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The Complex State Of Insurance In The Cannabis Business

By **Jan Larson and Philip Sailer** (September 9, 2021, 4:20 PM EDT)

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As the acceptance and use of medical and recreational marijuana continues to grow across the country, policyholders in the cannabis space continue to face the potential to be caught between conflicting state and federal regulatory schemes.

At the state level, 33 states and the District of Columbia permit only medicinal-use marijuana,[1] an additional 15 states have gone as far as legalizing both medicinal-use and recreational-use marijuana,[2] and two lone states still prohibit the use of marijuana altogether.[3]

But, while certain usage has been legalized at the state level, supporters of legalization have yet to make substantive inroads when it comes to federal-level policy beyond the deprioritization of enforcement.

As federal policy around the enforcement of the Controlled Substances Act[4] concerning marijuana remains unsettled, cannabis companies continue to face challenges when accessing coverage under basic insurance policies purchased to manage risk and facilitate ordinary business operations.

Policyholders risk that the insurance market will either (1) refuse to issue insurance policies altogether due to conflicts between state and federal legalization, or (2) issue insurance policies and then deny claims on the basis that the claim is excluded by various contract provisions, including the common provision that purports to exclude coverage for a claim that is otherwise uninsurable under applicable law.

This article attempts to identify the issues currently perplexing the judiciary and outline legislative solutions that could at least begin to reduce the challenges both policyholders and insurers face in this complex regulatory landscape.

Federal and State Courts Continue To Wrestle With Cannabis-Related Insurance Claims

Marijuana legalization has rapidly changed and proliferated across the country at the state level, but the federal government has failed to provide clear direction. State and federal courts have struggled to provide consistent guidance as to the interpretation of various provisions in insurance policies as applied to policyholders in, or otherwise impacted by, the cannabis industry.

The conflicting regulations have led to varying approaches throughout the state and federal court systems. Even recently decided cases identify at least some level of risk for policyholders in the face of complex regulatory schemes that are hazy at best.

Earlier this year, the New Jersey Supreme Court in Hager v. M&K Construction rejected a preemption claim and affirmed a lower court ruling that required an employer to reimburse an employee for medical marijuana.[5] The court relied on the federal government's deprioritization of prosecuting violations of the Controlled Substances Act, or CSA, involving marijuana, which, the court held, suggested a change in legislative intent.[6]

The federal government's policy change meant marijuana legalization at the state level was no longer "an obstacle to the accomplishment of congressional objectives" related to drug policy.[7] Finding no federal preemption, the New Jersey Supreme Court affirmed the lower court's decision.[8]

In 2019, the New Hampshire Supreme Court in Appeal of Panaggio likewise noted the apparent conflict between New Hampshire state law and that of other jurisdictions, which expressly prohibited coverage, and held that an insurer was not prohibited by state statute from reimbursing a worker's compensation claim for the cost of purchasing medical marijuana.[9]

Aside from preemption, the inclusion and interpretation of specific policy exclusions can further complicate the availability of insurance coverage to policyholders in, or otherwise impacted by, cannabis-related operations.

In 2012, the U.S. District Court for the District of Hawaii in Tracy v. USAA Casualty Insurance Co. upheld an insurer's denial of coverage with respect to a claim in which a policyholder medical patient sought coverage under her homeowner's insurance policy for stolen marijuana plants.[10] The insurance policy at issue explicitly covered loss to "trees, shrubs, and other plants," but did not expressly exempt marijuana plants.[11]

Notwithstanding the plain language of the terms in the insurance policy, the court effectively agreed with the insurer's coverage denial reasoning that requiring the insurer to pay insurance proceeds for marijuana plants "would be contrary to federal law and public policy, as reflected in the CSA."[12]

Query whether the outcome of this case would have been different in 2021 given that the possession and use of marijuana is now permitted in Hawaii in connection with certain medical conditions and a valid prescription — but still illegal under federal law.[13]

A few years later, in 2016, the U.S. District Court for the District of Colorado in Green Earth Wellness Center LLC v. Atain Specialty Insurance Co. took a different approach.[14] The policyholder, a medical marijuana dispensary, submitted two claims relating to wildfire destruction and theft of marijuana plants under a commercial liability insurance policy. Relying upon a contraband exclusion, the insurer denied the claims. The court ruled in favor of the policyholder on the basis that the term "contraband" within the exclusion was not defined.[15]

The court acknowledged the Tracy holding and decided in the alternative, citing the years that had gone by since Tracy, the continued lack of federal guidance, and the fact that the insurance company entered the contract "of its own will, knowingly and intelligently."[16] Other courts have followed suit, identifying the novel issues that arise as they "grapple[] with how to resolve conflicts in states that [have] authorized the use of medical marijuana."[17]

