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ALERT

California Supremes: At-will contracts can leave parties on the outside looking in, in cases of interference with prospective business advantage, absent a "separate wrong"

Contracts where either party may withdraw from participating at any time—known as "at-will contracts"—can provide flexibility on the one hand, but when a party withdraws, they can also cause unanticipated disruption to a non-withdrawing party, on the other. In this way, at-will contracts can leave that non-withdrawing party on the outside of the contract, looking in.

What can the non-withdrawing party do about it, though?

On August 3, 2020, in the matter of *Ixchel Pharma, LLC v. Biogen, Inc.* ("*Ixchel*"), California's Supreme Court examined what liability may result when a party to an at-will contract is induced by a third-party (such as a competitor business that is not a party to the at-will contract), to withdraw from the at-will contract. The Court ruled that when a third-party inducement occurs, there is no cause of action against that third-party for the tort of "intentionally interfering with a prospective economic relationship", unless that third-party commits an additional "independent wrong", in addition to inducing the party to withdraw. The California Supreme Court reasoned that at-will contracts merely provide the parties to such a contract, with a "prospective" right to a withdrawing party's future participation in the contract, rather than a right to *require* the withdrawing party's future participation in performing the contract.

Accordingly, in at-will contracts, a third-party, such as a direct competitor, is not liable in tort for intentionally interfering with an at-will contract, unless that third-party commits an "independent wrong" apart from the interference itself.

Although *Ixchel* was before the U.S. Court of Appeals for the Ninth Circuit, that Court tapped California's Supreme Court to address two (2) issues regarding "at-will" contracts:

- ***first***, whether in an at-will contract, a third party's interference must be independently wrongful in order to be actionable; and
- ***second***, whether Business & Professions Code section 16600 (generally voiding contracts that restrain business) can serve to void an at-will contract that precludes one of the contracting parties from continuing to do business with the other contracted party.

In *Ixchel*, two (2) pharmaceutical companies, Ixchel Pharma, LLC ("Ixchel") and Forward Pharma USA LLC ("Forward"), entered into an at-will contract whereby each party would work with the other to develop, manufacture then market a medication used in the treatment of Friedreich's ataxia. Because the subject contract was "at-will", both Ixchel and Forward were generally free to withdraw from the subject contract at any time, for any reason.

Forward did so withdraw from the subject contract in conjunction with its entering into a settlement agreement with a third-party pharmaceutical company, Biogen, Inc. ("Biogen"). In that settlement agreement, Biogen required Forward, and Forward agreed, to

- [T]erminate any and all existing, and not enter into any new, Contracts or obligations to Ixchel Pharma LLC . . . and/or any other Person, to the extent related to the development [by Forward and its affiliate companies] of any pharmaceutical product [containing the active ingredient] for the treatment of a human for any indication, including Friedreich's ataxia.

Notably, Forward's business solely involved the development of pharmaceuticals aimed at treating Friedreich's ataxia.

Upon learning that Forward was terminating its at-will contract with Ixchel, Ixchel sued competitor Biogen, alleging, among other claims, that Biogen had tortuously (i) interfered with Ixchel's contractual relationship with Forward, (ii) interfered with Ixchel's prospective economic advantages and (iii) that Biogen had engaged in unfair competition.

After oral argument, the Ninth Circuit Court of Appeals certified the two (2) questions of California law, set forth above, to California's Supreme Court. In addressing the first question—whether in an at-will contract, an interfering party must commit a "separate wrong" in addition to the interfering party's underlying tortious interference with a prospective economic opportunity, itself—the Court distinguished the elements for "the two economic relations torts" that "California has traditionally recognized": "interference with the performance of a contract" on the one hand, with "interference with a prospective economic relationship" on the other.

The Court held that in an contract that is not at-will, the parties have "a formally cemented economic relationship [that] is deemed worthy of protection from interference by a stranger to the agreement." For this reason, inducing the breach of a contract where the parties thereto expect future performance as a matter of *right*, is actionable without more. However, the Court reasoned that, "Economic relationships short of contractual, however, should stand on a different legal footing as far as the potential for tort liability is reckoned." Put another way, liability for interfering with a contract where future performance is guaranteed, has different liability implications than interfering with a contract whose future performance is merely possible, but not guaranteed as a matter of right.

At-will contracts, the Court reasoned, are firmly within the latter of these two (2) categories. Thus, the Court determined that in the case of at-will contracts, in addition to interfering therewith, the third-party must perform some *additional* wrong in order to become liable for interfering with a merely prospective—but not guaranteed—economic advantage.

Here, plaintiff Ixchel alleged that Biogen's additional "wrongful act" was requiring Forward to agree to a provision in its settlement agreement with Forward, requiring Forward to terminate its contract with Ixchel, and preventing Forward from engaging in business with any other company. Ixchel reasoned that these restraints, which resulted in Forward terminating the Ixchel-Forward contract, violated Business and Professions Code section 16600, which provides, "Except as provided in this chapter, every contract by which anyone is restrained from engaging in a lawful profession, trade, or business of any kind is to that extent void."

Accordingly, the California Supreme Court addressed, "not only whether section 16600 applies to contracts in the business context[,] but also the proper standard — in particular, whether a rule of reason applies — to evaluate whether restraints on trade in business contracts are void under section 16600." The Court addressed these matters as issues of first impression.

After distinguishing Business & Professions code section 16600's applicability to employment settings (applying a strict construction), versus its applicability in business-to-business contracts (applying a more liberal interpretation), the Court held that at least in the latter context, "section 16600 is best read not to render void per se all contractual restraints on business dealings, but rather to subject such restraints to the rule of reason." That is, in analyzing long-standing case law concerning business-to-business contracts, and whether such a contract is void under Business & Professions code section 16600, the Court recognized that in numerous cases, it had invalidated contractual restraints on business operations "only if such restraints were unreasonable."

Despite Ixchel's argument that the Forward-Biogen settlement agreement was a void (or voidable) contract because *Edwards v. Arthur Anderson LLP* (2008) 44 Cal. 4th 937 "conclusively held that section 16600 invalidates all restraints on trade for all contracts, no matter how reasonable[,]" the Court distinguished *Edwards* on the basis that *Edwards* involved an employment contract, and not a business-to-business contract. To this end, the Court held, "The question of whether noncompetition agreements outside the employment context are per se invalid was not presented in *Edwards*."

Accordingly, The Supreme Court reasoned that in the context of business-to-business contracts, and in assessing whether such a contract violates Business and Professions code section 16600, courts

must determine whether the restraint is reasonable (the contract is not void) unreasonable (the contract is void). The *Ixchel* Court therefore held that in the context of an at-will contract, at least, the Forward-Biogen settlement agreement did not impose an unreasonable restraint on Forward's ability to engage in lawful business activity.

In this way, the *Ixchel* Court left Ixchel on the outside looking in, *vis-à-vis* its at-will contract with Forward, because: (a) third-party Biogen did not commit a wrong independent of its alleged interference with Ixchel's merely *prospective* business opportunity *vis-à-vis* Forward; and (b) that because contracts between two (2) businesses restraining one of the businesses from engaging in lawful commercial activity with another business must be viewed through the lens of the "rule of reason", and because the restraint here was reasonable, that Ixchel's claim for unfair business practices failed.

If you or your business are a party to a contract, and you believe that a third party's conduct has caused you or your business harm or damage, you should review the subject contract with legal counsel in order to assess your rights *vis-à-vis* the third party.

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