

ENTREPRENEURIAL RISK: MARIJUANA, COMPLIANCE, AND THE SOCIAL CONSTRUCTION OF LAW AND MARKETS

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ABSTRACT

The schism between federal criminalization and state legalization of the marijuana industry provides a unique opportunity to examine entrepreneurial risk in an emerging market. Marijuana introduces a kaleidoscope of compliance issues including protecting intellectual property, drafting contractual choice-of-forum clauses, engaging in tax planning to garner favorable tax treatment, and arranging financial matters to sidestep federal money-laundering laws. In these and many other scenarios, the marijuana entrepreneur must assess the economic risks associated with an exceedingly dynamic legal environment. These assessments ultimately involve educated guesses, many of which motivate ethical considerations.

This Article contributes to the growing field of legal strategy. This literature typically employs the language of compliance and financial risk management. It also typically assumes that the law embodies a singular command that must be obeyed. Ethical and social responsibility issues arise only after legal obligations have been met, as legitimate economic gain can only be made through lawful means. Yet, the sudden birth of a quasi-legal marijuana industry illustrates that both legal obligations and economic opportunities must be socially constructed by the entrepreneur. Neither law nor markets exist in the abstract; each has meaning only in its evolving manifestations. The responsible entrepreneur recognizes this and injects ethical reflection into the social construction of compliance issues. This Article explains this social construction, drawing from legal philosophy, ethical philosophy, neoclassical economics, and strategic management to advance a vision of ethical compliance with evolving law.

I. INTRODUCTION

Entrepreneurial opportunity springs from dynamic social, technological, and legal environments.¹ Yet, dynamism also generates economic risk. The

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¹ The Merriam-Webster Dictionary defines an "entrepreneur" as "one who organizes, manages and assumes the risks of a business enterprise." *Entrepreneur*, Merriam-Webster Dictionary, <https://www.merriam-webster.com/dictionary/entrepreneur> (last visited Nov. 7, 2020). Entrepreneurs

entrepreneur must scan the environment for market opportunities while holding risk to acceptable levels. This Article uses the newly emergent medical and recreational marijuana industry as a case study illustrating the need for entrepreneurs to interpret legal compliance issues and to construct market opportunities while advancing their economic interests in a responsible way.

The social construction of legal obligations and market opportunities is highly creative, requiring projections and educated guesses on several fronts. Federal law continues to list marijuana as a Schedule I Controlled Substance, making it illegal to possess or distribute.² Simultaneously, eleven states and the District of Columbia have legalized recreational uses of marijuana, while twenty-eight states and the District of Columbia have legalized medicinal uses.³ Of course, when federal law directly conflicts with state law, the former controls. The sole reason that marijuana sells “legally” today in more than two dozen states is that the executive branch chooses not to enforce federal law. This policy began with President Obama and has continued with President Trump.

According to conventional views of social responsibility, entrepreneurs are free to maximize the value of their business ventures so long as they comply with the law and widely shared ethical customs.⁴ But, what if both law and ethical customs are in flux? In such situations, the socially responsible entrepreneur must construct legal compliance rules for the

translate inventions or technologies into goods and services. See David B. Audretsch, et al., *The Economics of Science and Technology*, 27 J. TECH. TRANSFER 155, 157 (2002) (noting that entrepreneurs “organize the capital, talent, and other resources that turn an invention into a commercially viable innovation.”). Within the field of economics, discussions of entrepreneurship trace to the eighteenth-century writings of Adam Smith but appear most pointedly in the works of mid-twentieth century Austrian economists, particularly Joseph Schumpeter and his notion of “creative destruction.” See BRUCE A. MCDANIEL, *ENTREPRENEURSHIP AND INNOVATION: AN ECONOMIC APPROACH* 5–11 (2002) (discussing contributions from Adam Smith and Joseph A. Schumpeter). See generally 1 ADAM SMITH, *AN INQUIRY INTO THE NATURE AND CAUSES OF THE WEALTH OF NATIONS*, 13–24 (R. H. Campbell & A. S. Skinner eds., Oxford Univ. Press 1976) (1776) [hereinafter SMITH, *WEALTH OF NATIONS*] (discussing entrepreneurial innovation in the making of pins); JOSEPH A. SCHUMPETER, *CAPITALISM, SOCIALISM AND DEMOCRACY* (Routledge 2003) (1942) (arguing that entrepreneurial innovation provides a disruptive force that sustains economic growth). In the late-twentieth century, the study of entrepreneurship emerged as a distinct field in many leading American business schools. See Donald F. Kuratko, *The Emergence of Entrepreneurship Education: Development, Trends, and Challenges*, 29 *ENTREPRENEURSHIP THEORY & PRAC.* 577 (2005) (discussing the genesis and growth of entrepreneurship in business education and summarizing its pedagogical content). See generally David E. Pozen, *We Are All Entrepreneurs Now*, 43 *WAKE FOREST L. REV.* 283 (2008) (discussing entrepreneurial opportunities spawned by dynamic uncertainty in law, technology, and social mores).

² See Comprehensive Drug Abuse Prevention and Control Act of 1970, 21 U.S.C. § 812 (2018). The Agriculture Improvement Act of 2018, 7 U.S.C. § 1639o (2018) distinguishes between hemp and marijuana and removes the former from the controlled substance list, while retaining the latter. Hemp contains tetrahydrocannabinol (THC), the compound in marijuana that causes marijuana users to get high. Plants constitute hemp so long as their THC level is less than 0.3%. Plants with a higher level of THC are marijuana and remain illegal under the Federal Controlled Substances Act. See Charisse Jones, *Weed? CBD? New Products, New Laws Are Causing Confusion in the Workplace*, USA TODAY (Jan. 21, 2020, 12:01 AM), <https://www.usatoday.com/story/money/2020/01/21/weed-and-work-cbd-may-legal-but-its-risky-office/2835517001>.

³ See Jones, *supra* note 2. Another seventeen states permit the use of products with a low level of THC, such as cannabidiol (CBD) derived from hemp, to address medical concerns. *Id.*

⁴ Gerlinde Berger-Walliser & Inara Scott, *Redefining Corporate Social Responsibility in an Era of Globalization and Regulatory Hardening*, 55 *AM. BUS. L.J.* 167, 214–15 (2018) (documenting a global trend to address CSR with formal regulations and emphasizing the need for corporations to supplement their regulatory compliance activities with an express commitment to the firm’s social and ethical duties to society); see generally Benedict Sheehy, *Defining CSR: Problems and Solutions*, 131 *J. BUS. ETHICS* 625 (2015) (surveying alternative views of corporate social responsibility (CSR) and defining CSR as “international private self-regulation”).

business and construct a market based on numerous projections regarding supply constraints, consumer demand, and technological imperatives. These legal constructions and economic projections typically involve pragmatic guesses that must be reassessed and adjusted as the enterprise unfolds.

This Article offers a framework for navigating entrepreneurial risk in a socially responsible and economically profitable manner.⁵ The analysis proceeds in three parts, followed by a conclusion. Following the introduction, Part II focuses on law. It first surveys formal legal impediments to the marijuana business and then discusses several legal tactics designed to cope with these illegalities. Part III incorporates ethics. It begins with the ethics of political obligation and then compares three approaches to legal interpretation—realism, formalism, and pragmatism—defending pragmatism as the most responsible approach to compliance issues. Part IV concludes with economics. It draws insights into entrepreneurial risk from the neoclassical theory of the firm. It then supplements the neoclassical approach with managerial insights derived from Michael Porter’s notion of managerial strategy.⁶ The combination of neoclassical theory and strategic management provides a practical framework attuned to the dynamic and uncertain markets posed by marijuana. The analysis concludes with a brief summary.

This Article makes two scholarly contributions. First, it provides an extended and novel discussion of ethical issues associated with legal strategy, defending a pragmatic interpretation of law as a means of avoiding difficulties associated with an overly restrictive legal view (legal formalism) or an overly permissive one (legal realism). Second, it offers a unique attempt to articulate a neoclassical economic approach to entrepreneurial risk, tempered with insights borrowed from strategic management.⁷ The resulting framework offers a means for addressing entrepreneurial risk when both law and markets are in flux.

II. COMPLYING WITH LAW

Writing about fifty years ago, Milton Friedman famously stated that the social responsibility of a business is “to make as much money as possible while conforming to the basic rules of society, both those embodied in law and those embodied in ethical custom.”⁸ To which ethical custom Friedman

⁵ The term, “framework,” as used in this article, refers to an instrument of practical reasoning. This article seeks to offer a useful means for sorting through legal, ethical, and economic issues in a social environment replete with dynamism and messy information. *See generally* Kenneth R. Andrews, *The Progress of Professional Education for Business*, 5 THEOLOGICAL EDUC. 144, 162 (1969) (defining a framework as “a simple practitioner’s theory, a kind of Everyman’s conceptual scheme”).

⁶ *See infra* Part IV.B.

⁷ *See generally* MCDANIEL, *supra* note 1, at 195–212 (critically evaluating the omission of the entrepreneur in much of neoclassical microeconomic theory); *see also infra* Part III.

⁸ Milton Friedman, *A Friedman Doctrine--The Social Responsibility of Business Is to Increase Its Profits*, N.Y. TIMES MAG. (Sept. 13, 1970), <https://www.nytimes.com/1970/09/13/archives/a-friedman-doctrine-the-social-responsibility-of-business-is-to.html>. Friedman’s article remains central to discussions of a corporate executive’s social responsibilities and many contemporary textbooks continue to reprint all or portions of it. Its influence would be difficult to overstate: textbooks continue to reprint all or portions of it.

was referring has been a matter of some speculation.⁹ Friedman himself did not explain.¹⁰ Nor, did Friedman expand on what he meant by “law.” His formulation, however, stands on its own: the drive for monetary gain must be subordinate to both law and ethical custom, whatever that may mean.¹¹

Holding money making subordinate to legal obligation proves problematic regarding marijuana. Under a formal definition of law, selling marijuana, even in states where marijuana dispensaries are permitted by state statute, remains illegal. This is true because under the Supremacy Clause of the U.S. Constitution, federal law preempts state law when there is a direct conflict. Not surprisingly, this illegality poses obstacles for the marijuana entrepreneur. For example, lenders may be reluctant to lend for fear of violating federal money laundering laws. Trademark protection may be unavailable for marketing marijuana. Certified public accountants may be unwilling to assist marijuana entrepreneurs in tax planning for fear of violating professional conduct standards.

Yet, the illegality of the marijuana business also offers opportunity. As one commentator observes, economic entrepreneurship “frequently thrives in the uncertain borderlands between what is legal and what is illegal.”¹² For example, the U.S. Patent and Trademark Office (“USPTO”) will not register a federal trademark for marijuana, but it often allows a federal trademark of cannabidiol (“CBD”) products. Legally astute businesspeople can profit by establishing a federal trademark for CBD, then using that same trademark to market marijuana in permissive states.¹³

One might ask whether there is anything unethical in using imperfections and inconsistencies in the law for economic gain. Presumably, direct

⁹ See, e.g., CHRISTOPHER D. STONE, WHERE THE LAW ENDS: THE SOCIAL CONTROL OF CORPORATE BEHAVIOR 74–112 (1974) (examining Friedman’s views and collecting contemporaneous reactions, both pro and con).

¹⁰ Friedman discussed CSR elsewhere, but he did not amplify or explain his notion of “ethical custom.” See, e.g., MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962); *Milton Friedman: The Playboy Interview*, PLAYBOY, Feb. 1973, at 59.

¹¹ Legal scholars typically trace discussions of CSR to a 1930s debate between Adolph Berle and Merrick Dodd. See, e.g., Berger-Walliser & Scott, *supra* note 4, at 175. Management scholars, by contrast, typically cite Howard Bowen, see HOWARD BOWEN, THE SOCIAL RESPONSIBILITY OF THE BUSINESSMAN (1953), as the person who coined the term CSR and prompted scholarly debate. See, e.g., Archie B. Carroll, *Corporate Social Responsibility: Evolution of a Definitional Construct*, 38 BUS. & SOC’Y 268, 268–70 (1999) (citing Bowen’s work as seminal and dating discussions of CSR to the 1950s); Lee E. Preston, *Corporation and Society: The Search for a Paradigm*, 13 J. ECON. LITERATURE 434, 435 (1975) (same). Bowen’s notion of CSR emphasized the need for businesspersons “to cooperate with government in the formulation and execution of public policy.” BOWEN, *supra* at 28; see also LEE E. PRESTON & JAMES E. POST, PRIVATE MANAGEMENT AND PUBLIC POLICY (1975) (emphasizing that a business executive’s economic duties are tertiary to ethical and legal concerns). In the 1980s, the CSR literature adopted the stakeholder concept, see Berger-Walliser & Scott, *supra* note 4, at 173–74, and explicitly incorporated what was already implicit in the works of Bowen, Friedman, and Preston and Post—responsible economic conduct requires legal and ethical means. Of course, the devil may be in the details, as scholars continue to offer alternative interpretations of legal and ethical duties owed in business settings. See Berger-Walliser & Scott, *supra* note 4 (detailing alternative conceptions); Sheehy, *supra* note 4 (same).

¹² Clayton M. Christensen, *The Innovator’s Dilemma* 47 (2011).