Last year, a California state court in Mosley v. Pacific Specialty Insurance Co. held that a specific plant growing exclusion could bar coverage for the policyholder's fire loss claim stemming from a tenant's marijuana growing operation, but reversed a grant of summary judgment due to open factual questions.[18] The policy at issue excluded losses from "[t]he growing of plants" and the "manufacture, production, operation or processing of ... plant materials."[19]

The court held that, because there was "no clear, controlling [state] law that establishes whether [the insurance company] properly denied coverage," summary judgment was inappropriate on the claim for breach of the covenant of good faith and fair dealing given the open factual questions.[20]

Activity within the cannabis space shows no signs of slowing down, especially as the percentage of people that support legalization and the number of states adopting related legislative measures grows. As the above cases show, increased legalization, whether for medical or recreational use, will continue to reshape many legal considerations, including the interpretation and application of insurance coverage.

To ensure they provide effective counsel to businesses entering this ever-changing legal landscape, practitioners should continue to stay informed about legislative developments at the federal, state and local level and, maybe more importantly, how federal and state courts are viewing these developments. While predictability is imperfect, an understanding of existing judicial precedent in specific jurisdictions will provide practitioners with the information needed to provide effective counsel in this area.

The CLAIM Act — A Safe Harbor for Insurers

In an effort to confront the challenges that companies in the cannabis industry face when seeking insurance coverage at all stages of the seed to sale process, five members of Congress have sponsored a bipartisan bill aimed at alleviating the risk that insurance companies have historically faced when doing business in the rapidly growing national cannabis industry.

The Clarifying Law Around Insurance of Marijuana, or CLAIM, Act was reintroduced in the U.S. Senate this March[21] after being first introduced in 2019, and offers "safe harbor for insurers and the business of insurance"[22] as it relates to the services that insurers can provide to companies operating within the cannabis industry.

Some insurers have been hesitant to underwrite insurance coverage in the cannabis space for fear of federal prosecution while cannabis remains a Schedule 1 drug under the CSA,[23] even though there has not been any increase in the frequency of federal prosecution of insurers otherwise legally operating within their relevant state framework by recent administrations.[24]

The CLAIM Act will offer various protections to insurers to encourage them to engage with potential policyholders operating in the cannabis industry, leading to a more robust and competitive insurance landscape.

As proposed, the CLAIM Act bars federal agencies from prohibiting, penalizing or otherwise discouraging an insurer from engaging in the business of insurance in connection with a company operating within the cannabis industry.[25]

Under the act, a federal agency cannot incentivize an insurance company to refrain from dealing in the

business of insurance with a potential policyholder simply because they are affiliated with a cannabis-related business;[26] nor can a federal agency take any adverse or corrective supervisory action on a policy involving a company operating within the cannabis industry solely because of the nature of the business.[27]

The entire bill will prove to be a substantial step by Congress to offer safe harbor to insurers to the potential benefit to policyholders as more states legalize medical-use and recreational-use marijuana.[28]

Federal Legalization, Is That You?

As much relief as the CLAIM Act would theoretically provide to insurers and potential policyholders operating within the cannabis industry, it is nonetheless legislation intended to mitigate risk because marijuana remains illegal at the federal level. If marijuana is descheduled under the CSA, the several bills that Congress has introduced such as the CLAIM Act, the SAFE Banking Act and others would arguably be unnecessary because the biggest hurdle to insurance and investment services in the cannabis industry — the criminalization of marijuana — would no longer exist.

At a time when the majority of the country's population supports marijuana legalization,[29] federal legislation continues to be introduced in Congress in hopes that criminalization gives way to a productive and regulated industry.

Enter the Cannabis Administration and Opportunity Act, recently introduced by Senate Majority Leader Chuck Schumer, D-N.Y., Senator Ron Wyden, D-Ore., and Senator Cory Booker, D-N.J.[30] The CAO Act, which supporters concede is a draft bill that is unlikely to pass as is, deschedules cannabis, and presents a new regulatory framework for cannabis under the U.S. Food and Drug Administration and the Alcohol and Tobacco Tax and Trade Bureau.[31]

Its sponsors actively and openly invited comment from industry stakeholders, which closed on Sept. 1, on a number of issues in the bill, including, but not limited to: measuring cannabis potency, the division of responsibilities between federal agency oversight, penalties for violations of state cannabis laws, the interaction between state minimum age laws and use of medication containing cannabis by minors, tax credits for small businesses, and recommendations for a Cannabis Products Regulatory Advisory Committee that the FDA would consult before promulgating cannabis-related regulations.[32]

