GIBSON DUNN

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CALIFORNIA SUPREME COURT ANSWERS IMPORTANT QUESTIONS ABOUT THE BOUNDS OF LEGITIMATE BUSINESS COMPETITION UNDER CALIFORNIA TORT AND ANTITRUST LAW

To Our Clients and Friends:

On August 3, 2020, in response to a request from the Ninth Circuit, the California Supreme Court provided guidance on important questions about the bounds of legitimate business competition under California tort and antitrust law in *Ixchel Pharma, LLC v. Biogen, Inc.*, No. S256927. The Court issued a unanimous opinion addressing two issues: (1) whether a claim for tortious interference with an at-will contract requires a showing of an independently wrongful act, and (2) whether business-to-business contracts imposing limits on a contracting party's business activities are *per se* illegal under California Business and Professions Code section 16600. Specifically, the Court held that tortious interference with at-will contracts does require independent wrongfulness, and that a rule of reason standard, rather than a *per se* prohibition, applies to determine whether a restraint in a business-to-business agreement violates section 16600. This decision provides important clarification regarding the elements of these claims, ensuring that vigorous competition aimed at winning customers away from competitors should not give rise to valid claims for tortious interference and that ancillary restraints within business-to-business agreements will continue to be assessed under a reasonableness standard, rather than as *per se* illegal under California law. Had the Court adopted the rule of *per se* illegality for such restrictions advanced by Plaintiff Ixchel Pharma, LLC, that approach would have called into question the legality of many common types of business arrangements, such as joint ventures with ancillary non-compete agreements, exclusive dealing agreements, vertical territorial or other restrictions on distributors, and franchise agreements.

Plaintiff Ixchel Pharma Sues Defendant Biogen Regarding A Settlement Agreement Provision That Allegedly Restrained Trade

Plaintiff Ixchel Pharma, LLC ("Ixchel"), a biotechnology company, entered into a terminable-at-will agreement with Forward Pharma ("Forward") to jointly develop a drug containing the active ingredient dimethyl fumarate ("DMF") for the treatment of Friedreich's ataxia, a neurodegenerative disorder. The companies engaged in joint development efforts until Forward decided to withdraw from the parties' at-will collaboration agreement. Forward terminated the agreement pursuant to a settlement agreement it reached with Defendant Biogen, Inc. ("Biogen") regarding a patent dispute between the companies related to the use of DMF for the treatment of multiple sclerosis. Ixchel sued Biogen in federal district court asserting violations of federal and state antitrust laws, tortious interference with contractual relations, and violation of California's unfair competition law (UCL), alleging that Biogen restrained Forward from engaging in lawful business with Ixchel and therefore violated section 16600's prohibition

against restraints of trade. The district court dismissed Ixchel's amended complaint on the grounds that the Forward-Biogen settlement agreement should be analyzed under the antitrust rule of reason and that section 16600 does not apply outside the employment context.[1]

Ixchel appealed the district court's decision to the Ninth Circuit. After oral argument, the Ninth Circuit certified two questions of California state law to the California Supreme Court.[2] The California Supreme Court accepted the certification but rephrased and reordered the questions as:

1. "Is a plaintiff required to plead an independently wrongful act in order to state a claim for tortious interference with a contract that is terminable at will?" and

2. "What is the proper standard to determine whether section 16600 voids a contract by which a business is restrained from engaging in a lawful trade or business with another business?" Slip Op. at 6.

The Court's Opinion Provides Important Clarity On The Elements Of A Claim For Tortious Interference With An At-Will Contract And The Standard For Assessing Business-To-Business Agreements Under Section 16600

Justice Liu authored the opinion of the Court, in which Chief Justice Cantil-Sakauye and Justices Chin, Corrigan, Cuéllar, Kruger, and Groban concurred.