¹³ CBD derived from hemp, with a THC level of less than 0.3%, became legal at the close of 2018 with the passage of the Agricultural Improvement Act. See USPTO, EXAMINATION GUIDE 1-19: EXAMINATION OF MARKS FOR CANNABIS AND CANNABIS-RELATED GOODS AND SERVICES AFTER ENACTMENT OF THE 2018 FARM BILL (2019) [hereinafter EXAMINATION GUIDE], <https://www.uspto.gov/sites/default/files/documents/Exam%20Guide%201-19.pdf>. Prior to December 2018, CBD from whatever source was illegal; nevertheless, the U.S. Patent and Trademark Office sporadically registered a CBD trademark, and some entrepreneurs used this regulatory anomaly as a strategic advantage. See *infra* Part II.B.2 (discussing the exploitation of legal confusion).

illegality should be beyond the pale. But, in the case of marijuana, it appears not to be. Marijuana is illegal, but the law is not enforced, so people sell it for profit. In fact, in twenty-eight states, they do so openly. The following sections address legal impediments facing the marijuana industry, and then examine legal tactics for transforming these impediments to entrepreneurial opportunities. Part II addresses ethics.

A. PROBLEMS OF FORMAL ILLEGALITY

The chasm between state legality and federal illegality poses unique legal challenges. Lawyers advising on marijuana law find two pools of clients: (1) entrepreneurs, including manufacturers, distributors, and retailers, and (2) third-party facilitators such as doctors, bankers, tax advisors, and real estate brokers. Clients sometimes seek advice on the legality of proposed actions; at other times, they seek transactional services, such as the drafting of contracts or the filing of a tax position. Yet, a lawyer cannot ethically assist a client in conduct that the lawyer knows to be criminal. The *Model Rules of Professional Conduct* state:

A lawyer shall not counsel a client to engage, or assist a client, in conduct that the lawyer knows is criminal or fraudulent, but a lawyer may discuss the legal consequences of any proposed course of conduct with a client and may counsel or assist a client to make a good faith effort to determine the validity, scope, meaning or application of the law.¹⁴

Several states have modified this rule to permit lawyers to advise marijuana clients regarding their legal rights under state law and to provide transactional services, so long as the lawyer also advises on the illegality of the marijuana business under federal law.¹⁵

The federal Drug Enforcement Administration (“DEA”) regulates marijuana pursuant to the Controlled Substances Act of 1970 (“CSA”). The CSA categorizes controlled substances into five schedules. Schedule I lists substances that have been determined to have “a high potential for abuse,” and “no currently accepted medical use in treatment in the United States.”¹⁶ Schedule I substances cannot be prescribed, and it is a federal crime to possess or distribute these substances. Marijuana, heroin, and LSD are Schedule I controlled substances.¹⁷

Schedule II contains substances with accepted medical use, but with “a high potential for abuse,” with use potentially leading to “severe psychological or physical dependence.”¹⁸ Examples include cocaine, methamphetamine, and oxycodone. Legal medical marijuana can exist in the United States only if Congress reclassifies marijuana from Schedule I to

¹⁴ MODEL RULES OF PROF'L CONDUCT r. 1.2(d) (Am. Bar Ass'n 2010).

¹⁵ See Bruce E. Reinhart, *Dazed & Confused: Legal and Ethical Pitfalls in Marijuana Law*, 31 CRIM. JUST. 4 (2017).

¹⁶ 21 U.S.C. § 812(b)(1) (2018).

¹⁷ *Id.*

¹⁸ *Id.*

Schedule II. Until that occurs, it remains illegal for anyone in the United States to grow, prescribe, dispense, or distribute marijuana.¹⁹

Lawyers advising clients on marijuana law face a complicated task. Whenever the marijuana business interfaces with areas of federal law, a legal landmine emerges. For example, even if state law permits marijuana sales, marijuana business owners may face federal criminal prosecution for violation of the CSA and various money laundering statutes.²⁰ Ancillary service providers, such as public accountants and bankers, risk indictment for conspiracy to commit a federal crime or for aiding and abetting a federal crime.²¹ Marijuana entrepreneurs find federal income tax deductions unavailable due to the source of the income. Bankruptcy protection or trademark registration, both areas of federal law, may also be restricted or unavailable. If the lawyer fails to bring these and similar legal risks to the client's attention, not only does the client suffer but the lawyer could be subject to bar sanctions, malpractice, or worse.

B. CONSTRUCTING LEGAL OPPORTUNITIES

At first blush, the problems posed by formal illegality may exceed the marijuana entrepreneur's tolerance for risk. Yet, legal obstacles, when viewed creatively, sometimes transform to one's advantage. George Seidel explained this transformation in his oft-cited book, *Using the Law for Competitive Advantage*.²² Seidel argued that effective management requires a "view from the balcony" where businesspeople, working with legal counsel, survey an ever-changing legal landscape to find ways to secure competitive advantages. Seidel was an early contributor to the growing field of scholarship, alternatively known today as proactive law, law and management, or more simply, legal strategy.²³ The following two subsections illustrate this strategic orientation to lawyering as applied to the marijuana industry.

1. Income Tax

Notwithstanding the threat of criminal indictment under the CSA, many marijuana insiders point to tax law as the biggest impediment to the state-permitted marijuana business.²⁴ State-approved marijuana dealers pay federal income taxes in accord with an Internal Revenue Code ("IRC")

¹⁹ Congresspersons periodically introduce bills to reclassify marijuana, but none have passed. *See, e.g.*, Ending Federal Marijuana Prohibition Act of 2013, H.R. 499, 113th Cong. (2013). In 2011, the governors of Washington and Rhode Island petitioned the DEA to use its administrative authority to reclassify marijuana. As required by law, the DEA asked the Food and Drug Administration (FDA) to provide "a scientific and medical evaluation of the available information and a scheduling recommendation for marijuana. . . ." *See* Denial of Petition to Initiate Proceedings to Reschedule Marijuana, 81 Fed. Reg. 53,688 at 53,690 (Aug. 12, 2016). The FDA found that the "available evidence is not sufficient to determine that marijuana has an accepted medical use." *Id.* at 53,689.

²⁰ *See, e.g.*, 18 U.S.C. §§ 1956–57 (2018); 21 U.S.C. §§ 841, 856 (2018).

²¹ *See* 18 U.S.C. § 2; 21 U.S.C. § 846.

²² George J. Seidel, *Using the Law for Competitive Advantage* (2002).

²³ *See* Thomas M. Madden, *Law and Strategy and Ethics?*, 32 GEO. J. LEGAL ETHICS 181 (2019) (providing a thorough review of the law and management literature); Evan A. Peterson, *Promoting Future-Oriented Legal Thinking in Long-Term Strategic Planning*, 29 S.L.J. 69 (2019) (same); *see also infra* Part IV.B (exploring the legal strategy literature for useful insights in constructing a framework for understanding entrepreneurial risk).

²⁴ *See* Benjamin Leff, *Tax Planning for Marijuana Dealers*, 99 IOWA L. REV. 523, 525–26 (2014).

provision specifically enacted in 1982 to punish illegal drug dealers.²⁵ Sellers of controlled substances must report their gross income under IRC section 61, but they cannot deduct their ordinary and necessary business expenses under section 280E.²⁶ This effectively causes the marijuana entrepreneur to pay tax on gross income rather than net income.

The IRC assesses a duty to pay tax on “all income from whatever source derived.”²⁷ In *Commissioner v. Teller*, the Supreme Court stated, “[i]ncome from criminal enterprise is taxed at a rate no higher and no lower than income from more conventional sources.”²⁸ With most criminal activities, this principle of equal treatment extends to deductions as well, treating legal and illegal businesses alike.²⁹ Yet, section 280E singles out income derived from the sale of controlled substances, disallowing the deduction of ordinary and necessary business expenses allowed to other sources of gross income, both legal and illegal. Section 208E states:

No deduction or credit shall be allowed for any amount paid or incurred during the taxable year in carrying on any trade or business if such trade or business (or the activities which comprise such trade or business) consists of trafficking in controlled substances (within the meaning of schedule I and II of the Controlled Substances Act) which is prohibited by Federal law or the law of any State in which such trade or business is conducted.³⁰

Enacted in 1982, section 280E took aim at organized crime and reinforced the war on drugs. Today, the section applies with dramatic (and arguably unintended) effect on marijuana businesses operating under the permission of state law in twenty-eight states.

²⁵ See *id.* at 526.

²⁶ See Edward J. Roche, Jr., *Federal Income Taxation of Medical Marijuana Business*, 66 TAX LAW. 429, 431 (2013) (citing I.R.C. § 280E as disallowing deductions for any expenses in carrying on a trade or business consisting of trafficking in controlled substances).

²⁷ I.R.C. § 61(a) (2018).

²⁸ *Comm’r v. Tellier*, 383 U.S. 687, 691 (1966). Applying this equality principle, courts allow taxpayers to deduct business expenses associated with illegal gambling, prostitution, racketeering, and various forms of organized crime. See Roche, *supra* note 26, at 434 (citing court cases illustrating each of these examples).

²⁹ Roche, *supra* note 26, at 434. The policy regarding equal treatment of business expenses has exceptions. Courts sometime disallow deductions on public policy grounds. For example, in *Tank Truck Rentals v. Comm’r*, 356 U.S. 30, 35–36 (1958), a company paid a fine for operating overweight trucks. Executives had calculated that it was more cost effective to violate the law and risk paying the fine than to reduce weight. In denying the deduction, the Supreme Court reasoned, “Deduction of fines and penalties . . . frustrate state policy in severe and direct fashion by reducing the sting of the penalty prescribed by the legislature.” *Id.* Although this “public policy” exception has a long lineage, the courts have always interpreted it narrowly. See *Tellier*, 383 U.S. at 693–94 (1966) (noting that the public policy exception should only be used “sparingly”). In 1969, Congress codified the public policy exception in I.R.C. § 162(c) (2018), disallowing business expenses analogous to the fine paid in *Tellier*. Since the enactment of section 162(c), the judicially created public policy exception has fallen into disuse. See Roche, *supra* note 26, at 436 (discussing the evolution of the public policy exception).

³⁰ I.R.C. § 280E (parentheticals in original). This section was added to the IRC by the Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97-248, §351(a), 96 Stat. 640 (1982).

To illustrate the effect of section 280E, consider the following hypothetical tax filing of a state sanctioned medical marijuana entrepreneur:

Gross Revenues	\$1,000,000
Cost of Goods Sold	<u>(\$800,000)</u>
Gross profit	\$200,000
Deductions	
Rent	\$61,000
Wages	\$115,000
Other	\$25,000
Total	(\$201,000)
Net Profit	-\$1,000

The IRC permits marijuana entrepreneurs to reduce their gross profit by deducting the cost of goods sold from gross revenues, but ordinary and necessary business expenses, such as rent, wages, and the like, are not deductible from gross profit.³¹ Due to section 280E, this hypothetical taxpayer must pay income tax on \$200,000 in gross profit even though the business actually lost \$1000. Assuming a thirty-five percent rate (including both federal and state income tax), the taxpayer owes \$70,000. To a small start-up, this tax treatment could prove fatal.

At least two tax scholars have suggested legal tactics to circumvent the difficulty posed by section 280E. Edward J. Roche, Jr. recommends assigning business expenditures to the cost of inventory, thereby reporting them as part of cost of goods sold rather than as business deductions. He writes:

[A] taxpayer engaged in the medical marijuana business would prefer to capitalize expenditures to the cost of inventory. These taxpayers may benefit from decades of legislation, cases, and Service rulings and arguments calling for an expanded interpretation of the capitalization rules. Medical marijuana businesses can benefit from *hoisting the Service with its own petard* and adopting an *expansive interpretation of the inventory capitalization rules* to increase the stated cost of their inventory, thereby reducing taxable income.³²

Inventory capitalization rules include rule 471, regarding full absorption inventory, and the uniform capitalization rules (“UNICAP”) created by section 263A.³³ These rules allow a business to use an inventory method of accounting whenever “the production, purchase or sale of goods is an income-producing factor.”³⁴ Due to section 280E, costs related to producing, acquiring, storing, and handling goods are not deductible as business

³¹ See Roche, *supra* note 26, at 429 (constructing a similar example).

³² *Id.* at 444 (emphasis added).

³³ 26 C.F.R. § 1.471 (2020); I.R.C. § 263A.

³⁴ 26 C.F.R. § 1.471-1.

expenses; however, under inventory accounting, a portion of these expenses can be included in cost of inventory and thereby increase the taxpayer's cost of goods sold.

