

Insuring The Ever-Growing Cannabis Industry: Part 1

By Jodi Green and Patricia Daza-Luu (January 29, 2019, 3:42 PM EST)

The perception of the cannabis plant in the United States has significantly evolved since the 1936 propaganda film “Reefer Madness,” which led Americans to believe that marijuana produced an aggressive “high” that would drive users into a murderous frenzy. Owing perhaps to advances in science coupled with creative marketing, roughly 62 percent of Americans now believe that marijuana should be legalized — a figure that has doubled since 2000.[1]

As this blockbuster industry continues to blossom, so too will the need for insurance coverage to protect cannabis-related companies. In this series of articles, we take a deep dive into cannabis insurance. As discussed in Part 1 of this series below, the present state of insurance for the cannabis industry remains unsettled, with a number of variables potentially impacting the market.

Cannabis: A Short Primer on the Plant and Its Many Forms

“What’s in a name? That which we call a rose by any other name would smell as sweet ...” William Shakespeare, “Romeo and Juliet.”

What’s in a name? Sometimes, quite a lot. William Shakespeare’s famous quote fails to consider the significance of marketing. Marijuana, with its more common monikers of “pot” or “weed,” carries a negative connotation. This perception is downplayed by the industry’s description of the plant in recent years by its botanical name: “cannabis.” Modern science teaches that chemicals derived from the cannabis plant can take many forms, not all of which result in a “high.” Take, for example, the chemicals THC and CBD. Tetrahydrocannabinol, or THC, has anti-inflammatory and pain-killing properties coupled with a psychoactive “high”-inducing effect. According to medical journals, CBD, or cannabidiol, has similar health benefits without the psychoactive impact and is used to treat disparate health conditions, including epilepsy, multiple-sclerosis and as an effective alternative to opioids for chronic pain.[2]

Currently, the federal Controlled Substances Act still lists cannabis as a Schedule I drug. Schedule I is the most tightly restricted category of the CSA reserved for allegedly dangerous drugs with “no currently accepted medical use.”[3] To put this in context, cocaine is considered a less-dangerous Schedule II drug, as cocaine is considered to have some medical value, despite having a “high potential for abuse.”[4]



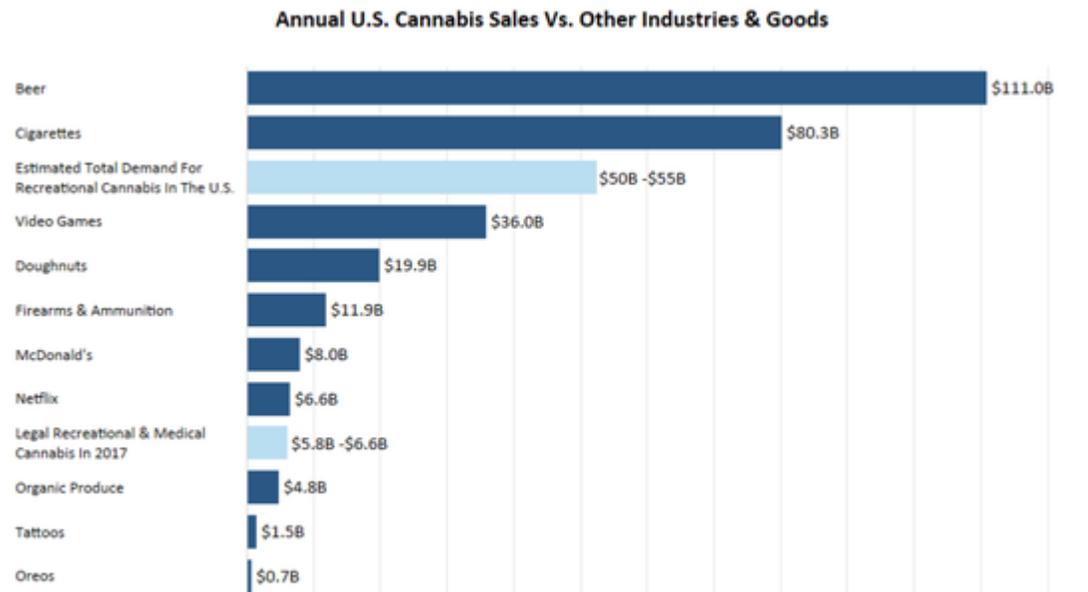
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In June 2018, however, the U.S. Food and Drug Administration approved the nation’s first CBD pharmaceutical product, Epidiolex, an oral spray for rare epileptic syndromes. In addition, certain products containing CBD and other cannabinoids are now considered exempt from the CSA with the passage of the Farm Bill on Dec. 20, 2018. Specifically, and subject to certain restrictions and licensing guidelines, the Farm Bill legalized “industrial hemp,” which is described as any part of the cannabis plant containing “not more than” 0.3 percent THC. On the state side, 32 states and the District of Columbia have legalized the use of medical marijuana, while 10 states and the District of Columbia allow recreational use. Only more states are expected to follow.[5]

