Insurance Coverage in the Cannabis Industry: An Evolving Picture

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As in many other areas (banking, taxation), cannabis businesses exist in something of a gray zone regarding insurance. Advising a regulated cannabis business—or any company doing business in the cannabis sector—about insurance will therefore involve more than the usual amount of lawyerly hedging. Get used to giving answers that start with "it depends" even more than usual. This article discusses challenges in insuring a regulated cannabis business, and also challenges in insuring non-regulated businesses that serve the cannabis industry.

Insuring Regulated Cannabis Businesses. Like all businesses, a cannabis business will need certain forms of insurance: workers' compensation insurance; property insurance; liability insurance; auto insurance; and perhaps specialized crop or stock "throughput" insurance. Washington requires that regulated businesses purchase particular forms of insurance;[1] Oregon does not. But even if not required, in many instances insurance will be required by a landlord, lender or investor, or supplier or reseller. Maintaining appropriate insurance is also simply good business practice.

It can be difficult for cannabis businesses to get insurance and to be sure that the insurance will respond to a loss. There are at least two reasons that getting this insurance can be difficult: (1) insurance industry appetite for cannabis risk is very low in light of the uncertainty of its status under federal law; and (2) express exclusions of cannabis risks from standard-form coverage are becoming more common. The lack of confidence that the insurance will respond can be traced to the continued existence of "public policy" against "illegal" contracts.

Insurance is available to cannabis businesses almost entirely on the "surplus lines" market. Surplus lines insurers, also referred to as "non-admitted" carriers, are not directly regulated by the state (for example, Oregon's Department of Consumer and Business Services ("DCBS")) and are not required to have their forms approved by the state, among other things. The surplus lines market is used in multiple hard-to-insure industries (including construction), so many brokers have developed some level of experience in that market.[2]

One common structure for a cultivator's liability insurance program is to have general liability insurance written on a normal broad form but that excludes (for both defense and indemnity): product-liability risks; liability arising out of operations not included on a schedule of properties; intellectual property risks; liabilities associated in any way with criminal acts; any tobacco-related risks; and any risk associated with governmental investigation or enforcement. In other words, very skinny general liability coverage.

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[1] *See* WAC § 314-55-082(1). The Washington regulations even require that the Washington Liquor and Cannabis Board be added as an additional insured. *See* WAC § 314-55-082(3).

[2] One of the biggest players in the surplus market is Lloyd's. Until May 2015, Lloyd's-related insurers insured many cannabis businesses. But Lloyd's concluded that it was at legal risk and left the market.

This is often paired with "claims-made" product liability coverage issued by a different insurer. Insurers use "claims-made" coverage when they want to severely limit their risk over time. A "claims-made" policy essentially expires at the end of the policy period; if no claim has been made and reported to the insurer during the policy period, the insurer's risk is over. This coverage may exclude claims arising out of mold or fungus (which is a common cannabis-product risk), claims arising from additives to the cannabis product, and for violation of law or governmental investigations or enforcement.

As a result, even the product liability coverage (which is critical for growers and manufacturers) may be skinnier than it seems. The interplay of exclusions and limited coverages in these cannabis-specific policies may require careful counseling of the business as to what it can and cannot do as the business grows and enters new markets or tries new products.

Insuring Non-Regulated Businesses Involved with Cannabis Risks. Another tricky aspect of the cannabis economy is insuring businesses that are not regulated themselves but have risk exposures associated with cannabis, such as equipment suppliers and commercial landlords. According to several brokers, even if an admitted carrier has sold existing coverage to such a "non-regulated" business, the carrier will attempt to "underwrite out" of the cannabis portion and force the business to purchase separate coverage for that risk. The temptation is, therefore, for non-regulated businesses not to disclose that they work with cannabis businesses.

The "Don't Tell" Option is Risky. Non-regulated businesses that do not disclose that they serve the cannabis industry may face a denial of coverage. Most commercial property policies contain a so-called "illegality" clause excluding coverage for "contraband" property. The exclusion is often phrased as follows: "2. Property Not Covered * * * Covered Property does not include: * * * e. Contraband, or property in the course of illegal transportation or trade."[3] The insurance industry commonly points to that exclusion as a basis for denying claims under commercial property policies, on the theory that a property where cannabis is being grown is in the "trader" of cannabis production, which is illegal under federal law.

