



## Vertical Integration: Reconciling MCRSA and Prop 64

### Background

MCRSA places several limitations on the number and type of licenses a cannabis business may acquire. Other than for testing and large-scale cultivation, Prop 64 does not have prohibitions against cross-licensure. Discrepancies between the laws will complicate implementation for state and local agencies and make compliance more difficult for licensees. This is particularly true for cultivation and distribution chains. To facilitate enforcement and compliance, there should be parity between cross-licensure rules in medical and recreational marijuana regulation, and prohibitions against cross-licensure should be removed.

### Policy Issues with Vertical Integration Prohibition or Mandates

**Creates a Competitive Disadvantage.** Washington State prohibits retailers from also being licensed as producers (cultivators). The state has issued significantly more producer licenses than retailer licenses, resulting in a major competitive disadvantage for producers. Retailers are allowed to hand-pick which producer to purchase from, while producers do not have any options to get rid of supply. Like we have seen with distributors in the alcohol industry, prohibiting cross licensure often gives one sector of an industry an unfair advantage without necessarily effectively limiting the size and scale of a business.

**Increases Risk of Outdated Oligopoly Models, Which Hurt Smaller Businesses.** A tiered regulatory model can provide benefits when producers do not have access to retailers, but the internet has largely rendered this justification irrelevant. Technology has made it much easier for manufacturers and retailers to find one another almost instantly giving them the ability to cut out the middleman and improve margins. Tiered regimes can stifle innovation, damage the quality of products, inflate costs and make it more difficult for otherwise compliant businesses to enter into the legal marijuana market.

**Fails to Consider Existing Industry Practices.** Allowing business that can comply with regulatory requirements to participate in a variety of sectors would benefit both the marijuana industry and public safety. Optional vertical integration will help marijuana businesses keep costs low, which will help encourage consumers to purchase cannabis from legal points of sale.

**Fails to Make Vertical Integration Optional, Not Mandatory.** Mandating vertical integration can be problematic as most business do not have the resources, sophistication, or incentive to be involved in all the stages between production and sale. The great variety of cannabis strains, concentrates and products means that no competitive cannabis dispensary can sell only the products that it produces.

### Policy Recommendations

**Utilize Seed-to-Sale Tracking Systems to Monitor Inventories and Product Movement, which will Help Keep Large and Small Businesses Accountable.** One of the main goals of the alcohol distribution model (along with preventing tied-house monopolies) was to prevent diversion of goods into the illegal market or illegal market goods entering the legal market. With the rise of digital tracking systems, this goal is accomplished in a more cost effective and accurate fashion. Seed to sale tracking has the added benefit of providing real-time data.

**Incentivize Licensure for Small and Minority-Owned Business to Allow for These Groups to Carve Their Niche in the Market.** The state already offers several incentives for small and minority owned business outside of the cannabis industry, like priority licensure and tax breaks. Providing similar incentives in the cannabis industry will reduce barriers of entry for small businesses while insuring more product diversity and points of sale in the market.

**Give the Market Time to Develop and Assess License Restrictions when You Have a Better Sense of How the Market is Taking Shape.** While California's cannabis industry is very sophisticated, it has been unregulated or under-regulated for over 20 years. Businesses practices are bound to change as regulations are implemented. The state should monitor how the marijuana industry grows and adjusts to regulations, particularly in the first years of implementation. If cross-licensure in certain categories is causing public safety problems, the state can make a more informed decision on what activities need to be separated.