While the future of the legal landscape relative to cannabis (in its many forms) remains unclear, the industry continues to grow and thrive. As the chart below depicts, sales of state-legal cannabis have now exceeded sales of one of America’s favorite junk foods (Oreos) and were almost on par with McDonalds’ revenue in 2017.[6] Cannabis-related business ventures — ranging from retail dispensaries to vacation destinations like California’s first “bud and breakfast” — are projected to surpass sales of \$50 billion in North America alone in the next few years.[7]



Source: Brewers Association, Alcohol & Tobacco Tax & Trade Bureau, Entertainment Software Association, Goldstein Research, IBIS World, Netflix, Nielsen, Nabisco
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Insurance for Cannabis: California as a Case Study

In November 2016, Californians voted to legalize recreational marijuana for persons aged 21 years or older, subject to certain sales and cultivation taxes.[8] Shortly after the 2016 vote, California Insurance Commissioner, Dave Jones, encouraged insurers to write insurance policies targeted for the cannabis industry, making it clear that California aimed to close insurance coverage gaps for California’s legal cannabis business. After holding a groundbreaking public hearing to identify businessowners’ concerns, Jones approved California’s first insurance company (Golden Bear Insurance Company) to issue insurance policies to the cannabis industry.[9]

On June 4, 2018, California approved the first cannabis business owners policy (described as “CannaBOP”), written by the American Association of Insurance Services. The CannaBOP policy form is targeted directly to cannabis dispensaries, storage facilities, processors, manufacturers, distributors and other cannabis-related businesses.[10] California’s push to protect its state-legal cannabis industry has not stopped there. On Aug. 9, 2018, Jones announced the formation of a working group in conjunction with the National Association of Insurance Commissioners to address cannabis insurance gaps.[11]

Despite these efforts, change has been slow to come. As a general matter, the insurance market for cannabis companies is still largely composed of nonadmitted surplus carriers. Not only are companies refusing to enter the market — some have withdrawn. For example, Lloyds of London exited the market in 2015. Although Lloyds writes coverage for cannabis companies in Canada, where recreational cannabis is legal, the company’s withdrawal from the U.S. market signals its concern regarding the absence of federal regulation. Without federal legitimization of cannabis, it is clear that many risk-averse publicly traded insurers still view the market as too uncertain. It remains to be seen whether the passage of the Farm Bill and its corresponding exemption of industrial hemp from the CSA may spur new interest.

Above all, however, the industry is not without hope for insurance. California has a strong track record of encouraging and legitimizing insurance coverage for other pioneering industries, such as ride share companies.[12] In turn, it would not require a great logical leap to suggest that California’s support of the cannabis industry could, by analogy, spur federal action. As the saying goes, “as California goes, so goes the nation.”

Legal Precedent: Conflicting Decisions Create Uncertainty

Even with some insurance available to cannabis-related ventures, the quality of that insurance may vary considerably from insurer to insurer, and policy to policy. Likewise, claims data remains sparse. Even for state-legal businesses that are able to obtain insurance, an open question remains as to whether claims will be paid and whether policies will be enforced.