First, the Court addressed whether Ixchel must allege that Biogen committed an independently wrongful act in order to state a claim for tortious interference with contract, in light of the fact that the parties' collaboration agreement was terminable at-will. The Court reviewed the history of economic relations torts under California law, emphasizing the distinction between tortious interference with contractual relations—which generally does not require independent wrongfulness—and tortious interference with prospective economic advantage—which does require an independently wrongful act. According to the Court, it had yet to determine which of those two categories "more closely resembles" the tort of interference with at-will contracts. Slip Op. at 10. After analyzing this issue in the context of its precedent, the Court concluded that "[l]ike parties to a prospective economic relationship, parties to at-will contracts have no legal assurance of future economic relations" (*id.* at 16) and, therefore, that to state a claim for interference with an at-will contract by a third party, the plaintiff must allege that the defendant engaged in an independently wrongful act (*id.* at 18). The Court reasoned that allowing claims of interference with at-will contracts without requiring independent wrongfulness would risk chilling legitimate competition and could "expose routine and legitimate business competition to litigation." *Id.* at 19.

The Court next turned to the question of the proper interpretation of section 16600. As an initial matter, the Court declined Ixchel's invitation to resolve only the narrow question of whether section 16600 applies to business contracts. Both parties agreed that it did—and the Court concurred. But the Court explained that because the "primary dispute" between the parties was "whether contractual restraints on business operations or commercial dealings are subject to a reasonableness standard under section 16600," an "important question of California law, potentially affecting all contracts in California that in some way restrain a contracting party from engaging in a profession, trade, or business," it was

appropriate for the Court to address the broader question of the appropriate standard for such claims. *Id.* at 19-20.

After reviewing the statutory history and state court precedent, the Court concluded, "a survey of our precedent construing section 16600 and its predecessor statute reveals that we have long applied a reasonableness standard to contractual restraints on business operations and commercial dealings." *Id.* at 36. In so stating, the Court noted that it was not disturbing its holding in *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937 (Cal. 2008), and other decisions in which section 16600 was strictly interpreted to invalidate noncompetition agreements that entirely prohibit an employee or business owner from engaging in a profession upon termination of their employment or sale of their interest in a business. Slip Op. at 36. But it distinguished those cases from ones, like the case at hand, involving "contractual restraints on business operations and commercial dealings." *Id.* The Court also emphasized the possible detrimental consequences from applying a *per se* standard to business agreements under section 16600, acknowledging that certain contractual restraints on competition in business-to-business agreements in fact "promote competition." *Id.* at 38.

Thus, the Court held that "a rule of reason applies to determine the validity of a contractual provision by which a business is restrained from engaging in a lawful trade or business with another business." *Id.* at 40-41. This means that in evaluating whether a restraint in business-to-business agreement runs afoul of section 16600, courts will generally look to whether the anticompetitive effects of the agreement outweigh its procompetitive effects. It remains to be seen precisely how courts will apply the reasonableness standard under section 16600. In its decision, the Court stressed the importance of harmonizing the Cartwright Act and section 16600, stating that they should be "interpreted together" (*id.* at 38), which suggests that the rule of reason analysis employed for claims brought under the Cartwright Act would also be used for section 16600 claims.

The Court's decision clarifies the elements of a claim for tortious interference with at-will contracts under California law. It also provides going-forward guidance to courts regarding the standard that applies to contractual restraints on business operations and commercial dealings under section 16600, and ensures that—in accord with federal antitrust law—such restraints will not be deemed *per se* unlawful.

Gibson, Dunn & Crutcher LLP represented the California Chamber of Commerce in filing an amicus brief in support of Biogen, Inc.

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[1] *Ixchel Pharma, LLC v. Biogen, Inc.*, No. 2:17-cv-00715-WBS-EFB, 2018 WL 558781 at *4 (E.D. Cal. Jan. 25, 2018).

[2] *Ixchel Pharma, LLC v. Biogen, Inc.*, 930 F.3d 1031, 1033 (9th Cir. 2019).

The following Gibson Dunn lawyers prepared this client alert: Rachel Brass, Thomas Hungar, Daniel Swanson and Caeli Higney.

Gibson Dunn's lawyers are available to assist in addressing any questions you may have regarding these developments. Please feel free to contact the Gibson Dunn attorney with whom you usually work, the authors, or any member of the firm's Antitrust and Competition or Appellate and Constitutional Law practice groups, or the following lawyers.

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