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Message from the Chair

By Will K. Woods, Baker & McKenzie, LLP

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With my term as Chair of the Forum ending in August, it is hard to believe I now compose my final Chair's column. Simply put, serving in the leadership of the Forum (from my time as YLD Liaison in 2006/2007 through my term as Chair over the past two years) has been formative to my career as a franchise lawyer, enriching it both professionally and personally, for which I will always be grateful.

As I recently conveyed to our 13 living past Chairs of the Forum, I believe that the greatest gift that one receives from the Forum is the body of relationships that involvement with it creates, often beginning as professional acquaintances and then evolving into lifelong personal friendships. This cultivation of life-enriching relationships happens, I believe, because the Forum is comprised of a *truly* diverse group of individuals who are united by a desire to practice our beloved profession with excellence. Composed of lawyers with wide-ranging political views, from different racial and ethnic backgrounds, of many national origins, and of varying sexual orientations, the success of the Forum on Franchising gives hope in an age of coarsening public discourse. I am heartened to know that despite our differences, the Forum and its members are, and continue to be, welcoming to all, tolerant of our differences, and firmly focused on our mission: "to be the preeminent forum for the study and discussion of the legal aspects of franchising."

I leave the role as Chair of the Forum in the very able hands of Ron Coleman, and I look forward to continuing to work with Ron as immediate past Chair.

As announced in May, the ABA updated its in-person meeting policy to permit live meetings going forward. I know all of us (especially those of us on the meeting planning committee) are very excited that we will be together again for a live meeting in Atlanta on October 13–15 with a full schedule of three intensive programs, 24 workshops, two plenary sessions, and all of the social and networking events that we have craved for so long!

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Ixchel Pharma v. Biogen: Is This the Big One?

By James M. Mulcahy and Sandra G. Gibbs, Mulcahy LLP

California's reputation for disfavoring post-term non-compete provisions is rock solid in franchise circles. Section 16600 of the California Business & Professions Code is unequivocal: "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." Court decisions over the years have supported a literal reading of this language in a variety of contexts, including the franchise context. Notably, a franchisor seeking registration in the Golden State is required to disclose that "a covenant not to compete which extends beyond the termination of the franchise . . . may not be enforceable under California law." Cal. Code Regs. tit. 10, § 310.114.1(c)(5)(B)(ii). As a result, franchisors have long resigned themselves to the reality that non-compete provisions will be unenforceable against California franchisees.

In August 2020, the California Supreme Court held, in *Ixchel Pharma, LLC v. Biogen, Inc.*, 9 Cal. 5th 1130 (2020), that in the context of business-to-business contracts, Section 16600 should be read to incorporate a rule of reason standard. The decision established a clear distinction between non-compete provisions in employment contracts—which remain *per se* unenforceable under Section 16600—and those in business contracts. Whether this decision will have a seismic effect on the enforceability of restrictive covenants in the franchise context, however, remains to be seen.

Ixchel concerned a collaboration agreement, terminable on 60 days' notice, between biotech companies Ixchel Pharma and Forward Pharma, under which Forward would develop, manufacture, and commercialize certain pharmaceutical products using certain patents owned by Ixchel that incorporated dimethyl fumarate ("DMF") as an active ingredient. Forward subsequently entered into a settlement agreement with Biogen, a competitor of Ixchel, which required Forward to terminate its relationship with Ixchel and agree not to enter into any new agreements with Ixchel relating to DMF. Ixchel sued Biogen, asserting tortious interference with its contractual and prospective economic relationship with Forward, among other claims. Finding that a party to an "at will" contract lacked an expectation of a continuing contractual relationship, the court ruled that under California law both of these claims required an independent wrongful act. Ixchel alleged that the exclusive dealing arrangement between Biogen and Forward satisfied this requirement by restraining Forward from engaging in lawful business with Ixchel in violation of Section 16600. The district court disagreed and dismissed the complaint. On appeal, the Ninth Circuit certified a question to the California Supreme Court regarding the standard for invalidating a business contract under Section 16600. *See Ixchel Pharma, LLC v. Biogen, Inc.*, 930 F.3d 1031 (9th Cir. 2019).

The California Supreme Court examined the statute's 150-year-long history and concluded that, while non-compete agreements after termination of employment had consistently been invalidated without regard to their reasonableness, agreements restricting trade in commercial agreements were generally only invalidated if (a) they were unreasonable; or (b) the primary purpose of the agreement was to create a monopoly, restrict supply, or fix prices. These results were in accord with the Cartwright Act, California's antitrust statutory scheme, which is worded in similarly absolute terms but is applied subject to the rule of reason. Because Section 16600 and the Cartwright Act share a common purpose and statutory context, the Court held, the two provisions should be "harmonized." 9 Cal. 5th at 1151. In support of its holding, the Court noted that businesses routinely enter into agreements that limit their freedom to engage in business with third parties, and that such agreements can have procompetitive effects. Specifically, exclusive dealing arrangements "can help businesses leverage complementary capabilities, ensure stability in supply or demand, and protect [the parties'] research, development, and marketing efforts from being exploited by contractual partners." *Id.* at 1160–61.