The case law on these "illegality"/"contraband" exclusions is mixed. In *Green Earth Wellness Center LLC v. Attain Specialty Ins. Co.,*[4] a federal trial court in Colorado held that the "contraband" exclusion was ambiguous because the insured's property was legal under state law, and refused to enforce the exclusion. But a Michigan federal court recently enforced an "illegal/dishonest acts" exclusion in a case involving tenants of a commercial landlord who had, without the landlord's knowledge, been conducting a grow operation.[5] What is troubling is that

[3] This is the language found in the most common "commercial property" insurance form, CP 00 10 10 12 (2011).
[4] 163 F. Supp.3d 821, 833-35 (D. Colo. 2016).
[5] *K.V.G. Properties, Inc. v. Westfield Ins. Co.*, No. 16-11561, 2017 WL 5170963, at *3 (ED Mich. Nov. 8, 2017). The import of this decision should not be overstated. In *K.V.G.* the landlord's policy excluded damage caused by "dishonest or criminal act[s]" by anyone to whom the landlord "entrusted" the property. *Id.* The court held that the tenant's acts were criminal but also dishonest, because the tenant had not disclosed the nature of the operation (or the extent to which they would make modifications to the building) to the landlord. *Id.*

the court enforced the exclusion *solely* on the basis that the conduct was illegal under federal law without regard for whether the conduct was legal under state law.[6]

It seems likely that an Oregon or Washington court would reach the same conclusion as the *Green Earth Wellness* court as to the ambiguity of standard policy language.[7] But that won't necessarily stop insurers from attempting to avoid coverage for a cannabis risk, particularly if the risk was not disclosed.

Insurers have invoked the common-law "public policy" against enforcing illegal contracts—including insurance contracts—in at least one Oregon state-court case involving a homeowner's policy that was silent about cannabis. In that case the insurer denied coverage for theft of cannabis-growing equipment, citing not policy language but Oregon public policy. The insurer relied on *N. W. Amusement Co. v. Aetna Co.*,[8] a case from 1940, in which the Oregon Supreme Court held that the insurer did not have to pay for the theft of "gambling machines" where a Portland ordinance made those machines illegal. The court held that the ordinance was incorporated into the policy by operation of law, and that Oregon courts should not aid policyholders seeking coverage for illegal acts.

The insurer also pointed to *Emerald Steel Fabricators, Inc. v. BOLI*,[9] in which the Oregon Supreme Court held that federal law pre-empted Oregon's medical marijuana statute when it came to requiring an employer to accommodate an employee's disability. *Emerald Steel* relied on the U.S. Supreme Court's ruling in *Gonzales v. Raich*,[10] holding that the federal Controlled Substances Act is a valid exercise of federal power even as to intrastate commerce. The insurer argued that under *N. W. Amusement* and *Emerald Steel,* in light of *Gonzalez,* Oregon courts may not enforce the insurance contract to the extent that it is assisting conduct illegal under federal law. Although that particular case settled at the trial court stage, the insurance industry is reportedly willing to pursue that line of argument again.

It may sound far-fetched to imagine that an Oregon court would deny coverage to a policyholder on the basis of "public policy" against illegal conduct where state law makes the conduct legal.[11] But in *Tracy v. USAA Cas. Ins. Co.,*[12] a Hawai'i federal trial judge did just that. In *Tracy*, the court held that a homeowner, who was growing plants for medical use as permitted

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[6] *Id.*

[7] *See, e.g., Hoffman Construction Co. v. Fred S. James*, 313 Or. 464, 469-71, 836 P.2d 703 (1992) (setting out interpretive steps for undefined policy terms); *Coos Cty. Airport Dist. v. Special Dist. Ins. Ser. Tr.*, 291 Or. App. 829, — P.3d — (2018) (applying *Hoffman*); *Boeing Co. v. Aetna Cas. & Sur. Co.*, 113 Wn.2d 869, 876 784 P.2d 507 (1990) (similar Washington law).

[8] 165 Or. 284, 285, 290,107 P.2d 110 (1940); *cf. Foraker v. USAA Cas. Ins. Co.*, No. 3:14-CV-87-SI, 2017 WL 3184716, at *7 (D. Or. July 26, 2017) (holding that Oregon would not recognize a negligence *per se* claim based on unfair claims handling statute).

[9] 348 Or. 159, 190, 230 P.3d 518 (2010).

[10] 545 U.S. 1, 125 S. Ct. 2195, 162 L.Ed.2d 1 (2005).

[11] We are not aware of a Washington court considering this issue under Washington's "public policy," perhaps because denials of coverage in Washington based on novel legal arguments can expose the carrier to significant bad-faith penalties.

[12] No. 11-00487 LEK-KSC, 2012 WL 928186 (D. Haw., Mar. 16, 2012).

by Hawai'i law, had an "insurable interest" in the plants but that "[t]o require Defendant to pay insurance proceeds for the replacement of medical marijuana plants would be contrary to federal law and public policy, as reflected in the CSA, *Gonzales,* and its progeny."[13]

The "Don't Tell" Option for Non-Regulated Business May Disappear Due to Express Exclusion of Cannabis Risks. Even if a non-regulated business decides that it would be worth it not to disclose to its insurer that it serves the cannabis industry, and plans to argue that neither the "illegality" exclusion nor public policy bar coverage because of ambiguity, that option may be increasingly unavailable, at least in Oregon. Recent action by Oregon's insurance regulator has pushed insurers to *explicitly* exclude cannabis risks, making it very difficult for a non-regulated company to rely on its "normal" insurance to cover a cannabis-related risk.