While few courts have had occasion to consider the enforcement of insurance policies relative to cannabis, the decisions that have are conflicting. One of the first decisions on the issue came in 2012, when the District of Hawaii upheld the denial of coverage for the loss of medical marijuana plants under a homeowner’s insurance policy.[13] The court’s decision was rooted not in the policy language, but was based on public policy, holding that “the cultivation of marijuana, even for the State-authorized medical use, violates federal law.”

Four years later, in direct contrast to the Hawaii court’s opinion, the District of Colorado reached an opposite conclusion in *Green Earth Wellness Center LLC v. Atain Specialty Insurance Co.*[14] That court upheld coverage under a commercial property and general liability insurance policy issued to a medical marijuana dispensary, finding that the insurer, well-aware of the insured’s business, was obligated to honor its policy’s paid-for coverages for harvested marijuana damaged in a fire. The court specifically declined to follow the Hawaii court’s opinion that insuring cannabis was against public policy, surmising that time had eroded any clear federal policy relative to the legality of cannabis. The court declared instead that the insurer, “having entered into the Policy of its own will, knowingly and intelligently, [was] obligated to comply with its terms or pay damages for having breached it.”[15]

Most recently, the U.S. Court of Appeals for the Sixth Circuit considered coverage for a landlord under a

first-party commercial property insurance policy in *K.V.G. Properties Inc. v. Westfield Insurance Co.*[16] The Sixth Circuit held that the policy's "Dishonest or Criminal Acts Exclusion" precluded coverage for alleged damage to the landlord's property resulting from the tenants' marijuana-related operations, which were apparently unauthorized by the landlord and abruptly ended by a U.S. Drug Enforcement Agency raid. According to the court, the tenants had significantly altered the policyholder's rental units by removing or damaging walls and ductwork, among other things, causing approximately \$500,000 in damages. The court's decision appeared to be premised on the policyholder's admission that its tenants had engaged in illegal activity coupled with the acknowledgment that cannabis was illegal under federal law. While medical marijuana was afforded some protection by Michigan law at the time the claim was made, the court reasoned that the raid itself "has some tendency to show that the tenants were not 'in clear and unambiguous compliance' with Michigan law."

Looking Ahead: The Future of Insurance for the Cannabis Industry

Because of the evolving nature of the legal cannabis industry, precedent involving insurance for cannabis-related claims remains sparse. Carriers interested in entering the market also struggle with an absence of claims, which stymies underwriters' efforts to quantify potential exposure associated with cannabis companies. As the industry grows, further judicial consideration of these issues, and more abundant claims data, should provide a baseline for underwriters to assess the potential risk related to coverage for the industry, and conceivably, pave the way for more insurance carriers to enter the market.

Even if the cannabis industry gains traction and more carriers enter the market, insurers and cannabis-related businesses can expect to encounter a host of concerns relative to insurance coverage, including:

- *Products Liability:* Many well-known businesses and new cannabis players are producing a wide range of cannabis products, from edible candies and chocolates, to smoking implements such as Chinese-made vapes and pipes. Product liability insurance for some of these companies is currently available at steep premiums, from few insurance carriers. Most carriers refuse to insure these products at all, voicing concerns regarding the nascent or "green" nature of the market, the potential for adulteration by mixing of products, the lack of standardized testing for quality, purity and safety, coupled with the importation of supplements, which exponentially increases safety and quality concerns.
- *Crop Valuation:* A single cannabis crop can be valued in the millions, depending on its volume and quality. Currently, insurance available for such crops is well below the crop's market value. It remains unclear how these coverage gaps will be addressed, in particular for California cannabis farmers in fire-prone areas.
- *Risk Assessment:* Without federal legalization of cannabis, most admitted insurance carriers refuse to insure cannabis-related industries, even in states where the crop is legal. The lack of historical claims data and legal precedent on the potential for insurer liability continues to keep most carriers at bay.