Roche explains how aggressive re-categorization of business expenses, using full inventory absorption accounting and UNICAP rules, could drastically reduce taxes for the marijuana entrepreneur.³⁵ He surmises that most items commonly reported as expenses could be apportioned to inventory.³⁶ This includes some portion of wages and payroll (including training expenses), insurance premiums, professional fees, rent and utilities, taxes and licenses, and other expenses. Each expense arguably relates to acquiring, storing, or selling inventory. Roche recommends that the marijuana entrepreneur take an aggressive tax posture regarding these expenses.³⁷

Benjamin Leff offers an alternative approach to the problems posed by section 280E.³⁸ He proposes that the marijuana business present itself as a tax-exempt organization. Leff explains that a marijuana seller cannot be exempt as a *charity* under IRC subsection 501(c)(3) because the so called "public policy doctrine" does not permit a charity to have a criminal purpose.³⁹ He argues, however, that this public policy doctrine does not affect the tax-exempt status of a *social welfare organization* recognized under subsection 501(c)(4).⁴⁰ There are four requirements for a marijuana business to qualify as a social welfare organization: (1) it must have a proper tax-exempt purpose; (2) it cannot inure profits to private persons; (3) it must avoid excessive business related political activity; and (4) it cannot operate in an excessively commercial manner.⁴¹

Proponents of legalized marijuana argue that legalization reduces crime, improves blighted neighborhoods, provides employment opportunities for youths affected by the drug trade, increases user safety, and raises state and local tax revenue.⁴² Accordingly, an entrepreneur seeking a "proper tax-exempt purpose" pursuant to subsection 501(c)(4) might choose dispensary locations in at-risk neighborhoods and hire troubled youth, providing them with counseling and social rehabilitation. The entrepreneur should also show concern with drug purity and labelling and avoid excessive lobbying. With respect to the "no inurement" requirement of subsection 501(c)(4), Leff notes that the rule permits the entrepreneur to reinvest profits into the organization and to compensate employees, managers, and suppliers of capital for their labor and risk.⁴³ Leff concludes that, although business reasons may preclude seeking this social welfare status, the tax benefits remain significant.⁴⁴

³⁵ See Roche, *supra* note 26, at 444–61.

³⁶ *Id.* at 460.

³⁷ *Id.* at 461.

³⁸ See Leff, *supra* note 24.

³⁹ *Id.* at 528 (discussing I.R.C. § 501(c) (2006)).

⁴⁰ *Id.* at 527–28.

⁴¹ *Id.* at 527.

⁴² *Id.* at 525.

⁴³ *Id.* at 543–45.

⁴⁴ Leff notes that the "business case" for operating as a social welfare organization is beyond the scope of his article. Leff, *supra* note 24, at 528. To determine if seeking social welfare status makes economic sense, "one would have to compare the cost of so operating it with the cost of operating as a

2. Trademark Registration

The state-sanctioned marijuana market totals billions of dollars annually, including robust and growing sales of various CBD products.⁴⁵ Not surprisingly, many entrepreneurs seek federal trademark registration to protect goodwill and brand recognition pursuant to the Lanham Act.⁴⁶ Among other conditions, the Lanham Act requires the entrepreneur to use the mark “in commerce,” which presumably means *legal* commerce.⁴⁷ Federal registration provides constructive notice that the mark is in use and prohibits use of the mark by competitors without reference to geographic scope.⁴⁸ The federal system works in harmony with state laws pertaining to trademarks used within a state. Hence, a trademark established in one state can be extended to all fifty states and beyond through recognition by the USPTO.

Due to the classification of marijuana as a Schedule I controlled substance, the USPTO refuses to register trademarks related to the marijuana business. Until recently, federal law prohibited CBD sales;⁴⁹ yet, oddly, the USPTO often permitted registration of CBD related trademarks. In a recent article, Michael Schuster and Jack Wroldsen label this divergent treatment as “legally incoherent.”⁵⁰ They explain, however, that this inconsistency, when viewed from a strategic perspective, provided an economic opportunity.⁵¹ Once a CBD mark received federal registration, protections for CBD products sold in a permissive state would extend to other states and potentially to other products as marijuana laws continued to evolve. Thus, early registration provided significant first-mover advantages.⁵²

Schuster and Wroldsen note that marijuana entrepreneurs have used state legalization to create ambiguities with regard to federal trademark law.⁵³ In the trademark application, the strategically minded entrepreneur employs words like hemp, CBD, and dietary supplements, and avoids direct references to marijuana.⁵⁴ The first federal trademark application for CBD appeared in 2013 immediately following enactment of the first state law approving CBD sales.⁵⁵ Hundreds of trademark applications soon followed,

traditional for-profit (subject to section 280E) and to a black-market operation (which presumably avoids all taxation by committing tax fraud).” *Id.* at 528 n.20 (parentheses in original).

⁴⁵ See Frank Robison, *Going Green: Legal Considerations for Marijuana Investors and Entrepreneurs*, 6 AM. U. BUS. L. REV. 57, 63–64 (2016).

⁴⁶ See 15 U.S.C. § 1051 (2018).

⁴⁷ See *Dessert Beauty, Inc. v. Fox*, 329 F. App’x 333 (2d Cir. 2009).

⁴⁸ See 15 U.S.C. § 1057(c).

⁴⁹ See EXAMINATION GUIDE, *supra* note 13 (noting the initial illegality of CBD and the shift in the law permitting the manufacture of CBD from low-THC hemp pursuant to the Agriculture Improvement Act of 2018).

⁵⁰ W. Michael Schuster & Jack Wroldsen, *Entrepreneurship and Legal Uncertainty: Unexpected Federal Trademark Registrations for Marijuana Derivatives*, 55 AM. BUS. L.J. 117, 117 (2018). The article was written prior to the passage of the Agricultural Improvement Act of 2018 which removed both hemp, and CBD derived from hemp, from the CSA. Hence, the authors’ critique addressed the incoherency of trademark law prior to this legal change.

⁵¹ *Id.* at 117.

⁵² *Id.* at 157–58.

⁵³ *Id.* at 130.

⁵⁴ See *id.* at 141–42 (noting that the USPTO rejected a mark of “America Marijuana Supply” for marijuana seeds, flowers, and plants because the application contained wording that suggested a substance, marijuana, that contravenes the CSA); *id.* at 149 (noting successful applications referencing hemp, dietary supplements, and CBD).

⁵⁵ See Gene Kennedy, *Utah Gov. Signs Bill to Bring Cannabis Oil to Utah*, KSTU (Mar. 21, 2014, 9:35 PM), <http://fox13now.com/2014/03/21/utah-gov-signs-bill-to-bring-cannabis-oil-to-utah>; UTAH CODE ANN. § 58-37-4.3 (West 2020) (repealed by UTAH CODE ANN. § 631-1-258).

and scores received approval.⁵⁶ Once the entrepreneur received federal registration, whether issued in error or not, that mark arguably extended to marijuana related businesses in the growing list of permissive states. Schuster and Wroldsen write, “In the spirit of ‘regulatory arbitrage,’ savvy firms are wise to seek CBD trademarks and use them to establish a brand name in the evolving marijuana market.”⁵⁷

III. INCORPORATING ETHICAL SELF-RESTRAINT

The legal strategies discussed above can prove profitable. Taking advantage of an unenforced federal law (CSA), reclassifying business expenses as an inventory cost,⁵⁸ presenting one’s business as a “social welfare organization,”⁵⁹ and exploiting imprecisions in regulatory law⁶⁰ can improve the firm’s bottom line. Yet, the question presents itself whether there is anything unethical about these and similar legal tactics. In a special issue of the American Business Law Journal, devoted to the emerging field of legal strategy, Robert Bird writes, “A discipline of legal strategy without an accompanying assessment of its ethics and values can too easily lend itself to encouraging a rudderless or winner-take-all managerial attitude toward the law.”⁶¹ The following three sections address ethical issues posed by aggressive legal strategies, beginning with the role of political obligation and then turning to legal philosophy and the convergence of ethical custom.

A. ROLE OF POLITICAL OBLIGATION

The topic of political obligation refers to the ethical duty to obey law. Plato famously raised this issue in the *Socratic Dialogues*.⁶² Government authorities convicted Socrates of corrupting Athenian youth and sentenced him to death. Visiting Socrates in jail, Crito proposed a means of escape; a conversation ensued. Socrates offered four reasons why he should obey the law and not escape: (1) consent, (2) reciprocity, (3) fairness, and (4) utility.⁶³

First, Socrates explained that he had chosen to live in Athens for decades and that this choice implied his *consent* to obey Athenian law. Second, Socrates had received many benefits from Athens, and this created a *reciprocal* duty to contribute to that society by obeying its laws. Third, Socrates’ fellow Athenians generally obeyed the law, so *fairness* required Socrates to obey as well. Fourth, widespread disobedience fostered societal disutility, for if no one obeyed the law, then Athens would surely fail. Ultimately, Socrates refused to escape and he drank the fatal hemlock.⁶⁴

⁵⁶ See Schuster & Wroldsen, *supra* note 50, at 147–49.

⁵⁷ *Id.* at 157–58 (internal quotation in original).

⁵⁸ See *supra* notes 31–37 and accompanying text.

⁵⁹ See *supra* notes 38–44 and accompanying text.

⁶⁰ See *supra* Part II.B.2.

⁶¹ Robert C. Bird, *The Many Futures of Legal Strategy*, 47 Am. Bus. L.J. 575, 585 (2010) (introducing the symposium issue).

⁶² Plato, *Crito*, in *THE GREAT DIALOGUES OF PLATO* (W.H.D. Rouse trans., Mentor Books 1956) (400 BCE).

⁶³ *Id.*

⁶⁴ *Id.*

Advocates of each of Socrates's four rationales for legal obedience have appeared over the centuries. John Locke rooted political obligation to the consent expressed in a hypothetical social contract.⁶⁵ H.L.A. Hart argued that benefits received from society generate a reciprocal duty to share in society's costs.⁶⁶ John Rawls identified a first-order deontological duty to obey reasonably just laws promulgated in a reasonably just society.⁶⁷ A rule utilitarian, such as John Stuart Mill,⁶⁸ would contend that widespread crime erodes the functioning of society.⁶⁹

The question at hand is whether a marijuana entrepreneur can ethically justify breaking federal law. Beyond the issue of direct legal disobedience, one might also ask whether there is anything unethical in taking advantage of underenforced laws, exploiting regulatory errors, or restructuring a transaction to curry favorable legal treatment without changing the transaction's underlying prohibited effects. The answers to most of these questions would seem to depend, at least in part, on the legal philosophy or approach to political obligation adopted by the legal strategist. The answers may also depend on the moral saliency of the law in question.

B. INTEGRATING LEGAL PHILOSOPHY

Under a formal definition of law,⁷⁰ the marijuana business is illegal. To justify marijuana entrepreneurship ethically, one needs a less formal conception of law and a more permissive view of the corresponding duty of legal compliance. The following subsection considers the perspective of legal realism, a jurisprudential view that arguably underscores much of legal strategy. The remaining two subsections reject legal realism as overly permissive and offer legal pragmatism as an alternative that permits marijuana entrepreneurship while simultaneously requiring ethical reflection and self-restraint.

1. Legal Realism

In an oft-cited article, Stephen Pepper contends that legal realism constitutes the "dominant American understanding of law—taught in the law schools and practiced in the law offices."⁷¹ In Pepper's view, legal realism is

⁶⁵ See JOHN LOCKE, *TWO TREATISES OF GOVERNMENT* (C.B. MacPherson ed., 1980) (1690).

⁶⁶ See H.L.A. Hart, *Are There Any Natural Rights?*, 64 *PHIL. REV.* 175 (1955).

⁶⁷ John Rawls, *A Theory of Justice* 354–55 (1971).

⁶⁸ See generally JOHN STUART MILL, *UTILITARIANISM* (1861) (providing a classic articulation of a utilitarian ethic).

⁶⁹ None of the four Socratic arguments has proven immune from philosophical attack, and scholarly consensus on political obligation has not emerged. See William A. Edmundson, *Introduction*, in *THE DUTY TO OBEY THE LAW: SELECTED PHILOSOPHICAL READINGS* (William A. Edmundson ed., 1999) (summarizing the scholarly debate). Notwithstanding this scholarly debate, it seems more likely than not a person has a duty to obey reasonably just laws promulgated in reasonably just societies. This article proceeds on that assumption. This article also recognizes that even in reasonably just societies, individuals have a duty to engage in acts of civil disobedience in some settings. See generally John Rawls, *The Justification of Civil Disobedience*, in *THE DUTY TO OBEY THE LAW: SELECTED PHILOSOPHICAL READINGS* 49–62 (William A. Edmundson ed., 1999) (discussing the role of civil disobedience in reasonably just societies).

⁷⁰ The phrase "formal definition of law" refers to a plain meaning interpretation of legal a text such as the CSA. Pursuant to the Supremacy Clause of the U.S. Constitution, the CSA makes marijuana illegal in all fifty states.

⁷¹ See Stephen L. Pepper, *Counseling at the Limits of the Law: An Exercise in the Jurisprudence and Ethics of Lawyering*, 104 *YALE L.J.* 1545, 1552 (1995).

“an amalgam of three major streams of American jurisprudence.”⁷² First, legal realism emphasizes the positive aspects of law and suppresses normative inquiries.⁷³ Second, realism is concerned with predicting the consequences of alternative actions and inactions.⁷⁴ Third, legal realists use these predicted consequences to direct economic planning.⁷⁵

The legal tactics suggested by Roche (inventory accounting and aggressive tax posturing), Leff (recasting the business as a social welfare organization), and Schuster and Wroldsen (exploiting a glitch in USPTO trademark policy) each seem to fit the legal realism mold described by Pepper. In each case, the strategist pays little or no attention to the ethical obligation to obey law. Each commentator explains a legal tactic that will prove economically advantageous for the entrepreneur with little or no reference to the social consequences of the tactic. In addition, each of the commentators focuses on the likely consequences of the tactic, largely ignoring any obligation to abide by a plain meaning interpretation of the CSA or the stated policies of the USPTO. Finally, for each legal strategist, the “law in action,” including the likelihood of interpretative error, problems of proof, and the enforcement proclivities of the executive branch, guides compliance issues with little or no weight placed on either the letter or the spirit of the law in question.

