications or discount plans; (ii) sale or display equipment or merchandising devices; (iii) sales techniques; (iv) promotional materials or cooperative advertising; (v) training regarding the promotion, operation, or management of the business; or (vi) operational, managerial, technical, or financial guidelines or assistance.

Being characterized as a franchise is noteworthy, because Washington imposes a number of requirements on sellers of franchise interests. For instance, franchisors must register with the Washington Department of Financial Institutions prior to offering for sale any franchise interests. Franchisors must also provide offering circulars to prospective franchisees that disclose certain information about the franchise. A franchisor that fails to comply with Washington's franchise laws may incur a variety of civil and criminal liabilities.

In addition to the Washington franchise laws, manufacturers should also evaluate whether their arrangements with Washington sales representatives or distributors constitute a "business opportunity" under Washington's Business Opportunity Fraud Act. The Business Opportunity Fraud Act defines a "business opportunity" as the sale or lease of any product, equipment, or service that enables the purchaser to start a business. To qualify as a business opportunity, the seller must also make a number of representations regarding business assistance, the seller's purchase of any products created under the business opportunity, or guaranteed income. If an

arrangement qualifies as a business opportunity, the seller must comply with a number of registration and disclosure requirements. Penalties for failing to satisfy those registration and disclosure requirements may include both civil and criminal liabilities.

Third, manufacturers should assess the possible state and local tax implications associated with entering into sales representative and distributorship arrangements in Washington. Washington's primary entity level tax is the business and occupation tax, commonly referred to as the "B&O" tax. Washington levies its B&O tax on the privilege of doing business in the state. Almost all businesses located or doing business in Washington are subject to the B&O tax, including corporations, limited liability companies, and partnerships. Unlike many other states, Washington levies its B&O tax, with few limited exceptions, against an entity's gross income. Accordingly, an entity could be liable for Washington's B&O tax even if that entity does not generate any profits.

Notwithstanding the relative breadth of Washington's B&O tax, Washington offers an exemption for sales by certain out-of-state persons through direct seller's representatives. Specifically, a Washington statute provides that the state's B&O tax will not apply to an entity's gross income derived from the business of making sales at wholesale or retail if such entity:

- (i) Does not own or lease real property within the state;
- (ii) Does not regularly maintain a stock of tangible personal property in the state for sale in the ordinary course of business;
- (iii) Is not a corporation incorporated under the laws of Washington; and
- (iv) Makes sales in Washington exclusively to or through a direct seller's representative.

The statute defines a "direct seller's representative" as a person who buys consumer products on a buy-sell basis or a deposit commission basis for resale. The direct seller's representative must also be paid in relation to sales or other output rather than the number of hours worked. Finally, the manufacturer and direct seller's representative must have a written contract specifying the services to be performed and providing that the direct seller's representative is not an employee for federal tax purposes.

Apart from the Washington B&O tax, manufacturers should also evaluate whether their activities could trigger Washington sale and use tax obligations. Washington levies its sales tax based on the destination of the sale (i.e., where the customer receives the product), not on the location of the seller. Washington imposes its use tax on the purchase, lease, or use of items where sales tax was not collected. Washington's sale and use taxes overlap each other so that items purchased for use in Washington are subject to either Washington's sales tax or use tax, but not both. Washington does not have a state level corporate, unitary, or personal income tax.

Finally, sales representative and distributorship arrangements can raise a number of issues with respect to Washington's antitrust laws. Courts generally treat the Washington antitrust laws as mirroring the federal antitrust regime. The most common antitrust issues presented by sales representative and distributorship arrangements include resale price maintenance (i.e., the seller and reseller agree that the reseller will charge a particular price for the goods on resale),

territorial and customer restrictions, exclusive-dealing and requirement contracts, and tying arrangements.

The above issues can be complex, and conclusions with respect to those issues will vary significantly depending on the facts of each unique situation. Manufacturers that are interested in pursuing a sales representative or distributorship arrangement in Washington are advised to assess such issues with local counsel.

Washington Resources

- Washington Department of Revenue: <http://dor.wa.gov/Content/Home/Default.aspx>. The Washington Department of Revenue is the state's primary tax collection agency. The Department's website offers a number of resources regarding the Washington B&O tax, as well as various other state and local taxes.
- Washington Department of Financial Institutions: <http://dfi.wa.gov/default.htm>. The Washington Department of Financial Institutions (DFI) regulates a variety of state chartered financial services, such as franchises and business opportunities. The DFI's website offers numerous publications describing Washington franchise and business opportunity laws.
- Washington Office of the Attorney General: <http://www.atg.wa.gov/default.aspx>. The Washington Office of the Attorney General's (OAG) Antitrust Division is responsible for enforcing Washington's antitrust laws. The Attorney General's website offers some helpful commentary regarding recent antitrust enforcement efforts.
- Access Washington: <http://access.wa.gov/Home.aspx>. Access Washington is a state government sponsored and maintained website accumulating links to various Washington government agencies.