In attempting to predict whether, and under what circumstances, restrictive covenants in

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franchise agreements may now be enforceable in California, it is critical to understand what *Ixchel* does and what it does not do. The opinion refers broadly to "agreements limiting commercial dealings and business operations" and makes no effort to distinguish between in-term restraints and post-term restraints; the underlying facts, however, reflect only an in-term restraint. As the court itself explains in distinguishing the case before it from its earlier decision in *Edwards v. Arthur Andersen LLP*, 44 Cal. 4th 937 (2008), "language in a judicial opinion is to be understood in accordance with the facts and issues before the court." 9 Cal. 5th at 1158. The *Edwards* case held that Section 16600 strictly bars all contractual restraints on an individual's pursuit of a business of any kind; *Ixchel* narrowed *Edwards* to restraints in the context of employment contracts. But the facts in *Edwards* were limited, as well, to a post-term restriction. So while *Ixchel* explicitly drew a hard line between employment restraints and business restraints, one wonders whether it implicitly drew a second line between the post-term restraints at issue in *Edwards* (unenforceable under Section 16600) and the in-term restraints at issue in *Ixchel* (potentially enforceable under Section 16600).

The question of *Ixchel*'s applicability to post-term restrictions is of special relevance to the franchise community. The relationship between franchisors and franchisees is between independent businesses; in its simplest form, the franchisor owns a valuable trademark and business system, and the franchisee seeks to use those assets, in combination with its own efforts and investment, to build its business for its own benefit. Part of the bargain is usually an exclusive dealing arrangement under which franchisees agree not to operate a similar business during the term of the franchise (an in-term covenant). The *Ixchel* court specifically noted the use of such arrangements in the franchise context and suggested that a rule of reason approach was appropriate. 9 Cal. 5th at 1161. A different part of the bargain, in most franchises, is an agreement that, at the end of the relationship, the franchisee will not operate a similar business for a certain reasonable amount of time, within a certain reasonable distance from its franchised location (a post-term covenant). Because of the franchisee's use of the franchisor's mark—which is, by definition, an integral aspect of franchising—a post-term covenant is necessary to protect the franchisor's goodwill associated with the trademark and to enable the franchisor to re-franchise the territory. This is where the franchise relationship differs from other types of business-to-business dealings, which generally do not involve post-term covenants.

Will such covenants—like those in other business contracts—now be subject to the rule of reason in California, rather than invalidated outright under Section 16600? Or will courts read into *Ixchel* an unstated assumption that post-term restraints are qualitatively different? In at least two pre-*Ixchel* cases relating to a franchise or trademark license agreement—*Dayton Time Lock Service, Inc. v. Silent Watchman Corp.*, 52 Cal. App. 3d 1 (1975) and *Comedy Club, Inc. v. Improv West Associates*, 553 F.3d 1277 (9th Cir. 2009)—the courts applied a rule of reason analysis to assess the enforceability of a covenant not to compete. In both cases, the courts went to some effort to emphasize that the only provision under consideration was an in-term (not post-term) covenant, suggesting that the distinction was significant. Can an inference be drawn that *Ixchel*'s failure to address that distinction means that it is no longer significant? Indeed, the reasoning in both *Dayton Time Lock* and *Comedy Club*, as well as in *Ixchel*—that restraints in the business context can be procompetitive and should therefore not be invalidated outright—can apply as forcefully to post-term covenants as to in-term covenants.

While no California court has yet ruled definitively on the proper standard for post-term covenants, the winds appear to be blowing in the direction of a more lenient rule of reason standard. In *NuLife Ventures, Inc. v. Avacen, Inc.*, No. 20-cv-2019, 2020 WL 7318122 (S.D. Cal. Dec. 11, 2020), the court drew no distinction between in-term and post-term restraints and proceeded to apply a rule of reason analysis to a post-term non-solicitation agreement. However, in doing so, it likened the independent contractors who were subject to the non-solicitation provision to employees and, relying on *Edwards*' policy arguments, ruled that the restriction failed the rule of reason test because—rather than promote competition—it limited the contractors' ability to practice their profession. A district court in Colorado leveraged *Ixchel* to suggest that Section 16600 no longer strictly prohibits post-term covenants not to compete in the franchise context. In *Postnet Int'l Franchise Corp. v. Wu*, No. 20-cv-03790, 2021 WL 1037914 (D. Colo. Feb. 19, 2021), the court held that a former franchisee failed to demonstrate that California had a materially greater interest than Colorado in the enforcement of a post-term non-compete

provision. Although it acknowledged that *Ixchel* concerned an in-term covenant, the court took the position that California would now evaluate *all* "business dealings"—including post-term non-competes in franchise agreements—under a rule of reason standard. *Id.* at *10. *See also Bambu Franchising, LLC v. Nguyen*, No. 21-cv-00512, 2021 WL 1839664, at *6 n.6 (N.D. Cal. May 7, 2021) (noting that *Ixchel* "recently held that a rule of reason applies to contractual restraints on business operations and commercial dealings under section 16600," but without drawing a distinction between in-term and post-term covenants).

Whether or not *Ixchel* will ultimately be interpreted to apply to post-term non-compete provisions, this new rule of reason standard may result in a tsunami of litigation in franchising and beyond. ■