Consider, first, the legal philosophy incumbent in the tax planning offered by Roche.⁷⁶ Roche recommends inventory accounting to address the impact of IRC section 280E, disallowing deductions of ordinary and necessary expenses for marijuana businesses.⁷⁷ Roche recommends “*hoisting the Service with its own petard* and adopting an *expansive interpretation* of the inventory capitalization rules to increase the cost of their inventory, thereby reducing taxable income.”⁷⁸ Of course, overly expansive (and disingenuous) interpretations of tax law can constitute tax evasion, carrying both prison terms and civil fines. Yet, if the taxpayer can offer a literal interpretation of inventory rules in support of the tax position taken, then—even if that position is disallowed—the matter becomes tax avoidance, not evasion, and is no longer criminal.⁷⁹ In such settings, the taxpayer’s self-interest suggests taking an aggressive tax position after calculating the potential challenges by the I.R.S. and the likely consequences at trial. Pursuant to the *Model Rules of Professional Conduct*, a tax lawyer can recommend a tax position even if the lawyer believes that the position is unlikely to succeed at trial, so long as that lawyer thinks there is a likelihood that the law may change in support of the taxpayer.⁸⁰ This permissive

⁷² *Id.*

⁷³ *Id.*

⁷⁴ *Id.*

⁷⁵ *Id.*

⁷⁶ See *supra* notes 31–37 and accompanying text.

⁷⁷ Roche, *supra* note 26, at 444.

⁷⁸ *Id.* (emphasis added).

⁷⁹ See generally Zoe Prebble & John Prebble, *The Morality of Tax Avoidance*, 43 CREIGHTON L. REV. 693, 702–09 (2010) (distinguishing tax evasion from tax avoidance and discussing various definitions of the latter).

⁸⁰ “A lawyer shall not bring or defend a proceeding, or assert an issue therein, unless there is a basis in law and fact for doings so that is *not frivolous*, which includes a *good faith* argument for an extension, modification or reversal.” MODEL RULES OF PROF’L CONDUCT r. 3.1 (AM. BAR ASS’N 2020) (emphasis added). The Comment to Rule 3.1 explains that “the law is not always clear and never is static [and]

standard incentivizes aggressive tax planning with little or no reference to any ethical obligation to help finance vital public infrastructure or governmental services. Here, the legal strategists see tax law as a tool used to reduce the private burden of taxation whenever possible. So viewed, tax planning requires little or no ethical reflection.⁸¹

The tax planning proposed by Leff seems a bit more attuned to ethics.⁸² Leff begins by stating policy goals supporting liberalization of marijuana laws, including “reducing crime, improving blighted neighborhoods, giving opportunities to youth impacted by the drug trade, increasing marijuana users’ safety, and raising state and local government revenue.”⁸³ He then explains how a marijuana entrepreneur can contribute to these laudable goals while simultaneously reducing private taxes. Leff proposes structuring the business to fit the defining characteristics of a tax-exempt social welfare organization.⁸⁴ This strategy, of course, could work whether it signifies sincere ethical reflection or is merely a sham. Legal strategy works equally well in either scenario. Hence, Leff’s advice turns less on ethics than on a calculation of likely results.

Schuster and Wroldsen offer a legal strategy attuned to the dynamic nature of law.⁸⁵ State legalization of marijuana continues unabated and entrepreneurs need strategic positioning in a dynamic market. The authors recommend first establishing a state-authorized CBD business, followed by obtaining a U.S. trademark registration. Federal law does not permit registration for businesses that transact in Schedule I substances; however, even prior to the enactment of the Agriculture Improvement Act of 2018 (removing hemp-derived CBD from the CSA) the USPTO often approved CBD trademarks.⁸⁶ The authors call this USPTO practice “legally incoherent.”⁸⁷ They emphasize, however, that a federal trademark extends to all fifty states and may extend, in practice, to related marijuana products, providing a first-mover advantage as marijuana laws continue to evolve. This strategy (1) emphasizes the positive rather than the normative aspects of law; (2) defines law with reference to the enforcement proclivities of the executive branch and to regulatory confusions of the USPTO; and (3) uses an incoherency in the law as a tool of private planning with little or no reference to compliance obligations. In short, this strategy embraces legal realism.

account must be taken of the law’s ambiguities and potential for change.” *Id.* at r. 3.1 cmt. 1. The Comment also explains that a legal “action is not frivolous even though the lawyer believes that the client’s position ultimately will not prevail.” *Id.* at r. 3.1 cmt. 2.

⁸¹ *But see* Prebble & Prebble, *supra* note 79 (addressing moral issues associated with tax avoidance); Daniel T. Ostas & Axel Hilling, *Global Tax Shelters, the Ethics of Interpretation, and the Need for a Pragmatic Jurisprudence*, 53 AM. BUS. L.J. 745, 757-62 (2016) (examining the ethics of tax interpretation).

⁸² *See supra* notes 38–44 and accompanying text.

⁸³ Leff, *supra* note 24, at 525.

⁸⁴ *Id.* at 527–28.

⁸⁵ *See supra* Part II.B.2.

⁸⁶ Schuster & Wroldsen, *supra* note 50, at 147–49.

⁸⁷ *Id.* at 117.

2. Conventional View of Law

The scholarly field of law and management, or legal strategy, has a twenty-year history.⁸⁸ Much of this literature, including the tax and trademark articles just examined, emphasizes cases studies and applied contexts. A seminal article penned in 2000 by Lynn LoPucki and Walter Weyrauch, by contrast, offers a general theory of how legal strategies work in practice.⁸⁹ The authors also offer a caution of potential abuse.

LoPucki and Weyrauch begin by distinguishing the “conventional” from the “strategic” view of law.⁹⁰ In the conventional view, the judge determines the facts and then applies the law to the facts to generate outcomes. They write:

In the strict, formalist version of the conventional view, the law consists principally of rules in which the outcomes of cases are already implicit. In the more popular version, the law is a mix of fixed rules and flexible standards that sometimes permit courts to inquire into purpose and to exercise judgment and discretion. In either version, the conventional view holds written law to be an important determinant of legal outcomes.⁹¹

LoPucki and Weyrauch contend that “[n]early all academics subscribe to one or the other version of the conventional view.”⁹² The strategic view, by contrast, emphasizes the role of legal counsel as working in harmony with the client.⁹³ Careful planning and adept legal maneuvering play a huge part in legal outcomes, and the law, as written, plays a subordinate role. LoPucki and Weyrauch provide an example of a strategist who creates a judgment-proof business to engage in hazardous activity.⁹⁴ To protect business assets, the legal strategist rents the plant and equipment, transacts only in cash, and disperses profits to shareholders frequently.⁹⁵ Other strategies include drafting form contracts with arbitration clauses that deny class action status to customers, patients, or employees.⁹⁶ In addition, form contracts often contain choice of forum and exculpatory clauses that benefit the company.⁹⁷ Once litigation starts, the strategist may employ expense and delay to

⁸⁸ See *supra* notes 22–23 and accompanying text (citing Seidel’s 2002 book on the strategic use of law as seminal and citing two recent literature reviews recounting the twenty years history of law and management scholarship); see also *infra* Part IV.B.2 (examining several seminal works on legal strategy).

⁸⁹ See Lynn M. LoPucki & Walter O. Weyrauch, *A Theory of Legal Strategy*, 49 DUKE L.J. 1405 (2000).

⁹⁰ *Id.* at 1405

⁹¹ *Id.* at 1407–08 (citation omitted).

⁹² *Id.* at 1408 n.4.

⁹³ See generally Constance E. Bagley, *Winning Legally: The Value of Legal Astuteness*, 33 ACAD. MGMT. REV. 378 (2008) (explaining the need for client and lawyer cooperation and for executive fluency in law).

⁹⁴ See LoPucki & Weyrauch, *supra* note 89, at 1474.

⁹⁵ *Id.*

⁹⁶ See Colleen M. Baker & Daniel T. Ostas, *Ethics of Legal Astuteness: Barring Class Actions Through Arbitration Clauses*, 29 S. CAL. INTERDISC. L. REV. 399 (2020) (examining recent Supreme Court precedents that empower this tactic and arguing for self-restraint among legal strategists who implement the strategy).

⁹⁷ See MARGARET JANE RADIN, *BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW*, at xv–xvi (2013) (discussing the strategic use of unread and non-negotiable consumer contracts to shift legal rights to the drafting party).

bankrupt an underfunded plaintiff and prompt a favorable settlement.⁹⁸ LoPucki and Weyrauch note that star litigators draw on years of experience in presenting a case to a jury, and, even to the casual observer, the quality of lawyering is highly correlated with success.⁹⁹ Legal strategies also include lobbying activities where the entrepreneur seeks to direct the law toward private advantage.¹⁰⁰ In each case, the conventional view, where a judge dispassionately applies legal texts to a set of facts, gives way to the strategic view.

LoPucki and Weyrauch caution that overly aggressive legal strategies can enable clients to “win judgments in cases that have no merit, prevent meritorious cases from ever reaching trial, turn victims into wrongdoers, and make the system set the guilty free.”¹⁰¹ They also contend that the strategic view captures the reality of the legal process while the conventional view misses it.¹⁰² They further speculate that the unpleasant implications that follow from the strategic view explain in part why the conventional view has continued to dominate. They warn that an aggressive use of legal strategy may be difficult to defend on ethical grounds.¹⁰³

3. Legal Pragmatism

It is difficult to imagine a law void of all moral content. Laws typically project a moral vision and/or seek to advance value-laden objectives. Most commonly, laws seek to balance competing social norms. If a given law has moral content, then using legal strategies to circumvent the intent of legislators or judges requires ethical justification. Legal pragmatism, a resurgent jurisprudential view, acknowledges the moral content of the law; hence, it rejects the positivistic tenet of legal realism.¹⁰⁴ It also conceives of law as constantly changing, driven largely by new technologies and evolving social mores.

Translating the ethics of political obligation into pragmatic terms, the socially responsible marijuana entrepreneur, together with legal counsel, would inquire into the dynamic evolution of the law and adopt a compliance stance that respects the democratically determined norms that drive legal evolution.¹⁰⁵ Echoing legal realism, pragmatists perceive the law to be a

⁹⁸ See, e.g., JONATHAN HARR, *A CIVIL ACTION* (1995) (documenting the strategic use of expense and delay to frustrate plaintiffs' attempts to litigate a class-action lawsuit for damages allegedly caused by toxic waste).

⁹⁹ See LoPucki & Weyrauch, *supra* note 89, at 1472.

¹⁰⁰ See generally Daniel T. Ostas, *The Law and Ethics of K Street: Lobbying, the First Amendment, and the Duty to Create Just Laws*, 17 *BUS. ETHICS Q.* 571 (2007) (exploring the need for ethical self-restraint when lobbying from a position of advantage).

¹⁰¹ See LoPucki & Weyrauch, *supra* note 89, at 1409 (citations omitted).

¹⁰² *Id.* at 1410.

¹⁰³ *Id.* at 1483. “Because legal strategies are attempts to manipulate the outcomes of cases irrespective of their supposed merits under written law, strategies are *widely viewed as unethical*. Lawyers are reluctant to publicize the strategies they pursue partly for that reason.” *Id.* (emphasis in original).

¹⁰⁴ See generally Symposium, *The Revival of Pragmatism*, 18 *CARDOZO L. REV.* 1 (1996) (providing several complementary but distinct views of pragmatism); Symposium on the Renaissance of Pragmatism in American Legal Thought, 63 *S. CAL. L. REV.* 1569 (1990) (same).

¹⁰⁵ See Steven D. Smith, *The Pursuit of Pragmatism*, 100 *YALE L.J.* 409, 444–49 (1990) (summarizing legal pragmatism as an “exhortation to skepticism” as to both the ends sought in law and means employed to achieve those ends).

function of legal strategy.¹⁰⁶ However, unlike realism, legal pragmatism offers a means to channel strategic discretion.

Legal pragmatism directs the marijuana entrepreneur to consider the values that underscore the Schedule I classification of marijuana under the CSA. In 2016, the FDA refused to reclassify the drug, stating that although "research with marijuana has progressed . . . more research is needed into marijuana's effects, including potential medical uses for marijuana and its derivatives."¹⁰⁷ The FDA report recommended further clinical research into therapeutic and medical uses for marijuana and marijuana-derived drugs.¹⁰⁸

Concerns remain regarding overuse of marijuana, particularly by minors, with evidence mounting that overuse can lead to psychosis.¹⁰⁹ Israeli chemist, Raphael Mechoulam, widely known as the "patriarch of cannabis science,"¹¹⁰ has played a leading role in promoting medicinal cannabis to treat diseases such as glaucoma, Crohn's disease, Tourette's syndrome, and asthma.¹¹¹ Yet, this patriarch of cannabis insists that marijuana is "not an innocuous substance."¹¹² He cites studies showing that extended use of high-THC strains of marijuana can change the way young brains develop, sometimes inducing chronic anxiety and schizophrenia among those with a predisposition for the disease.¹¹³ In short, Mechoulam embraces medicinal uses of marijuana, but disfavors recreational use.¹¹⁴ Beyond mental health issues, the more traditional concerns with marijuana include motivational effects, impaired driving, and the potential for marijuana use to lead to experimentation with other illegal substances. Although marijuana advocates may contest some of these points, the potential harms nonetheless deserve consideration by the marijuana entrepreneur.