Despite a host of challenges, all signs point to growth. To begin, the passage of the Farm Bill foreshadows that the archaic federal designation of cannabis as a dangerous Schedule I drug (with no beneficial use) will eventually catch up to both science as well as the public's softening perception of cannabis. As the legal cannabis industry continues to grow and mature, the demand for insurance coverage will correspondingly increase. With limited insurance coverage available from the majority of

admitted insurance carriers, the current rift in coverage will continue to expand unless carriers risk entering the market.

Even if competition from additional insurers helps to address some coverage gaps, however, the keys to the availability of insurance coverage for this new risk will likely focus on: market stability, the existence of claims-data, further judicial precedent and above all — federal legitimization of the cannabis industry. Further articles in this series will explore these and other concerns in more depth.

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[1] Hannah Hartig & Abigail Geiger, Pew Research Center, About six-in-ten Americans support marijuana legalization (Oct. 8, 2018), available at <http://www.pewresearch.org/fact-tank/2018/10/08/americans-support-marijuana-legalization>.

[2] National Academies of Sciences, Engineering, and Medicine: Health and Medicine Division, Committee on the Health Effects of Marijuana, “The Health Effects of Cannabis and Cannabinoids: The Current State of Evidence and Recommendations for Research” (January 12, 2017), available at <https://www.ncbi.nlm.nih.gov/books/NBK425767/>.

[3] See 21 U.S.C. 13 § 801, et seq.

[4] Drug Scheduling, United States Drug Enforcement Administration (“DEA”), <https://www.dea.gov/drug-scheduling>.

[5] Matt Ferner, Huffington Post, “3 States Legalize Marijuana for Recreational or Medical Use” (Nov. 7, 2018), https://www.huffingtonpost.com/entry/midterm-election-marijuana-legalization_us_5be26aa3e4b0dbe871a45fd7.

[6] Any debate regarding the relative alleged harm and addictiveness of cannabis versus fast food products will be saved for another day.

[7] (Philip Santos, Times-Standard, “Riverbar Pharms is Humboldt County’s first ‘bud-and-breakfast’” (Oct. 19, 2018), <https://www.times-standard.com/2018/10/19/riverbar-pharms-is-humboldt-countys-first-bud-and-breakfast/?fbclid=IwAR3uRDS5S864LYd6yw8y7BZsX4ZkcZc4Vm-ZjKwORapySLIYyIIIzi8PTRk.>; <https://www.forbes.com/sites/kevinmurphy/2018/09/06/legal-marijuana-the-9-billion-industry-that-most-banks-wont-touch/#497443203c68>

[8] (Nov. 8, 2016 Statement of Vote, California Secretary of State, <https://elections.cdn.sos.ca.gov/sov/2016-general/sov/2016-complete-sov.pdf>).

[9] Nov. 2, 2017 Cal. Dept. of Ins. Press Release: “First commercial insurer to file cannabis business insurance is approved by insurance commissioner,” <http://www.insurance.ca.gov/0400-news/0100-press-releases/2017/release119-17.cfm>.

[10] June 4, 2018 Cal. Dept. of Ins. Press Release: "California's cannabis insurance marketplace continues to grow with commissioner's latest approval," <https://www.insurance.ca.gov/0400-news/0100-press-releases/2018/release064-18.cfm>.

[11] Aug. 8, 2018 Cal. Dept. of Ins. Press Release: "California Insurance Commissioner appointed chair of national cannabis insurance committee," <https://www.insurance.ca.gov/0400-news/0100-press-releases/2018/release089-18.cfm>.

[12] See Irene Moore, NBC Los Angeles, "New Insurance Product Announced Meant to Close Gap For Drivers and Rideshare Companies", May 27, 2015, <https://www.nbclosangeles.com/news/local/New-Insurance-Product-Announced-Meant-to-Close-Gap-For-Drivers-and-Ridershare-Companies-305203761.html>.

[13] Tracy v. USAA Cas. Ins. Co. , No. 11-00487 LEK-KSC, 2012 WL 928186 (D. Haw. Mar. 16, 2012).

[14] 163 F. Supp. 3d 821, 834-35 (D. Colo. 2016)

[15] Id. at 835.

[16] 900 F.3d 818 (6th Cir. 2018)