In late June 2017, at the urging of cannabis advocates, the DCBS issued a Bulletin called "Clarifying Coverage for Marijuana Items and Activities."[14] The Bulletin took insurers to task for relying on "general" language and took the position that "[i]n some cases, failing to pay a claim for a marijuana-related loss based on vague exclusionary language may be an unfair claims settlement practice."[15] The Bulletin then required that if an insurer intends to "exclude loss, damage, or liability associated with marijuana items and marijuana activities," its policies must (going forward) contain language in the policy expressly excluding such risks.[16]

In response, the insurance industry moved aggressively to exclude cannabis risks on a broad scale. On September 22, 2017, an industry entity that creates the standard forms submitted a package of exclusionary endorsements relating to cannabis, for regulatory approval. The package included endorsements for use in connection with all forms of commercial property and liability coverage.

The "Oregon-Marijuana Exclusion" endorsement that was approved to modify the "commercial property" or "standard property" coverage forms provides that marijuana is not covered property and that business-income-related coverage will not apply to operations losses relating to marijuana. On the liability side, one form "Marijuana Liability Exclusion" endorsement excludes bodily-injury or property-damage claims relating only to marijuana intoxication or illegal sales, and applies only to cannabis businesses and (in some forms) to those who knowingly lease property to a cannabis business. Other form marijuana-liability-exclusion endorsements that won approval contain much broader exclusionary language, including exclusion for property damage or bodily injury arising out of "the design, manufacture, distribution, sale, serving, furnishing, use or possession of" cannabis.

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[13] 2012 WL 928186, at *13.
[14] DFR 2017-14 (June 29, 2017).
[15] *Id.*
[16] The Bulletin included a phase-in provision permitting policies issued between August 29, 2017, and June 29, 2018, to be accompanied by a notice to the same effect; after June 29, 2018, the exclusion must be in the policy itself. As a stop-gap measure, some admitted insurers began to include a notice parroting the language of the Bulletin, stating that cannabis risks are excluded.

These broad-form exclusions, if widely adopted by major insurance carriers, may prove effective in eliminating coverage for most types of cannabis-related risks and will cut down on the ability for policyholders to argue that some ambiguity exists in policies not specifically issued for a cannabis business.

This may result in non-regulated businesses that are only partially exposed to cannabis-related risks themselves moving to the surplus lines market to avoid the form exclusion endorsements, but ending up with policies that are not clear about covering cannabis risks. Surplus lines carriers are not subject to direct regulation by the state, do not have their forms approved by the regulator, and do not need to include the notices required by the Bulletin. They are therefore unlikely to use the approved "Oregon" form exclusions.

Will a surplus lines carrier that sells an ambiguous policy have to contend with the Bulletin's pronouncement that if not specifically excluded, cannabis is covered? Perhaps not. Just because the DCBS expresses the view that relying on "vague exclusionary" language to deny a claim would be an "unfair claims settlement practice" does not mean that a private policyholder will be able to take advantage of the Bulletin. There is currently no private right of action under Oregon's unfair claims settlement practices law, ORS 746.230.[17] Only the state may bring an action directly under that statute.[18] Creative coverage lawyers may be able to come up with some ways to use the Bulletin, but success is not guaranteed.[19]

Conclusion. Insurance is an essential for the cannabis business and for those who participate in any way in the cannabis industry. Getting coverage may be difficult because of low appetite in the admitted insurance market and newer broad-form exclusion endorsements. In addition, there are sure to be continuing coverage battles regarding cannabis businesses, and in particular businesses (and homeowners) with policies that neither specifically include cannabis-related risks nor use the new standard-form exclusion endorsements. As with all things in the cannabis world, attention to detail in insurance-coverage matters will be required for businesses that want to carefully manage their risk in order to thrive.

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[17] *Employers' Fire Ins. v. Love It Ice Cream*, 64 Or. App. 784, 790, 670 P.2d 160 (1983); *Farris v. U. S. Fid. and Guar. Co.*, 284 Or. 453, 458, 587 P.2d 1015 (1978).

[18] *See Love It Ice Cream*, 64 Or. App. at 790.

[19] In particular, the Bulletin may support a claim for negligence *per se* against an insurer. *See Clinicient, Inc. v. Sentinel Ins. Co*., No. 3:16-CV-478-PK, 2016 WL 8470106, at *6 (D. Or. Nov. 28, 2016), *report and recommendation adopted,* 3:16-CV-478-PK, 2017 WL 991295 (D. Or. Mar. 14, 2017), *citing Abraham v. T. Henry Constr., Inc*., 230 Or. App. 564, 217 P.3d 212 (2009), *aff'd on other grounds*, 350 Or. 29 (2011).

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