In sum, the responsible legal strategist/entrepreneur needs to consider both the advantages and the disadvantages of cannabis use and structure their entrepreneurial activities in accord. The entrepreneur must avoid any self-serving bias. Just because a strategy appears profitable, does not mean that it is defensible. Ethical reflection is necessary, particularly when knowingly

¹⁰⁶ The fact that legal pragmatism echoes legal realism is not a coincidence. Realism was born as a revolt against formalism that characterized early-twentieth century jurisprudential debates. See MORTON WHITE, *SOCIAL THOUGHT IN AMERICA: THE REVOLT AGAINST FORMALISM* 11–18 (1949). Realists split into two camps, with the more radical members emphasizing the indeterminate nature of law, and the less radical seeking to ground law to empirically based social policy (legal pragmatism). See GARY MINDA, *POSTMODERN LEGAL MOVEMENTS: LAW AND JURISPRUDENCE AT CENTURY'S END* 28–33 (1995) (distinguishing two forms of realism: radical and progressive); Gary Peller, *The Metaphysics of American Law*, 73 CAL. L. REV. 1151, 1219–26 (1985) (same). See generally Daniel T. Ostas, *Postmodern Economic Analysis of Law: Extending the Pragmatic Visions of Richard A. Posner*, 36 AM. BUS. L.J. 193, 198–210 (1998) (discussing the historical antecedents of legal pragmatism).

¹⁰⁷ Denial of Petition to Initiate Proceedings to Reschedule Marijuana, 81 Fed. Reg. 53,767, 53,792 (Aug. 12, 2016).

¹⁰⁸ See *id.*

¹⁰⁹ See ALEX BERENSON, *TELL YOUR CHILDREN: THE TRUTH ABOUT MARIJUANA, MENTAL ILLNESS, AND VIOLENCE* (2019) (recounting interviews with experts on marijuana and mental illness and concluding that "heavy cannabis use can lead to psychotic disorders for previously healthy adults outside the normal window for the disease.").

¹¹⁰ See Hampton Sides, *The Chemist—The Treasure Trove*, NAT'L GEOGRAPHIC 62, 66 (2019) (appearing in a special issue entitled "Marijuana Medicine: The Science of Unlocking the Secrets of Cannabis").

¹¹¹ *Id.* at 67.

¹¹² *Id.* (quoting from an interview with Mechoulam).

¹¹³ *Id.*

¹¹⁴ *Id.*

engaging in activities that remain illegal. Open and honest reflection should ensure that relevant facts are checked, and results measured in an unbiased manner. As the science of marijuana advances, social attitudes change, and the legal landscape shifts, the entrepreneur should continuously adjust legal strategies. All of this reflects pragmatic and responsible entrepreneurship at its best.

C. CONVERGENCE OF ETHICAL CUSTOM

On first blush, the assertion that profitable legal strategies must give way to ethical self-restraint may appear odd. It should not. The notion that ethics trumps economics is incumbent in Milton Friedman's CSR admonition to maximize wealth subject to law and "ethical custom."¹¹⁵ The entrepreneur is free to make profit, but the means chosen must be ethical. The following subsections consider ethical custom as articulated by John Rawls, Aristotle, and Adam Smith. The discussion demonstrates a convergence of opinion with regard to the ethics of political obligation and the corresponding ethics of legal strategy.

1. Rawlsian Civility

A Theory of Justice by John Rawls remains one of the most influential works of political philosophy penned in the twentieth century.¹¹⁶ Employing contractarian logic and the imagery of a veil of ignorance, Rawls articulates his vision of a just society.¹¹⁷ Within this society: (1) everyone has equal access to the various stations in life, and (2) public policy assures the least well-off person is as well-off as possible.¹¹⁸ Armed solely with these two principles, Rawls defends government-enforced redistribution that lies at the heart of the democratic welfare state.¹¹⁹

Although his treatise focuses on political economy, Rawls also addresses personal ethics.¹²⁰ With regard to political obligation in a just society, Rawls articulates a virtue of personal civility and defends that virtue on first-order grounds.¹²¹ For Rawls, civility requires widespread support of reasonably just

¹¹⁵ See Friedman, *supra* note 8, at 32.

¹¹⁶ Rawls, *supra* note 67.

¹¹⁷ Under a veil of ignorance, a person is unaware of their initial endowment of wealth and talent. Rawls argues that under such conditions people would agree to form political institutions that (1) guaranteed the greatest possible liberty compatible with similar liberty to others and (2) only permitted social and economic inequalities that would inure to the benefit of all. *Id.* at 136–41.

¹¹⁸ *Id.* at 60–61, 65 (known respectively as the "equal liberty principle" and the "difference principle").

¹¹⁹ Recognizing that redistribution erodes work incentives, justice permits income inequalities that inure to the benefit of the least well off. Hence, Rawls is not articulating an egalitarian state. Nor is he describing utilitarianism. His principles proceed in serial order with the liberty principle coming before the difference principle. *Id.* at 61. Rejecting utilitarianism, he writes, "This ordering means that a departure from the institutions of equal liberty required by the first principle cannot be justified by, or compensated for, by greater social and economic advantages." *Id.*

¹²⁰ Rawls notes that the principles of justice for institutions are distinct from the principles that apply to the behavior of individuals. *Id.* at 54.

¹²¹ Rawls distinguishes between "strict compliance" and "partial compliance" ethical theories. *Id.* at 8. Strict compliance applies to reasonably just societies where everyone "is presumed to act justly and to do his part in up-holding just institutions." *Id.* Partial compliance theory, by contrast, informs the theory of punishment and the scope of permissible civil disobedience. *Id.* Rawls notes that justifications for punishment and civil disobedience are important topics, but his primary aim is in describing virtues appropriate for perfectly just societies. *Id.*

social institutions, including the administration of law.¹²² As a corollary, Rawls addresses aggressive legal strategies. He writes:

[We] have a natural duty of civility not to invoke the faults of social arrangements as too ready excuse for not complying with them, not to exploit the inevitable loopholes in the rules to advance our interests. The duty of civility imposes a due acceptance of the defects of institutions and certain restraint in taking advantage of them.¹²³

Hence, for Rawls, regulatory arbitrage,¹²⁴ imperfections in legal drafting,¹²⁵ problems of proof,¹²⁶ legal confusions,¹²⁷ or other legal imperfections should be availed, if at all, only after careful ethical reflection and justification.¹²⁸

Rawls recognizes and accepts the self-interested nature of humans.¹²⁹ He notes that complete egalitarianism destroys work incentives and impoverishes all.¹³⁰ Self-interest, by contrast, motivates industry and generates bounty;¹³¹ yet, when *unrestrained*, self-interest becomes ethically unjustifiable. Rawls writes, “Although egoism is logically consistent and in this sense not irrational, it is incompatible with what we intuitively regard as the moral view. The significance of egoism philosophically is not as an alternative conception of right but as a challenge to any such conception.”¹³²

Ultimately, whether the ethic of Rawlsian civility permits an entrepreneur working with legal counsel to employ an aggressive legal strategy may depend on the moral pedigree of the manipulated law.¹³³ Even among philosophers that support a robust duty to obey law, room remains for

¹²² *Id.* at 312.

¹²³ *Id.*

¹²⁴ In international transactions, regulatory arbitrage often refers to forum shopping to take advantage of favorable laws presented in one jurisdiction but denied in another. *See, e.g.*, Frank Partnoy, *Financial Derivatives and the Costs of Regulatory Arbitrage*, 22 J. CORP. L. 211, 227 (1997) (“Regulatory arbitrage consists of those financial transactions designed specifically to reduce costs or capture profit opportunities created by differential regulation or laws.”). Used more broadly, regulatory arbitrage refers to strategies where business actors restructure a transaction to gain favorable regulatory treatment without changing the transaction’s underlying economic effects. *See, e.g.*, Victor Fleischer, *Regulatory Arbitrage*, 89 TEX. L. REV. 227 (2010).

¹²⁵ *See, e.g.*, Roche, *supra* note 26, at 444 (explaining the need to interpret inventory capitalization rules and advocating an “expansive interpretation” that hoists “the Service with its own petard”).

¹²⁶ *See, e.g.*, Leff, *supra* note 24; *supra* text accompanying note 38. After proposing restructuring the firm as a social welfare organization, Leff speculates that the Service is unlikely to permit the designation. Applying the adage that it is often better to ask for forgiveness than to seek permission, Leff recommends employing his proposed strategy in hopes that it will go unchallenged, or if challenged, it will succeed in court, or if it fails, the penalties will be low. Leff, *supra* note 24, at 569.

¹²⁷ *See, e.g.*, Schuster & Wroldsen, *supra* note 50 and accompanying text (describing the USPTO policy distinction between marijuana and CBD as “incoherent” and suggesting means to take advantage of that error).

¹²⁸ *But see* Fleischer, *supra* note 125, at 271–72 (“Expecting a lawyer to advise a client to forego regulatory-cost savings because she feels a little [ethically] queasy about it is naïve.”).

¹²⁹ *See* RAWLS, *supra* note 67, at 11.

¹³⁰ *Id.* at 286.

¹³¹ *Id.* at 151.

¹³² *Id.* at 136–37.

¹³³ *See* Fleischer, *supra* note 125, at 234 (“Whether a particular regulatory arbitrage technique is good or bad necessarily depends on a prior question of whether a particular regulation enhances social welfare.”). After raising the issue of the moral pedigree of the regulation affected by the arbitrage strategy, Fleischer declines to examine the normative issues. He writes, “There is a spectrum of arbitrage techniques, some good, some bad, and drawing the line between them is beyond the scope of this Article.” *Id.* at 235.

justified civil disobedience if the law in question is either inane or unjust.¹³⁴ Here, pragmatic reflection on the competing values that underscore the marijuana debate proves useful. It seems that certain medicinal uses of marijuana are gaining widespread scientific support. In many medicinal marijuana markets, federal law may be lagging behind more enlightened and compassionate advances in state law. In this light, federal tax discrimination, lack of bankruptcy protection, and trademark restrictions reflect misguided federal policies given the trends we are seeing in the states related to marijuana use and regulation.” Regarding legitimate medicinal uses, circumventing federal laws, though legally risky, may be ethically justifiable.

2. Aristotelian Decency

Aristotle’s approach to political obligation mirrors, in many respects, that advanced by Rawls. Echoing Rawlsian civility, Aristotle offers *epieikeia*, (translated to decency) which similarly calls for a cooperative embrace of political obligation.¹³⁵ Developed by Aristotle in Book V of the *Nicomachean Ethics*, the virtue of decency addresses the imprecise nature of law. Like Rawls,¹³⁶ Aristotle notes that legal error—particularly in legislation—is unavoidable.¹³⁷ For Aristotle, error is the natural consequence of the inability of universal language to address the variety of factual detail incumbent in human experience.¹³⁸ How then, does the practically wise and just person respond to deficient law? Aristotle provides a generic heuristic. The decent person seeks to “rectify the deficiency [guided by] what the legislator would have said himself if he had been present there, and what he would have prescribed.”¹³⁹ Aristotle notes that decency often requires “taking less than one might even though he has the law on his side.”¹⁴⁰

For Aristotle, the first step toward political obligation involves legal compliance—following the rules.¹⁴¹ Aristotle calls this “legal justice.”¹⁴² Because legal justice is imprecise, Aristotle offers the virtue of decency to help close the gaps. For example, consider the contemporary problem of profit shifting to foreign tax shelters.¹⁴³ Offshoring profits may fit within legal justice, but it remains ethically tainted.¹⁴⁴ The tax strategist: (1) exploits a

¹³⁴ See Rawls, *supra* note 69 (discussing the prerequisites for justifiable acts of civil disobedience); see also Daniel T. Ostas, *Civil Disobedience in a Business Context: Examining the Social Obligation to Obey Inane Laws*, 47 AM. BUS. L.J. 291 (2010) (distinguishing between unjust and inane laws and arguing that civil disobedience can be justified for either, depending upon the moral pedigree of the law in question).

¹³⁵ ARISTOTLE, *NICOMACHEAN ETHICS* (Terence Irwin, trans., Hackett Publishing 3d ed. 2019) (c. 384 B.C.E.). See generally Gaston de los Reyes, Jr. & Kristen Martin, *Not from Guile but from Entitlement: Lawful Opportunism Capitalizes on the Cracks in Contracts*, 67 BUFFALO L. REV. 1, 24–25 (2019) (examining Aristotelian decency in the context of contractual opportunism).

¹³⁶ See RAWLS, *supra* note 67, at 312 (citing “inevitable loopholes” in law).

¹³⁷ Imprecision arises because universal rules are difficult to apply to the variant nature of human experience. “[A]ll law is universal, but in some areas no universal laws can be correct.” ARISTOTLE, *supra* note 136, at 1137b.

¹³⁸ *Id.*

¹³⁹ *Id.*

¹⁴⁰ *Id.* at 1138a.

