

Key California M&A Considerations for Life Sciences Businesses: Part 2

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This is the second article in our two-part series addressing a few key issues and considerations that life sciences business owners should consider when dealing with a merger or acquisition in California. [Part one](#) covered approval mechanics, board composition, protections for minority and dissenting shareholders, California's permit and fairness hearing process and the quasi-California corporation statute. Part two addresses dispute resolution provisions, the enforceability of noncompetition and nonsolicitation covenants and tax considerations that commonly influence deal structure and negotiations.

7. **Pre-Dispute Waiver of Jury Trial.** In *Grafton Partners L.P. v. Superior Court*, the California Supreme Court unanimously held that contractual pre-dispute waivers of jury trial are unenforceable (36 Cal.4th 944 (2005)). As a result of *Grafton*, parties cannot waive jury trials simply by including a standard waiver in an agreement before an actual dispute (assuming the agreement is governed by California law). Consequently, parties seeking to avoid a jury trial in the event of future disputes related to a merger or acquisition should ensure that either the agreement is governed by non-California law (such as Delaware or New York, where pre-dispute jury waivers are enforceable) or that a mandatory alternate dispute resolution mechanism is specified.
8. **Enforceability of Noncompetition Agreements.** Under § 16600 of the California Business and Professions Code (CBPC), any agreement restraining anyone "from engaging in a lawful profession, trade, or business of any kind" is void, unless a statutory exception applies. This limitation has been held to apply broadly and includes both noncompetition and nonsolicitation covenants. The narrow statutory exceptions to the prohibition of noncompetition agreements are set out in §§ 16601, 16602 and 16602.5 of the CBPC. Under these sections, a noncompetition agreement is enforceable only against a seller in connection with any of the following: (i) the sale of the goodwill of a business or the ownership interests in a business; (ii) the sale or dissolution of a partnership or the dissociation of a partner from the partnership or (iii) the sale or dissolution of a limited liability company or the termination of the member's interest in the limited liability company. Thus, unless the narrow statutory exceptions apply, noncompetition agreements are generally unenforceable in California, even if they contain reasonable time, location and industry limitations. Consequently, parties seeking to enforce a noncompetition agreement involved in a merger or acquisition should ensure that one of the narrow statutory exceptions apply or consider whether the agreement should be governed by non-California law (which may be difficult if the restricted person is a California based employee).
9. **California Taxation.** California has various taxes that need to be considered when entering into a merger or acquisition. This includes, but is not limited to, the tax impact on all parties when structuring the deal as an asset sale, stock sale, an f-reorganization, etc. The following are a few taxes in California that should be considered:
 - **S Corporations.** California LLCs or corporations that choose S corp. taxation must pay a 1.5 percent state franchise tax on their net income.

- Income. California has nine state income tax rates, ranging from 1 percent to 12.3 percent.
- Capital Gains. California's capital gains tax rates align with its progressive income tax system, ranging from 1 percent to 13.3 percent.

The considerations outlined in this two-part series cover only a subset of the issues that can arise in California M&A transactions. Solutions to some of these challenges may involve voting agreements or drag along rights, which function as pre-approvals rather than eliminations of voting rights. Even so, many of these issues can materially complicate negotiations and, in some cases, prevent consummation of a transaction. Life sciences business owners should consult their legal advisors regarding these matters.