The CAO Act follows on the heels of the Marijuana Opportunity Reinvestment and Expungement, or MORE, Act, which was introduced in the U.S. House of Representatives in May.[33] As proposed, the MORE Act centers on the decriminalization of cannabis and the creation of social equity regulations that will allow funds to be reinvested in communities.[34]

Though neither bill is expected to make it to President Biden's desk with the sort of immediacy that industry players may prefer, both bills demonstrate that Justice Clarence Thomas' opinion on the state of cannabis law in the U.S. is widespread: "Once comprehensive, the Federal Government's current approach is a half-in, half-out regime that simultaneously tolerates and forbids local use of marijuana. This contradictory and unstable state of affairs strains basic principles of federalism and conceals traps for the unwary."[35]

Soon, insurers and policyholders alike may be in a position to immerse themselves in the cannabis

industry without the current level of uncertainty and wariness needed to navigate compliance with both state and federal policy.

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[1] Alabama, Arkansas, Connecticut, Delaware, District of Columbia, Florida, Georgia, Hawaii, Indiana, Iowa, Kansas, Kentucky, Louisiana, Maryland, Minnesota, Mississippi, Missouri, New Hampshire, New Mexico, New York, North Carolina, North Dakota, Ohio, Oklahoma, Pennsylvania, Rhode Island, South Carolina, Tennessee, Texas, Utah, Virginia, West Virginia, Wisconsin, Wyoming. Claire Hansen, Where Is Marijuana Legal? A Guide to Marijuana Legalization US News (Jun. 30, 2021, 12:12 PM).

[2] Alaska, Arizona, California, Colorado, Illinois, Maine, Massachusetts, Michigan, Montana, Nevada, New Jersey, Oregon, South Dakota, Vermont, and Washington. Id.

[3] Idaho and Nebraska. Id.

[4] The CSA outlines federal drug policy and regulations related to the manufacture, importation, possession, use, and distribution of certain substances. Effective since 1971, the CSA makes it illegal to possess or use certain substances, including marijuana.

[5] Hager v. M&K Constr., 247 A.3d 864 (N.J. 2021).

[6] See id.

[7] Id. at 886.

[8] Id. at 886-88.

[9] Appeal of Panaggio, 205 A.3d 1099, 1103 (N.H. 2019).

[10] Tracy v. USAA Casualty Insurance Co., 2012 WL 928186 (D. Haw. Mar. 16, 2012).

[11] Id. at *3-4.

[12] Id. at *39.

[13] Haw. Rev. Stat. § 329 et seq.

[14] Green Earth Wellness Center, LLC v. Atain Specialty Insurance Co., 163 F. Supp. 3d 821 (D. Colo. 2016).

[15] Id.

[16] Id. at 835.

[17] Mann v. Gullickson, No. 15-CV-03630-MEJ, 2016 WL 6473215, at *4 (N.D. Cal. Nov. 2, 2016).

[18] Mosley v. Pacific Specialty Ins. Co., 49 Cal. App. 5th 417 (Cal. Ct. App. 2020), as modified on denial of reh'g (June 24, 2020), review denied (Aug. 12, 2020).

[19] Id. at 420.

[20] Id. at 436.

[21] Ian A. Stewart & Katherine E. Tammaro, The SAFE Banking and CLAIM Acts Will Transform the Cannabis Insurance Industry, The National Law Review (Mar. 22, 2021).

[22] CLAIM Act, S.2201, 116th Cong. (2019).

[23] Bipartisan Bill Would Provide Federal Safe Harbor for Insurance for the Cannabis Industry, Cooley LLP (Mar. 23, 2021).

[24] Hansen, supra note 1.

[25] CLAIM Act, supra note 6.

[26] Stewart, supra note 5.

[27] Id.

[28] The text of the bill can be found at https://www.congress.gov/bill/116th-congress/senate-bill/2201/text.

[29] Iris Dorbian, Record High Percentage Of Americans Support Marijuana Legalization, Says New Poll, Forbes (Nov. 9, 2020, 3:41 PM).

[30] A summary of the CAO Act can be found here (hereinafter "CAO Act Detailed Summary"), and the full text of the draft bill can be found here.

[31] CAO Act Detailed Summary.

[32] Id.

[33] Kyle Jaeger, Bill to Federally Legalize Marijuana Reintroduced In Congress As Senate Prepares Separate Measure, Marijuana Moment (May 28, 2021).

[34] Id.

[35] Standing Akimbo, LLC v. United States, 141 S. Ct. 2236, 2237 (2021), reh'g denied sub nom. STANDING AKIMBO, LLC, ET AL. v. UNITED STATES, No. 20-645, 2021 WL 3711643 (U.S. Aug. 23, 2021).