¹⁴¹ *Id.* at 1135b.

¹⁴² *Id.*

¹⁴³ See generally Edward D. Kleinbard, *Stateless Income*, 11 FLA. TAX REV. 699 (2011) (explaining the technique of profit shifting).

¹⁴⁴ See Richard J. Kovach, *Taxes, Loopholes and Morals Revisited: A 1963 Perspective on the Tax Gap*, 30 WHITTIER L. REV. 247 (2008) (questioning the ethical dimensions of profit-shifting and other tax

lack of governmental will to challenge the practice, (2) constructs complicated corporate structures to conceal unsavory tactics, (3) seeks out sovereigns willing to protect financial records, and (4) ignores general anti-avoidance rules designed to discourage tax arbitrage.¹⁴⁵ One suspects that Aristotle would disapprove of offshoring.¹⁴⁶

The offshoring strategy could potentially help the marijuana entrepreneur as well. For example, an entrepreneur could domicile the business in Canada, where marijuana is legal, and sell the product through a wholly owned subsidiary in a permissive state, such as Illinois.¹⁴⁷ Sales revenues transferred to the Canadian parent in the form of royalty payments, or fees for management services, could run through Canadian banks, and one could argue that U.S. money laundering laws would not apply. This could help alleviate the liquidity crisis currently plaguing domestic producers.¹⁴⁸ Of course, one could debate whether such a strategy would offend the virtues of Aristotelian decency or Rawlsian civility. Ultimately, this may depend upon the moral underpinnings of current federal prohibitions of marijuana businesses. If one disagrees with the wisdom of the federal rules, then circumventing those rules becomes more ethically acceptable.

3. Smithian Prudence

The discussion of ethical custom now turns to the patriarch of classical economic theory, Adam Smith.¹⁴⁹ Smith wrote two great treatises: *The Theory of Moral Sentiments* (*Moral Sentiments*), and *An Inquiry into the Nature and Causes of the Wealth of Nations* (*Wealth of Nations*).¹⁵⁰ The former, published in 1759, discusses personal ethics; the latter, published in 1776, addresses political economy. The two works are related. The system of justice laid out in the *Wealth of Nations* presumes that people have a natural propensity to abide by the virtues delineated in *Moral Sentiments*. Hence, Smith's dual examination of political economy and personal ethics follows the same pattern found in Rawls, whose vision of a just society presumes that people

avoidance techniques); Prebble & Prebble, *supra* note 79 (arguing that tax avoidance, while legal, is nonetheless unethical).

¹⁴⁵ See Ostas & Hilling, *supra* note 81, at 762–69 (discussing the sporadic uses of anti-avoidance rules by the U.S. courts and calling for a more aggressive judicial application of these rules).

¹⁴⁶ Gabriel Zucman estimates an annual governmental loss of seventy billion dollars in U.S. corporate income tax due to profit shifting to tax havens. See Gabriel Zucman, *Taxing Across Borders: Tracking Personal Wealth and Corporate Profits*, 28 J. ECON. PERSP. 121, 122–30 (2014) (noting that the annual U.S. corporate income tax totals about \$350 billion and estimating a twenty percent loss due to profit shifting). If the taxpaying public perceives profit shifting as a manipulation of tax obligations owed by the rich and powerful, general cynicism is likely to rise and voluntary compliance is likely to erode. See Kovach, *supra* note 145, at 275 (raising this concern).

¹⁴⁷ In 2018, Altria, the maker of Marlborough cigarettes, bought forty-five percent of a Canadian cannabis company along with the right to buy a further ten percent of the company. See Hampton Sides, *Corporate Cannabis: The Future of the Industry*, NAT'L GEOGRAPHIC 81 (2019) (appearing in a special issue devoted to cannabis).

¹⁴⁸ See generally Patrick A. Tighe, Note, *Underbanked: Cooperative Banking as a Potential Solution to the Marijuana-Banking Problem*, 114 MICH. L. REV. 803 (2016) (discussing impediments to marijuana entrepreneurship posed by U.S. banking regulations).

¹⁴⁹ On the designation of Smith as the father of classical economics, see JOHN K. GALBRAITH, *ECONOMICS IN PERSPECTIVE* 57–72 (1987) (placing Smith's ideas in historical context).

¹⁵⁰ There is an immense literature addressing the works of Adam Smith. See generally EAMONN BUTLER, *ADAM SMITH: A PRIMER* (2007) (providing a useful summary of Smith's writings); EDWIN G. WEST, *ADAM SMITH: THE MAN AND HIS WORKS* (1976) (offering a short biographical overview of Smith's life, work, and influence).

behave with ethical civility. The twin themes also appear in Aristotle's works, which examine both political justice and the just person who behaves decently in support of political institutions, including the administration of law.

In the *Wealth of Nations*, Smith emphasizes the importance of specialization. In fact, specialization provides the sine qua non of prosperous nations.¹⁵¹ Specialization requires exchange; therefore, political institutions, including law, should seek to facilitate mutually advantageous trades.¹⁵² Citing a natural human propensity to “truck, barter, and exchange,”¹⁵³ Smith argues that governments need to specify property rights, protect those rights, and facilitate the exchange of those rights.¹⁵⁴ For Smith, the common law of property, tort, and contract provide the legal foundations of a market, and any regulatory interference with the market requires special justification.¹⁵⁵ Left to its own devices, the market will tend to allocate resources to efficient uses and generate bounty.

In *Moral Sentiments*, Smith describes the ethical virtues that support market activities. Smith begins the treatise by asserting that humans have an instinctual capacity to care about the welfare of others.¹⁵⁶ Humans also have consciences and can be harsh self-critics.¹⁵⁷ As people interact, they observe the effects of their behavior on others, and learn what constitutes appropriate and inappropriate behavior.¹⁵⁸ Hence for Smith, ethics derives, at least in part, from social learning driven by sympathy and conscience.

Through social learning, a virtuous person acquires the habits of justice, beneficence, and prudence.¹⁵⁹ Justice prevents harming others,¹⁶⁰ beneficence promotes the happiness of others,¹⁶¹ and prudence tempers self-interest.¹⁶² With regard to market activities, prudence plays the most direct role. In the *Wealth of Nations*, Smith explains that markets derive, not from benevolence, but from “self-love.” He writes,

It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.

¹⁵¹ Smith, *Wealth of Nations*, *supra* note 1, at 31–36.

¹⁵² *Id.* at 37–46 (noting that exchange is limited by the extent of the market).

¹⁵³ *Id.* at 25.

¹⁵⁴ *Id.* at 31–36.

¹⁵⁵ As an example of necessary regulation, Smith supports active antitrust policy to counteract collusion. *Id.* at 84. He writes, “People of the same trade seldom meet together, even for merriment and diversion, but the conversation ends in conspiracy against the public, or in some contrivance to raise prices.” *Id.* at 145. Smith also supports governmental spending on education and infrastructure that promotes commerce. *Id.* at 724.

¹⁵⁶ “How selfish soever man may be supposed, there are evidently some principles in his nature, which interest him in the fortune of others, and render their happiness necessary to him, though he derives nothing from it, except the pleasure of seeing it.” ADAM SMITH, *THE THEORY OF MORAL SENTIMENTS*, at 9 (1759), *reprinted in* 1 *GLASGOW EDITION OF THE WORKS AND CORRESPONDENCE OF ADAM SMITH* (D.D. Raphael & A.L. Macfie eds., Oxford Univ. Press 1976) [hereinafter *SMITH, MORAL SENTIMENTS*].

¹⁵⁷ Smith observes that the loss of a little finger may be more palpable to a person than an earthquake that destroys countless lives in China, but conscience would never permit the loss of multiple lives that sacrificing a finger could prevent. *Id.* at 136–37.

¹⁵⁸ *Id.* at 137.

¹⁵⁹ *Id.* at 212–62.

¹⁶⁰ *Id.* at 227–34 (stressing that “justice” (not harming others) is fundamental to a healthy human society).

¹⁶¹ *Id.* at 235–36.

¹⁶² *Id.* at 212–18.

We address ourselves, not to their humanity but to their self-love, and never talk to them of our own necessities but of their advantages.¹⁶³

By self-love, Smith does not imply greed or selfishness. He is referring to prudence, which is self-interest tempered with sympathy for the welfare of others.¹⁶⁴ Comparing Smith's call for prudence with the calls for civility and decency expounded by Rawls and Aristotle, one finds a convergence. For each writer, ethical custom sometimes requires self-sacrifice, and strategic attempts to circumvent public institutions, including law, always require ethical justification. In this light, the responsible entrepreneur maximizes long-run returns while complying with a good faith interpretation of the law and evidencing ethical sympathy for the welfare of others.¹⁶⁵

IV. ECONOMICS OF ENTREPRENEURIAL RISK

Drawing on legal pragmatism, Part I examined the social construction of compliance issues; Part II examined ethics. Part III now turns to economics, asking how a marijuana entrepreneur can identify and sort through market decisions to manage entrepreneurial risk and increase long run returns. The discussion starts with the neoclassical theory of the firm.¹⁶⁶ Perfected in the late nineteenth century, this model remains a staple in economic pedagogy. The model provides insights into the sources of entrepreneurial risk. The discussion then turns to the field of strategic management, first championed by Michael Porter, and increasingly incorporated into thoughtful discussions of legal strategy.¹⁶⁷ By combining insights from neoclassical theory with a perspective offered by strategic management, a framework emerges for organizing legal, ethical, and economic issues pertaining to the marijuana business.

A. NEOCLASSICAL THEORY OF THE FIRM

Neoclassical economics offers a highly stylized and abstract conception of market activities.¹⁶⁸ Within the neoclassical theory of the firm, entrepreneurs face two markets: one for factors of production, such as labor and capital, and another for the firm's product. The theory assumes that

¹⁶³ SMITH, WEALTH OF NATIONS, *supra* note 1, at 26–27.

¹⁶⁴ See SMITH, MORAL SENTIMENTS, *supra* note 157, at 212–18.

¹⁶⁵ This phrasing essentially restates Friedman's influential and oft-cited definition of CSR. See *supra* note 8 and accompanying text.

¹⁶⁶ See *infra* Part IVIII.A.

¹⁶⁷ See *infra* Part IVIII.B.

¹⁶⁸ “Neoclassical economics may be conveniently defined as an approach which (1) assumes rational, maximizing behavior by agents with given and stable preferences functions, (2) focuses on attained, or movements toward, equilibrium states, and (3) excludes chronic information problems.” Geoffrey Hodgson, *The Approach of Institutional Economics*, 36 J. ECON. LIT. 166, 169 n.4 (1998) (parenthetical omitted). The neoclassical approach originates in the nineteenth century works of Alfred Marshall and Leon Walras. See ROBERT B. EKELUND, JR., & ROBERT F. HEBERT, A HISTORY OF ECONOMIC THEORY AND METHOD 328 (1983) (citing Marshall and Walras as the “twin founders of neoclassical analysis”). Some scholars define economics with sole reference to neoclassical techniques. See, e.g., GARY S. BECKER, THE ECONOMIC APPROACH TO HUMAN BEHAVIOR 4–5 (1976) (defining any question that can be addressed with neoclassical techniques as an “economic question”). For a useful summary of alternative approaches to economics including Austrian, Institutional, and Marxian see NICHOLAS MERCURO & STEVEN G. MEDEMA, ECONOMICS AND THE LAW: FROM POSNER TO POSTMODERNISM (1997).

entrepreneurs seek to maximize profits and predicts that a firm will produce its product as cheaply as possible and sell for as much as the market will bear.¹⁶⁹

Three relationships, or functions, reside at the core of neoclassical market theory.¹⁷⁰ Neoclassical economists predict entrepreneurial behavior exclusively from these three functions.¹⁷¹ The first is the utility function of consumers—specifying consumer preferences for various products. The second is the firm’s cost schedule—specifying the price the firm must pay for various levels of inputs. The third is the firm’s production function—specifying the combination of inputs that will generate a given output. Combining the production function with the cost schedule generates the firm’s supply curve.¹⁷² The firm’s demand curve is an aggregation of the utility preferences of consumers subject to their ability to pay.¹⁷³ The forces of supply and demand dictate profit-maximizing behavior.¹⁷⁴

The critical point for entrepreneurship is that each of the three functions is exogenous—that is, each is independent of the actions of the entrepreneur.¹⁷⁵ Consider, first, the exogenous nature of the neoclassical utility function. The model assumes that consumer preferences exist absent any influence of the firm.¹⁷⁶ Preferences are data which the firm takes as a given. Causation flows only one direction—the consumer influences firm decisions, but the firm cannot modify consumer tastes.¹⁷⁷ In addition, the

¹⁶⁹ The assumption of profit maximization is axiomatic within the neoclassical approach. See Hodgson, *supra* note 169, at 169 n.4. The neoclassical model does not suggest that executives *should* maximize profit, rather it *predicts* how they will do so, given an assumption of maximizing behavior. See MILTON FRIEDMAN, *The Methodology of Positive Economics*, in *ESSAYS IN POSITIVE ECONOMICS* 3, 15 (1953) (emphasizing the role of prediction in neoclassical analysis).

