LOS ANGELES & SAN FRANCISCO
Daily Journal
www.dailyjournal.com
WEDNESDAY, OCTOBER 13, 2021

PERSPECTIVE

Antitrust verdict provides lessons for cannabis businesses

By Leo Caseria and Thomas Tyson

A California jury last month handed down what has been reported to be the first antitrust jury verdict involving the cannabis industry. As the cannabis industry continues to grow and evolve, cannabis-related antitrust disputes may well increase. In this article, we highlight several lessons cannabis companies can learn from the alleged conduct at issue in *Richmond Compassionate Care Collective v. Koziol, et al.*, MSC16-01426 (Contra Costa Super. Ct.).

Richmond involved a dispute between medical marijuana collectives in Richmond, California. At the center of the controversy was Richmond Marijuana Ordinance No. 28-10 N.S., which restricted the operations of medical marijuana collectives to a limited subset of commercial properties located within certain distances from schools and other specified facilities. The ordinance further required collectives to obtain city council approval before opening to the public.

Defendants Richmond Patient's Group, Holistic Healing Collective, Inc., and 7 Stars Holistic Foundation, Inc. were dispensaries operating under the ordinance. Plaintiff Richmond Compassionate Care Collective, another dispensary in the Richmond area, obtained permitted status in 2011. However, RCCC struggled to gain traction in the market, spending years attempting to secure a long-term location for its business.

In 2014, the ordinance was amended to require dispensaries to commence operations within six months of permit approval, or the permit would expire. RCCC, still searching for a location for its business, was unable to secure a lease within the six month period and, as a result, lost its permitted status.

In addition to antitrust lawsuits brought by private parties, such as the one filed by RCCC, government enforcers have also been increasingly using the antitrust laws to investigate the cannabis industry.

RCCC contended that Richmond Patient's Group, Holistic Healing and 7 Stars, along with their principals and agents, conspired to prevent it from opening a dispensary by blocking access to compliant properties. RCCC alleged that the defendants presented phony leases, letters of intent to lease or purchase, and purchase agreements to landlords with available commercial properties in an effort to "tie [the landlords] up with paper" so as to prevent RCCC from securing a property before its pending permit expired. Defendants also allegedly went door-to-door to landlords in an attempt to convince landlords not to lease or rent their properties to RCCC, and demanded noncompete clauses in their own commercial leases to contractually prevent landlords from leasing or renting their properties to RCCC.

RCCC brought suit in 2016, alleging that defendants' scheme constituted an unlawful group boycott in violation of California's Cartwright Act. RCCC sought millions of dollars in damages.

In their motion for summary judgment, defendants argued, among other things, that RCCC could not prove its inability to secure a compliant property was caused by defendants' conduct. The court disagreed and denied the motion in January 2021. The court held that there was ample support for RCCC's claim, most notably in the form of co-conspirator Lisa Hirschhorn's sworn testimony attesting that she had witnessed much of the defendants' alleged conspiratorial conduct designed to harm RCCC. The court ruled that such direct evidence was sufficient to rule in favor of RCCC and deny the motion for summary judgment.

When RCCC's case ultimately went to trial in August, the only remaining defendants were RPG owners and directors William Koziol, Darrin Parle and Alexis Parle. On Sept. 23, the jury returned a verdict against Koziol and Darrin Parle, awarding $5 million in damages, which will be automatically trebled to $15 million. Alexis Parle was found not liable.

Lessons Learned

In the still fragmented cannabis industry, which is experiencing significant growth and consolidation, market participants need to be cognizant of federal and state antitrust laws regulating competition. In particular, and as demonstrated by the *Richmond* case, cannabis companies should exercise caution and consult an antitrust attorney before interacting with competitors, and also

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before undertaking any action which may have the effect of foreclosing a competitor from market entry or expansion. Such conduct could expose companies and individuals to liability under both federal and state antitrust laws if care is not taken.

In addition to antitrust lawsuits brought by private parties, such as the one filed by RCCC, government enforcers have also been increasingly using the antitrust laws to investigate the cannabis industry. For example, over the past few years, the U.S. Department of Justice has pursued a disproportionately high number of federal antitrust investigations regarding cannabis mergers and acquisitions. See Leo Caseria and Thomas Tyson, "High Risk of Second Requests in the Cannabis Industry," Cannabis Law Blog (July 2, 2020).

In light of these developments, cannabis companies should make sure they understand the antitrust risks posed by their business plans and strategies before executing them. Particular care should be taken in certain situations, including those identified below:

Horizontal agreements. Several types of agreements between competitors are subject to per se treatment by courts, meaning they are unlawful without regard to procompetitive effects or justifications. These include agreements to fix prices, allocate markets, or rig bids. As the defendants in Richmond learned, courts also give per se treatment to agreements between competitors to boycott another competitor. Steps should be taken in advance to educate and train employees and principals about how to avoid such conduct, because after the fact justifications will not be considered.

Vertical agreements. Unlike agreements between competitors, most agreements between entities that have a vertical relationship are subject to the "rule of reason," which means that a court will consider procompetitive and anticompetitive justifications and effects. Agreements with vendors, suppliers and customers are all subject to the rule of reason. This would also include lease agreements, such as those between the *Richmond* defendants and landlords of commercial properties from which cannabis businesses operate.

Unilateral conduct. Under California's Cartwright Act, only anticompetitive *agreements* are unlawful; the act does not reach unilateral conduct. However, federal antitrust law prohibits unlawful unilateral conduct under Section 2 of the Sherman Act. Thus, efforts to foreclose a competitor from a market, even if undertaken unilaterally and not as the result of an agreement, can potentially be unlawful if carried out by a monopolist or in an attempt to obtain a monopoly. Many types of conduct can foreclose a competitor, including, as was the case in *Richmond*, denial of access to a key resource or facility.

Noncompete clauses. In order to be enforceable, a contractual noncompete clause must be reasonably necessary and ancillary to achieving the contract's legitimate purpose. This means it must be limited in scope and cannot be the main purpose of the agreement. Entering into an agreement for the purpose of obtaining a noncompete to foreclose a competitor is not advisable and may result in an unenforceable noncompete. ■

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