CARLTON FIELDS

So You Want to Enter the Cannabis Industry — Antitrust Basics for the New Market Entrant

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The cannabis industry is booming. Legal pot is now a more than $10 billion industry in the United States, supplying hundreds of thousands of American jobs. As states continue the trend toward legalization, and the federal government continues (for now) to stay its hand in those states with regulatory programs, it is critical for the new industry entrant to become familiar with the laws that set the metes and bounds of permitted competition in the space. As Justice Thurgood Marshall once explained, the "[a]ntitrust laws in general, and the Sherman Act in particular, are the Magna Carta of free enterprise." Antitrust constitutes a relatively light form of regulation that, generally speaking, focuses on two categories of conduct: (1) naked agreements by individuals and firms of any size to corrupt the competitive process, which are unlawful "per se"; and (2) agreements and conduct by firms with "market power" that, on net, unreasonably restrict competition and reduce marketwide output. This entry is the first in a series of posts providing the basics of antitrust to cannabis industry members. We focus initially on the category of per se violations, as it would be especially unfortunate for entrants in a newly legalized marketplace to suddenly find themselves the subject of an FBI "dawn raid" and, down the line, potentially massive fines, and even prison time, for purchasing or selling *legal* cannabis in a criminal way. ***Horizontal agreements as to price:*** Price fixing is antitrust's capital crime. It takes place when two or more competitors agree as to price or its equivalent (such as agreements on output or capacity). Once proven, the government (or a civil plaintiff) need not show the prices set were unreasonably high, as injury to competition is presumed to flow from these agreements. It is important to recognize that the term "agreement" is construed broadly; there are no formal requirements (e.g., need not be in writing) and a meeting of the minds can be inferred through conduct. Horizontal agreements as to price on the purchasing side, known

as “bid-rigging,” are also per se unlawful.

> Example: *You own a dispensary and attend an event hosted by a cannabis industry trade association. You overhear the owner of a rival dispensary complaining about plummeting prices caused by an overly permissive licensing regime. You join the conversation, agree profits have been hard to come by, and assert that, hypothetically, business would be better for everyone if local dispensaries competed vigorously on non-price elements — quality, location, service, etc. — but less vigorously on price, suggesting that a floor of $300 per ounce would ensure that stores made a profit. Your new friend responds that, hypothetically, a $300 floor just might work. The following week you raise your price, and your fellow dispensary immediately follows suit. The agreement is per se unlawful.*

Market Allocation: Competitors can reduce output and raise prices without agreeing on price terms by, for example, agreeing not to compete (or compete too vigorously) for one another’s customers, or on the other firm’s “turf.” Such agreements are the equivalent of price-fixing agreements and are per se unlawful.

> Example: *At the same industry meeting, two growers express excitement following the announcement that two new dispensaries, one in the eastern part of the state, and one in the west, are about to open and require supply. The first grower observes that, coincidentally, her farm is in the eastern part of the state, and the second’s is in the west. In transportation costs alone, she exclaims, each would save a bundle by bidding to serve only the new store in her respective territory. Better yet, she adds, each farm could better serve customers in its territory by reinvesting those savings in new tractors, and isn’t that what the antitrust laws are all about? If the western grower agrees, the two are subject to criminal (and civil) enforcement.*

Concerted Boycotts: Businesses have the right to decide with whom they will conduct business, but should exercise that right carefully: agreements among competitors to refuse to deal with someone are per se unlawful. As with other agreements with competitors, courts can look to circumstantial evidence and draw inferences to find that you engaged in prohibited conduct. Even if the idea was not yours, your company (and you) can face antitrust liability for knowingly joining an agreement organized by others.

> Example *A large chemical concern with an organic farming division hosts an extravagant dinner annually at our convention. A group of organic farmers scoffs at attending and supporting a company many need, but none like. They commence their own barnburner of a dinner and, after many drinks and a round-robin of grievances, agree that skipping a dinner is not enough. From this point forward, none of them will purchase from the concern. The agreement is per se unlawful.*

Tying: Tying is often grouped with per se offenses, but is not quite so. Tying involves the seller

conditioning the sale of one item (the tying product) on the purchase of another (the tied product). It is unlawful if the seller has market power — often shown through evidence of a high market share — in the tying product market.

> Example *Seed Co. conditions the purchase of its patented "Ultra Strain" seeds on the purchase of its non-patented seeds. If it can be demonstrated that Seed Co. has market power in a well-defined antitrust market, liability may follow.*

What can cannabis industry firms do to reduce their risk exposure?

- Implement an antitrust compliance policy.
  - Companies should educate their employees as to antitrust compliance through a written compliance policy and continuing formal educational programs.
  - The government will consider whether a company has an antitrust compliance policy both in its decision to charge a company and in its position as to sentencing of convicted companies.
- Be vigilant at industry meetings.
  - Trade associations need antitrust counsel and a formal, public antitrust policy.
  - There are certain topics that should not be discussed, especially those involving future prices.
- Stay tuned for future posts in our monthly series, which will address topics including non-per se civil antitrust offenses, M&A, and other topics.

Please contact the authors if you have any questions.

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