¹⁷⁰ The theory of the firm appears in virtually every microeconomic textbook at both the graduate and undergraduate levels. The conceptual content does not change, but the reliance on mathematics increases for the more advanced student. See, e.g., MILTON FRIEDMAN, *PRICE THEORY: A PROVISIONAL TEXT* (Routledge 2017) (1962) [hereinafter *FRIEDMAN, PRICE THEORY*] (providing a conceptual approach with little mathematics); HAL R. VARIAN, *INTERMEDIATE MICROECONOMICS: A MODERN APPROACH* (1st ed. 1987) (drawing on elementary algebra and numerical examples while delegating calculus to appendices); JAMES M. HENDERSON & RICHARD E. QUANDT, *MICROECONOMIC THEORY: A MATHEMATICAL APPROACH* (3d ed. 1980) (employing differential and integral calculus and matrix algebra).

¹⁷¹ Neoclassical economics is deductive, assuming certain central axioms as inviolate and deducing the logical ramifications of those axioms. See Daniel M. Hausman, *Economic Methodology in a Nutshell*, 3 J. ECON. PERSP. 115 (1989). Although neoclassicism dominates contemporary economic thought, not all economists embrace its deductive technique. *Id.* at 116 (tracing an inductive method to John Stuart Mill).

¹⁷² See generally *FRIEDMAN, PRICE THEORY*, *supra* note 171, at 85–87 (discussing supply curves); *VARIAN, supra* note 171, at 367–82 (same).

¹⁷³ See generally *FRIEDMAN, PRICE THEORY*, *supra* note 171, at 37–39 (discussing demand curves); *VARIAN, supra* note 171, at 20–31, 70–75 (same).

¹⁷⁴ See generally *HENDERSON & QUANDT, supra* note 171, at 64, 83 (specifying optimal firm decisions given supply and demand); *VARIAN, supra* note 171, at 325–27 (same).

¹⁷⁵ Hal Varian defines an “exogenous variable” as “predetermined by factors not discussed in this particular model.” *VARIAN, supra* note 171, at 2. He defines an “endogenous variable” as “determined by the forces defined in the model.” *Id.* James Henderson and Richard Quandt provide a superb summary of which variables within the neoclassical model are exogenous, describing such variables as “data.” See *HENDERSON & QUANDT, supra* note 171, at 230–31.

¹⁷⁶ See *FRIEDMAN, PRICE THEORY, supra* note 171, at 12–13 (“Wants are to be taken in our analysis as givens, or data The economist has little to say about the formation of wants; this is the province of the psychologist. The economist’s task is to trace the consequences of any given set of wants.”); *VARIAN, supra* note 171, at 34–38 (expressing the same view).

¹⁷⁷ Economic thought is beginning to open the “black box” of exogenous preferences. See, e.g., GARY S. BECKER, *ACCOUNTING FOR TASTES* (1996) (exploring the implications of evolving preferences). But see Hodgson, *supra* note 169, at 177 n.8 (1998) (arguing that Becker’s analysis reveals a “meta-preference” that remains temporarily primary and inviolate).

price the consumer is willing to pay defines the product's value.¹⁷⁸ A profit-maximizing firm takes this notion of "exchange value" as the sine qua non directing its behavior.¹⁷⁹ The consumer emerges as sovereign, and the entrepreneur reacts to an exogenously determined market demand for the firm's product.

A set of exogenous utility functions also drives the entrepreneurs input decisions. Neoclassical market theory assumes that workers have preferences for work and leisure.¹⁸⁰ To entice a laborer to work, the firm must offer an acceptable wage given the laborer's tastes and their options within the labor market. The worker's other employment options are taken as a given and are not within the entrepreneur's power to influence.¹⁸¹ The laborer, like the consumer, is sovereign. The worker's tastes and work options dictate the terms of employment, including pecuniary wages and demands for safety, privacy, or other social issues in the workplace. The profit-maximizing firm takes these wage demands as a given and reacts to them.

The final function—the production function—is similarly outside of entrepreneurial control. A production function captures technological realities.¹⁸² It specifies the combination of inputs that will generate a given output.¹⁸³ Technological options in a static equilibrium model are taken as a given over which the entrepreneur exerts no creative control.¹⁸⁴ Combining exogenous production possibilities with exogenous wage demands determines the firm's supply curve. The supply curve specifies the minimum price required to cover the costs of producing a given level of output. When coupled with an exogenous demand curve, both product price and the quantity demanded emerge.

Taken collectively the theory of the firm defines a market as an external force over which a profit-maximizing entrepreneur has no control. The

¹⁷⁸ The model posits that the only way that a firm can infer preferences is through the actions of its customer as revealed by their offers to pay. See Paul A. Samuelson, *Consumption Theory in Terms of Revealed Preference*, 15 *ECONOMICA* 243 (1948) (seminal work); VARIAN, *supra* note 171, at 114–21 (discussing the theory of revealed preferences). But see Jeffrey L. Harrison, *Egoism, Altruism, and Market Illusions: The Limits of Law and Economics*, 33 *UCLA L. REV.* 1309, 1316–19 (1985) (critiquing the tautological nature of revealed preference theory).

¹⁷⁹ The search for a theory of value provides a core theme in the history of economic thought. See generally EKELUND & HEBERT, *supra* note 171 (contrasting the "labor theory of value" associated with classical economists such as Adam Smith, David Ricardo, and Karl Marx with the exchange theory developed by Alfred Marshall and Leon Walras). Neoclassical economics offers no notion of objective value, content to reveal the mysteries of relative values as revealed in market prices. See WENDELL GORDON & JOHN ADAMS, *ECONOMICS AS SOCIAL SCIENCE: AN EVOLUTIONARY APPROACH* 83–99 (1989) (comparing use, labor, and exchange theories of value).

¹⁸⁰ See HENDERSON & QUANDT, *supra* note 171, at 24–25; VARIAN, *supra* note 171, at 170–72.

¹⁸¹ The neoclassical theory of the firm is a "partial equilibrium" model in which the prices and wages in all markets other than the one examined hold constant. See EKELUND & HEBERT, *supra* note 171, at 369 (discussing the *ceteris paribus* assumptions of partial equilibrium). Relaxing this assumption and assuming instead that the actions of one market actor will influence the actions of another spawned game theory. See generally JOHN VON NEUMANN & OSKAR MORGENSTERN, *THEORY OF GAMES AND ECONOMIC BEHAVIOR* (1944) (seminal work on game theory); VARIAN, *supra* note 171, at 466–78 (discussing game theory).

¹⁸² See VARIAN, *supra* note 171, at 309 ("Nature imposes the constraint that there are only certain feasible ways to produce outputs from inputs."). See generally HENDERSON & QUANDT, *supra* note 171, at 230 (stating that production functions are exogenous).

¹⁸³ See HENDERSON & QUANDT, *supra* note 171, at 67 (defining the "marginal product" of an input as the "rate of change in total product with respect to variations in the quantity" of that input); VARIAN, *supra* note 173, at 314–15 (same).

¹⁸⁴ For an example of a dynamic model where technology evolves, see GORDON & ADAMS, *supra* note 180.

question becomes whether this vision of exogenous markets is of any practical use to a marijuana entrepreneur facing a dynamic world replete with social, legal, and technological uncertainties. The answer is probably a “qualified yes.” *If fully specified* the model could, at least in theory, remove entrepreneurial discretion while simultaneously addressing dynamic concerns. The qualification comes from the inability to fully specify the model, or particularly, from a failure to recognize this inability and to account for this inability.

To illustrate both the promise and the limitations of neoclassical theory, consider the economic issues surrounding a marijuana entrepreneur’s choice of hiring policies in the workplace. Suppose the entrepreneur wanted to set these policies to maximize long-run profit. To find the “best answer,” the entrepreneur would need a lot of data. First, the utility preferences of workers would have to reflect not just a wage demand, but also a disaggregation of that wage into its constituent parts, including the value workers place on workplace privacy, workplace safety, family leave, and flexible work schedules. To fully specify this cost function, the entrepreneur would need to know the shifts in worker preferences if new policies were enacted.¹⁸⁵ Similarly, the firm’s production function needs to specify the effect on productivity, both in the short and long run of implementing various employment policies.¹⁸⁶ Presumably, consumer preferences would be independent of labor issues, but it is possible that consumers would prefer to purchase products from firms with a progressive view of worker rights.¹⁸⁷ A fully specified model would capture these and other details. Hence, in theory, the neoclassical model could address employment concerns.

The problem, of course, is that the utility and production functions of neoclassical theory are never fully specified. Entrepreneurs do not know exactly how much utility a worker receives from any given employment policy,¹⁸⁸ nor do they know the exact effect such policies will have on productivity. The entrepreneur must make a prediction, or best guess, on many fronts. These guesses involve discretion, which in turn, motivates both a social construction of the market and gives room for ethical reflection. In this light, the neoclassical model may provide a heuristic for organizing thought, but ultimately the entrepreneur creates markets through their personal construction of the data necessary to complete the neoclassical vision.¹⁸⁹

¹⁸⁵ Empirical evidence suggests that once an entitlement (such as workplace privacy) is experienced, preferences for that entitlement change. See Daniel Kahneman et al., *Experimental Tests of the Endowment Effect and the Coase Theorem*, 98 J. POL. ECON. 1325, 1327 (1990) (referencing eleven studies).

¹⁸⁶ A choice of technology is made under conditions of uncertainty. Experience with the chosen technology will suggest alternative advances, also made under conditions of uncertainty. Hence, “progress” depends on the various paths chosen, rather than on some ultimate and inevitable *telos*. See generally GORDON & ADAMS, *supra* note 180, at 41 (exploring the idea of path dependence as applied to technological change).

¹⁸⁷ See generally Cass R. Sunstein, *Incommensurability and Valuation in Law*, 92 MICH. L. REV. 779 (1994) (discussing second-order preferences as preferences about preferences).

¹⁸⁸ One source of uncertainty may be information asymmetry between the firm and its employees, but it is more complex than that. Workers themselves may not know the value of workplace policies until they experience them.

¹⁸⁹ In a metaphysical sense, utility preferences and production possibilities may indeed exist without reference to the free will or creative imagination of entrepreneurs. It may be reasonable, for example, to assume that preferences and technologies pre-exist creative imagination, and that the role of the

B. STRATEGIC MANAGEMENT

Strategic management scholars focus on entrepreneurial opportunities and threats.¹⁹⁰ Michael Porter's classic "Five Forces" framework has proven particularly influential.¹⁹¹ Porter emphasizes that entrepreneurs face competition from rivals on quality and price.¹⁹² In addition, entrepreneurs face negotiating pressures from suppliers and customers and must fend off potential new entrants and substitute products. Each of these five forces reduces entrepreneurial profit, enabling only a competitive return. Porter emphasizes that an enterprise can only earn a super-competitive return if it can establish a difference in price or product that it can *preserve*.¹⁹³

Porter's emphasis on preserving a competitive distinction maps directly to law.¹⁹⁴ For example, an entrepreneur may seek to influence government regulations in ways that tend to block new entrants.¹⁹⁵ Patents and other forms of intellectual property can limit competition from rivals and parry threats posed by substitute products.¹⁹⁶ In addition, contractual terms can be drafted

entrepreneur is to discover these preferences and technologies. So viewed, utility and production functions are exogenous, but unknown. Note, however, that it is also reasonable to assume that preferences and technology do not exist outside of their material manifestations. Compare Richard Taylor, *Reality Consists of Matter*, in CLASSIC PHILOSOPHICAL QUESTIONS 347 (James A. Gould ed., 1971), with George Berkeley, *Reality Consists of Ideas*, in CLASSIC PHILOSOPHICAL QUESTIONS, *supra*, at 321. These manifestations, in turn, appear as a product of free will and human intervention. Hence, entrepreneurs truly create, rather than simply discover markets.

The practical entrepreneur, however, has no need for such metaphysical inquiries. In the practical world in which business decisions are made, it makes no difference whether the entrepreneur is discovering a technology (or preference) from a Platonic menu of pre-existing ideas or creating that technology (or preference) through an act of free will. Discovery and creation, in a practical sense, conflate. They have similar practical implications. Both direct an inquiry into the unknown. Both encourage the entrepreneur to seek out new and better ways to identify and satisfy worker and consumer demands and new means of increasing productivity. Both call for an active role for entrepreneurial discretion and imagination.

¹⁹⁰ See GEORGE J. SEIDEL & HELENA HAAPIO, PROACTIVE LAW FOR MANAGERS 3–4 (2011) (stressing that firms continuously seek competitive advantage over rivals); David J. Teece, et al., *Dynamic Capabilities and Strategic Management*, 18 STRATEGIC MGMT. J. 509, 509 (1997) ("The fundamental question in the field of strategic management is how firms achieve and sustain competitive advantage.").

¹⁹¹ See Michael E. Porter, *Competitive Advantage: Creating and Sustaining Superior Performance* (1985); Michael E. Porter, *Competitive Strategy: Techniques for Analyzing Industries and Competitors* (1980).

¹⁹² Explaining his focus on practical frameworks, rather than on the theoretical models, Porter observes, "On the Business School side of the Charles River, *ceteris paribus* assumptions don't work. Managers must consider everything. I concluded that we needed frameworks rather than models. We also needed a more disciplined way to think about strategy." Nicholas Argyres & Anita M. McGahan, *An Interview with Michael Porter*, 16 ACAD. MGMT. EXEC 43, 43 (2002).

