

From the QE Cannabis Industry Litigation Group
Insurance Recovery—Obtaining “Releaf” for the Cannabis Industry

More than half of U.S. states have now legalized medical or recreational marijuana, and the number of cannabis-related businesses is increasing rapidly. But due to uncertainty related to the division between state and federal legal status, insurance companies have historically been cautious in entering the cannabis market. There has been a recent increase in the availability of certain insurance products as a result of reports stating that the Trump Administration would refrain from using federal law enforcement against cannabis businesses that comply with state law, but cannabis businesses still struggle to find affordable coverage sufficient to safeguard against the numerous risks facing the nascent industry. And even when businesses are able to find coverage, the current legal landscape provides avenues for insurers to evade their responsibilities to their insureds and deny legitimate claims.

This alert provides a brief overview of cannabis business risks and the types of insurance products currently available to manage those risks. We also address the state of the law today when it comes to collecting on a policy.

Cannabis Business Supply Chain Risks and Insurance Availability

Cannabis-related businesses are subject to risk at every stage of the supply chain. Some of the most substantial risks are theft, general liability and product liability. Cannabis-related retail businesses do not have the benefit of traditional banking and credit acceptance due to federal regulations and are thus forced to handle large amounts of cash, subjecting these entities to a higher theft risk. Retail operations also face potential third party risks because dispensaries—unlike establishments that sell alcohol—are not currently protected by “dram shop” laws that limit liability for actions taken by customers under the influence of cannabis products. Cannabis-related manufacturing and grow operations must also guard against general liability and other risks agricultural and manufacturing businesses face. These include damage to property and crop failure and the increased risks of fire associated with cannabis extraction and production.

Production of cannabis-infused edibles also gives rise to product liability risks and potential safety recalls. To obtain adequate insurance, growers and producers must have a rigorous testing program and testing labs must provide cannabis manufacturers with precise information to ensure compliance with state regulations. Cannabis businesses risk lawsuits based on claims that their products are mislabeled, that product packaging and labels are misleading to consumers regarding stated benefits or potency, or that products are contaminated with harmful pesticides or mold. Strict liability applies to product liability claims, so claimants need only show that the product was defective, not that negligence created a defect. Further, many states have expansive consumer protection statutes that may give rise to legal liability to consumers when a cannabis business commits a technical violation of any of the many dozens of statutes and regulations governing the industry. Most businesses are able to procure general liability coverage to protect against these types of risks, but insurers are reluctant to provide adequate coverage to cannabis businesses due to legal uncertainty.

Certain insurance products common to other industries are currently not widely available to cannabis businesses. There is presently little to no coverage for outdoor grow operations, and it is difficult to obtain adequate general and products liability excess coverage. Professional liability

insurance and insurance for cash and cargo has historically been limited, but availability is expanding. Some crop insurance is available to the cannabis market and it is an essential coverage for growers. Cannabis crops are very valuable and take several months to harvest. Fires, like the recent California wildfires, can destroy an entire crop either from the fire itself or the toxic ash that falls on to the plants.

Common insurance products such as products liability, commercial general liability, property, and errors and omissions do exist for cannabis businesses but to a more limited extent (and at a higher cost) than in other industries. For example, many policies offer shared limits with general liability and products liability on the same coverage form. But states are working with insurance companies to ensure that cannabis businesses can obtain better coverage. For example, California's Insurance Commissioner recently announced the approval of insurance carriers to offer insurance coverage expressly to California cannabis businesses. California also is the frontrunner in approving cannabis-specific insurance policies, having approved a cannabis business owners policy (CannaBOP). The CannaBOP program provides a package policy containing both property and liability coverage for qualifying cannabis dispensaries, storage facilities, distributors, processors, and manufacturers.

Cannabis businesses should be careful to ensure that they have adequate coverage for each risk. And when obtaining a policy it is essential to examine policy language carefully to ensure that exclusions do not limit coverage for basic operational risks such as risk to crops or goods in transit. Policy definitions should be examined to ensure that coverage is appropriate—for example, the definition of “cannabis” may include coverage for plants but not edibles, seeds, or concentrates. It is also essential that the insurance carrier be informed of the nature of the business and inventory to be covered, so that it is clear that the insurer and insured share a mutual intention that the policy is intended to cover cannabis-related risks.