¹⁹³ See Michael Porter, *What is Strategy?*, 74 HARV. BUS. REV. 61, 62 (1996) ("A company can outperform rivals only if it can establish a difference it can preserve.").

¹⁹⁴ See G. Richard Shell, *Make the Rules or Your Rivals Will* 124–26 (2004).

¹⁹⁵ See *id.* at 125. See generally George J. Stigler, *The Theory of Economic Regulation*, 2 BELL J. ECON. & MGMT. SCI. 3 (1971) (providing the seminal work articulating the capture theory of regulation); Richard A. Posner, *Theories of Economic Regulation*, 5 BELL J. ECON. & MGMT. SCI. 335 (noting that special interest lobbying can result in regulations that create entry barriers, rate controls, and product standard that mirror those created by economic cartels).

¹⁹⁶ See SHELL, *supra* note 195, at 125. See generally Ross D. Petty, *The Strategic Use of Legal Margins: How to Introduce an Extension of Someone Else's Brand*, in LEGAL STRATEGIES: HOW CORPORATIONS USE LAW TO IMPROVE PERFORMANCE 317 (Antoine Masson & Mary J. Shariff eds., 2010) (distinguishing between fair use and wrongful use and discussing how a legally astute company can free ride on the trademark of another firm while limiting the risk of a lawsuit); David Orozco, *Legal Knowledge as an Intellectual Property Management Resource*, 47 AM. BUS. L.J. 687 (2010) (exploring intellectual property law as a source of competitive advantage).

to gain leverage with both suppliers and customers.¹⁹⁷ Not surprisingly, a robust literature combining strategic management and law has emerged.¹⁹⁸

Robert Bird's "Five Pathways" approach to legal strategy provides insights into the entrepreneurial risks facing the marijuana industry.¹⁹⁹ Bird argues that entrepreneurs can adopt one of five strategic attitudes toward law: (1) avoidance, (2) compliance, (3) prevention, (4) advantage, or (5) transformation. Avoidance means to ignore one's legal obligations and to actively circumvent governmental enforcement efforts.²⁰⁰ The compliance pathway requires abiding by formal legal rules as a means of reducing fines and other legal costs.²⁰¹ The prevention pathway goes beyond rule obedience and seeks to "inculcate the organization with values and practices that will prevent future problems."²⁰² Bird explains, "A truly effective prevention program encourages a culture where 'correct' legal decisions become instinctive."²⁰³ The advantage pathway draws on firm competencies and extends them in ways that are difficult for rivals to copy.²⁰⁴ Examples include exploiting intellectual property by reinforcing patent acquisition through aggressive licensing that increases brand value.²⁰⁵ Finally, transformation occurs when an adopted legal strategy alters the mission of the firm in fundamental ways, creating value where none was thought to exist.²⁰⁶ Bird illustrates the transformation pathway with a welding company that eschews the at-will employment practices of its rivals in favor of a no-layoff policy.²⁰⁷ The policy fosters worker loyalty that generates a host of business benefits and cost savings that rivals have been unable to match.²⁰⁸ The firm's legal strategy transformed the for-profit enterprise into an employee benefit enterprise which in turn generated unexpected and sustained super-competitive returns.

Applying Bird's framework, note that every marijuana entrepreneur, at least in some sense, employs the avoidance pathway. As a formal legal matter, selling marijuana remains a federal felony in all fifty states. To

¹⁹⁷ See SHELL, *supra* note 195, at 125–26. See generally Larry A. DiMatteo, *Strategic Contracting: Contract Law as a Source of Competitive Advantage*, 47 AM. BUS. L.J. 727 (2010) (discussing the strategic role of contracting).

¹⁹⁸ A symposium issue on legal strategy was published in the *American Business Law Journal* in 2010. See Daniel R. Cahoy, *Editors Corner: Assembling a Special Issue on Law as a Source of Strategic Advantage*, 47 AM. BUS. L.J. v (2010). Recent works extending the field include: Gerlinde Berger-Walliser, et al., *From Visualization to Legal Design: A Collaborative and Creative Process*, 54 AM. BUS. L.J. 347 (2017) (exploring how "design thinking" regarding law supports a competitive advantage); David Orozco, *A Systems Theory of Compliance Law*, U. PENN. J. BUS. L. 244 (2020) (providing a process-oriented framework for understanding strategic thinking).

¹⁹⁹ See Robert C. Bird, *Pathways of Legal Strategy*, 14 STAN. J.L. BUS. & FIN. 1 (2008); see also Robert C. Bird & David Orozco, *Finding the Right Corporate Legal Strategy*, 56 MIT SLOAN MGMT. REV. 81 (2014).

²⁰⁰ Bird, *supra* note 200, at 12 (noting that "not all firm strategy is good strategy, and certain practices lend themselves to unethical and destructive behavior.").

²⁰¹ *Id.* at 17–22 (explaining that pursuant to this pathway, compliance is perceived as a cost, but that compliance-oriented firms do not pursue illegal behavior to reduce costs).

²⁰² *Id.* at 23.

²⁰³ *Id.* After signing a consent decree to end gender discrimination, Home Depot adopted an automated hiring promotion system that inculcated a culture of inclusion and generated a competitive advantage. *Id.* at 24–25 (using Home Depot to illustrate a prevention strategy).

²⁰⁴ *Id.* at 27.

²⁰⁵ *Id.* at 30 (illustrating with a pharmaceutical firm that licenses manufacturing of medicines, increasing its brand equity through greater visibility which reinforces the value of its future patents).

²⁰⁶ Bird, *supra* note 200, at 31.

²⁰⁷ *Id.* at 34–35.

²⁰⁸ *Id.*

engage in the marijuana business while simultaneously respecting one's obligation to obey law,²⁰⁹ the entrepreneur needs a less formal conception of law. The legal realism perspective, where one simply does what one can get away with, does not suffice.²¹⁰ The understanding of political obligation viewed through the lens of legal realism²¹¹ disrespects the virtues of civility, decency, and prudence that dictate self-restraint.²¹² Moreover, legal realism denies the moral content of law, releasing legal strategies to unrestrained egoism.²¹³ Pragmatism, by contrast, offers a middle way—more permissive than conventional formal views of law and more restrictive than legal realism.²¹⁴ Legal pragmatism requires a good faith examination of the competing norms that inform the evolving legal landscape. Concerns of drug abuse (particularly among minors), drug purity, and other social concerns that underscore the federal prohibition of marijuana deserve respect. These matters must be weighed against (and potentially reconciled with) arguments that favor legalization.

Once the marijuana entrepreneur decides to breach federal law, other pathways of strategic management come to the fore. For example, the inventory strategy proposed by Roche illustrates both the strengths and the limits of the compliance pathway.²¹⁵ Federal tax law requires both legal and illegal businesses to pay income tax, but it disallows the deduction of ordinary business expenses incurred by businesses engaged in trafficking in controlled substances. Roche proposes to report these payments as capital expenditures rather than as business expenses so as to reduce both gross profit and net taxes.²¹⁶ This inventory tax plan can be accentuated through vertical integration by the taxpayer and aggressive use of transfer pricing.²¹⁷ Roche speaks of “hoisting the Service with its own petard and adopting an expansive interpretation of inventory capitalization rules.”²¹⁸ Translating this plan to Bird's pathways, one finds a compliance strategy. Roche's plan emphasizes formal rules, but there is no true integration of legal and business strategy. In addition, this tax plan could be easily copied by rivals, eliminating any long-term super-competitive profits.²¹⁹

²⁰⁹ See *supra* Part III.A (defining political obligation as the duty to obey law and discussing the Socratic reasons to obey – consent, reciprocity, fairness, and utility).

²¹⁰ See LoPucki & Weyrauch, *supra* note 89, at 1409–10 (distinguishing between the conventional view of law and the strategic view and fearing that an overly aggressive use of the legal strategies will lead to perverse results).

²¹¹ See Pepper, *supra* note 71, at 1552 (observing that legal realism dominates both legal education and legal practice and noting that realism (1) denies moral content to the law, (2) defines law with reference to legal consequences, and (3) uses legal predictions as a tool of strategic planning).

²¹² See *supra* Part III.C (finding convergence between Rawls' civility, Aristotle's decency, and Smith's prudence and noting that each virtue calls for cooperation with the spirit of reasonably just laws).

²¹³ See RAWLS, *supra* note 67, at 136 (“The significance of egoism philosophically is not as an alternative conception of right but as a challenge to any such conception.”).

²¹⁴ See *supra* Part III.B.3.

²¹⁵ See *supra* notes 38–44 and accompanying text.

²¹⁶ See Roche, *supra* note 26, at 444.

²¹⁷ See Leff, *supra* note 24, at 534 (“If a marijuana seller is vertically integrated, growing the marijuana she sells, then opportunities to shift expenses to COGS are multiplied, because cultivation costs are properly classified as costs of goods sold.”).

²¹⁸ Roche, *supra* note 26, at 444.

²¹⁹ See Porter, *supra* note 194, at 61–62. Porter distinguishes between “operational effectiveness” and “strategy.” The former refers to a business tactic that is efficient and necessary, but because it is replicable by rivals, it is insufficient to sustain a competitive advantage. *Id.*

The trademark strategy proposed by Schuster and Wroldsen illustrates Bird's advantage pathway.²²⁰ The authors argue that federal registration of a CBD trademark could potentially generate a long-term competitive edge.²²¹ They recount a poignant story of how a high-CBD strain of cannabis, Charlotte's Web, developed in Colorado, helped alleviate seizures of a young girl suffering from epilepsy.²²² Once the story appeared in the media, counterfeit Charlotte's Web products began appearing around the country.²²³ These counterfeits posed both a competitive threat to the Colorado firm and a public health risk. Several counterfeits had high levels of THC instead of CBD and others contained pesticides or other contaminants.²²⁴ Schuster and Wroldsen explain how federal registration of the CBD product, though technically against USPTO policy, could help protect and extend the brand equity of the trademark holder.

Leff's plan to position a marijuana business as a social welfare organization illustrates the power of Bird's transformation pathway.²²⁵ The plan originates in tax law but, if implemented with sincerity, could transform the business, altering the entrepreneurial mission of the firm and uncovering unexpected sources of value not easily replicated by rivals. To qualify for a tax exemption, among other things, the firm would need to serve a social agenda such as improving blighted neighborhoods, helping disadvantaged youths, and promoting community health and safety.²²⁶ One route would be to hire youths afflicted with drug dependency, providing them with both compassionate support and access to social rehabilitation. The entrepreneur also could locate in depressed neighborhoods and seek to develop a reputation for drug purity and accurate labeling.

Although prompted by tax law, these entrepreneurial changes could have profound and long-lasting economic effects.²²⁷ In neoclassical terms, demand likely would improve, as local customers may prefer to support socially responsible enterprises. This transformation in demand could be permanent as brand loyalties tend to resist change.²²⁸ The entrepreneur's production technologies would likely improve, as dedicated employees typically feel empowered to share innovated ideas.²²⁹ The entrepreneur's costs would drop due to reduced rent in blighted neighborhoods and a workforce willing to accept slightly less pay in exchange for job security and a feeling of respect.²³⁰ In addition, the enterprise can anticipate support from local government and police authorities who are likely to respect the underlying spirit embodied in social entrepreneurship. This transformation pathway

²²⁰ See *supra* Part II.B.2.

²²¹ See Schuster & Wroldsen, *supra* note 50.

²²² *Id.* at 158.

²²³ *Id.*

²²⁴ *Id.*

²²⁵ See Leff, *supra* note 24; *supra* text accompanying notes 38–44.

²²⁶ See Leff, *supra* note 24, at 525.

²²⁷ See *supra* Part IV.A (discussing entrepreneurial strategies with reference to the neoclassical theory of the firm).

²²⁸ See Sunstein, *supra* note 188 and accompanying text (discussing second-order preferences).

²²⁹ See GORDON & ADAMS, *supra* note 180; *supra* text accompanying note 185 (examining prompts to technological innovation).

²³⁰ See Kahneman et al., *supra* note 186 and accompanying text (discussing neoclassical cost functions).

cannot easily be replicated and potentially generates a long-term competitive advantage.

V. CONCLUSION

The inquiry began with law, shifted to ethics, and concluded with the economics of strategic management. Federal prohibitions on marijuana pose both legal landmines and strategic opportunities. Part I recounted three coping strategies: two rooted in tax law and one in trademark law. Part II used the *Socratic Dialogues* to support an ethical obligation to obey law and then compared alternative jurisprudential conceptions of this obligation. A jurisprudence equating law with predicted consequences and subordinating law's normative aspects was rejected in favor of a pragmatic view directing due respect for the competing ethical norms that law expresses, reconciles, and promotes. This pragmatic view was supported with ideas of political obligation incumbent in Rawlsian civility, Aristotelian decency, and Smithian prudence. Turning to economics, Part III supplemented insights drawn from neoclassical theory with ideas borrowed from strategic management. Bird's "Five Pathways" for legal strategy proved useful in framing the legal, ethical, and economic issues posed by marijuana entrepreneurship. Overall, this Article contributes to the scholarly literature by offering an original and extended look at the ethics of legal strategy and by articulating an economic approach to entrepreneurial risk tempered with insights from strategic management in a useful and novel way.