Cannabis-Related Coverage Issues

Even if a cannabis business obtains coverage, there is always the possibility that the insurer will attempt to avoid paying a claim for a large loss. Insurance providers have argued in recent years that policies issued to cannabis-related businesses should be void on public policy grounds because these businesses operate in violation of federal law. Some courts have accepted this argument as a justification to avoid responsibility under a contract with a cannabis-related business, but several courts—including federal courts—have rejected this argument in recent decisions.

Contractual disputes involving cannabis-related businesses have been addressed in recent federal court opinions in Colorado, Hawaii and California: (1) *Tracy v. USAA Cas. Insurance Co.*, (D. Haw. Mar. 16, 2012); (2) *Green Earth Wellness Ctr. LLC v. Atain Specialty Insurance Co.*, 163 F. Supp. 3d 821, 831 (D. Colo. 2016); and (3) *Mann v. Gullickson* (N.D. Cal. Nov. 2, 2016).

In *Tracy v. USAA*, the District Court of Hawaii considered a claim under a homeowners insurance policy for stolen medical marijuana plants. The court held that the policyholder had a legal interest in the plants under a state medical marijuana statute but found that requiring the insurer to pay a claim would essentially be requiring it to pay for replacement plants in violation of federal law and public policy. In ruling, the court noted that: “the cultivation of marijuana, even for the State-authorized medical use, violates federal law and the enforcement of an insurance policy under the particular circumstances of this case is contrary to public policy[.]”

In *Green Earth v. Atain*, the District Court of Colorado was asked to decide whether Green Earth's insurer must pay for damage to Green Earth's marijuana plants and products resulting from

wildfire debris that entered a greenhouse ventilation system. The court declined to follow *Tracy* on grounds of the “erosion of any clear and consistent federal public policy in this area,” recognizing that “federal authorities had made public statements that reflected an ambivalence towards enforcement of the Controlled Substances Act in circumstances where a person or entity’s possession and distribution of marijuana was consistent with well-regulated state law.” The court also considered that the insurer knew that Green Earth grew cannabis and had agreed to insure risks arising out of that business. On those grounds, the court decided the insurer was required to cover Green Earth’s losses.

In *Mann v. Gullickson*, a party to the sale of a cannabis-related business attempted to use a public policy argument to avoid its obligations under the sales contract. After a lengthy analysis of the conflict between state and federal law, the court found that the contract should be enforced. In doing so, the court weighed “the federal government’s wavering policy on medical marijuana in states that regulate this substance, and California’s expressed policy interest in allowing qualified patients to obtain medical marijuana” and held that “the purported illegality here is not one the Court finds to mandate non-enforcement of the parties’ contract.”

More recent federal decisions have relied on *Green Earth* and *Mann* in rejecting similar public policy arguments in contract disputes. See *Tan v. Det-CO, Inc.*, 2018 WL 922133 (D.Colo. Feb. 15, 2018) (refusing to allow party to contract to escape liability based on public policy argument that business partner operated a cannabis-related business in contravention of federal law). But the law is far from established. For example, even post-*Green Earth*, federal courts continue to dismiss federal bankruptcy cases involving marijuana businesses due to those businesses’ continuing violation of federal law. See, e.g., *In re Way To Grow, Inc.*, 2018 WL 7357408 (D. Colo. Bankr. Dec. 14, 2018).

As more states legalize cannabis for medical and recreational use and more time passes without federal interference, we expect that courts will continue to uphold agreements knowingly entered between insurers and cannabis-related entities that are operating in full compliance with applicable state law. However, the legal landscape is still in flux, and cannabis-related businesses should be aware of the possibility that they may face a coverage dispute in the event of a significant claim.

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If you have any questions about the issues addressed in this memorandum, or if you would like a copy of any of the materials mentioned in it, please do not hesitate to reach out to:

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