

MEALEY'S®

Emerging Insurance Disputes

The Cannabis Industry Is Risking It All

by
James P. Lagios
Joshua D. Smith
and
Mark J. Wagner Jr.

Rivkin Radler LLP
Uniondale, NY

**A commentary article
reprinted from the
October 1, 2020 issue of
Mealey's Emerging
Insurance Disputes**



Commentary

The Cannabis Industry Is Risking It All

By

James P. Lagios

Joshua D. Smith

and

Mark J. Wagner Jr.

[Editor's Note: James P. Lagios, a partner in Rivkin Radler LLP, maintains a general law practice with emphases in business transactions, commercial litigation, professional liability, and debtor/creditor rights. Joshua D. Smith, a partner at the firm, is a commercial litigator and health-care attorney. Mark J. Wagner, Jr., is an associate in the firm's Commercial Litigation and Health Care Services Practice Groups. The authors may be contacted at james.lagios@rivkin.com, joshua.smith@rivkin.com, and mark.wagner@rivkin.com, respectively. Any commentary or opinions do not reflect the opinions of Rivkin Radler LLP or LexisNexis®, Mealey Publications™. Copyright © 2020 by Rivkin Radler LLP. Responses are welcome.]

Cannabis-related entities, like other manufacturing and retail businesses, need insurance coverage to insulate themselves from potential operational liabilities. The cannabis industry, however, faces unique obstacles when seeking to cover its risks. This article discusses a number of the most significant issues to consider before entering into the industry.

Introduction

Companies that manufacture and sell products and those that simply sell goods to consumers or other buyers all purchase insurance to protect themselves and their officers, directors, employees, and other workers from well-known operational risks.

The insurance that these businesses acquire typically ranges from commercial general liability insurance, directors and officers insurance, and business interruption coverage to product liability, workers' compensation,

commercial vehicle, and hazard or commercial property coverage, among others.

These kinds of insurance policies (subject of course to their precise terms) can provide coverage for injuries suffered by customers; damage to property belonging to others; fire or other damage to the insured's office, plant or other building facilities, or crops; and work-related injuries to employees. They also can cover litigation against the company relating to its products or stemming from its advertising or marketing practices, as well as claims against its executives.

Cannabis-related entities ("CREs") – including those that grow and cultivate cannabis, manufacturers of standalone cannabis products and infused goods, dispensaries, retailers, and landlords to these entities – have the same needs and face the same risks as other businesses, as well as some that are unique to the cannabis industry. Like all businesses, CREs can suffer accidents at the workplace and can incur property damage. Additionally, CREs may face an increased risk of fires, as well as theft and product liability claims, compared with other businesses, due to the nature of their operations. Additionally, CREs face several distinct obstacles to obtaining adequate insurance coverage for these types of events, as well as risks unique to the cannabis industry.

Federal Law

Although a large majority of U.S. states has legalized the medical and/or recreational use of marijuana, it remains a Schedule I drug under the federal Controlled

Substances Act of 1970. The U.S. Justice Department's Drug Enforcement Administration ("DEA") indicates that:

- A Schedule I drug has a high potential for abuse;
- A Schedule I drug has no currently accepted medical use in treatment in the United States; and
- There is a lack of accepted safety for use of the drug under medical supervision.

Because marijuana remains unlawful under federal law, many insurance carriers are reluctant to issue policies to certain CREs. Moreover, as discussed in a recent study by British-based New Dawn Risk Group Limited entitled "Understanding and opening up the US cannabis insurance market,"¹ insurers and brokers typically do not advertise their products to CREs, often leaving them to rely on word of mouth to find whatever coverage is available to them.

Cash Is Not King

As many have recognized and acknowledged, cash is the predominant method of payment accepted by CREs. That is because, under the existing federal scheme, CREs generally are unable to open bank accounts, obtain financing, or establish traditional depository relationships with regulated lenders.

The severe banking restrictions stemming from federal law and governing regulations impede CREs from obtaining insurance coverage because:

- 1) Given the susceptibility of cash to theft and to being misplaced or otherwise lost, cash generally is not insurable property or an asset that can be covered by insurance policies; and
- 2) Insurers generally are not in the practice of accepting premium payments in cash. This can be a particularly difficult issue for the cannabis industry, where premiums are often higher than in other industries.

Coverage Limits

Yet another troublesome issue that CREs face is that the insurance policies that they are able to acquire often come with policy limits well below the policy limits typically offered to other businesses with similar resources, assets, employees, income, and expenses. Notably, the

policy limits offered to CREs are usually lower than what is needed to satisfactorily insure their operations. According to a recent report by A.M. Best, "Special Report: Cannabis: New Opportunities for Insurers, But with Burgeoning Risks,"² commercial general liability, property, and product liability insurance policies available to CREs are capped at \$1 million per occurrence and \$2 million in the aggregate.³

These limits may be insufficient for many CREs, which in certain instances might require \$5 million or even \$10 million limits, or even higher to sufficiently insure against potential operational risks. However, it may be quite some time before such policy limits are available to CREs. Insurers are relatively new to the cannabis market and to evaluating the risks involved with CREs. Currently, there are approximately 25 carriers writing policies in the United States and Canada.⁴ Those insurers that are offering insurance coverage to CREs are also still not finding a strong reinsurance market, which presents another obstacle for insurers looking to mitigate risk.⁵

Business Practices

A CRE that is able to obtain insurance coverage may find that the policy imposes certain "best practices" requirements on the way it conducts its business. These requirements may improve the CREs' operations but they can be costly and, in some instances, perhaps difficult (or virtually impossible) to meet.

These requirements can include mandating that the business store its product in a locked safe and insisting that the premises be alarmed and connected to a central monitoring station. Insurers also might require an assessment of the electric or other power available to the CRE, and regular audits of its stock, sales, expenses, and receipts, which may be difficult to track at times.

Policy Exclusions

Finally, CREs, like other policyholders, must be attuned to the exclusions within the insurance policies that they obtain. For instance, cannabis insurance policies might exclude coverage for seeds or flowering plants, injuries to the owners of the business, or damage from specified products, such as vape carts or edibles.

One important exclusion relates to losses stemming from unlawful conduct or operations. An insurance policy issued to a CRE is likely to contain such an exclusion.

Yet it may not be clear whether the prohibited conduct refers to prohibitions under federal or state law (or both). A CRE operating lawfully in a state might assume that the exclusion refers to state law, but that may ultimately not be the correct interpretation.

Federal versus state law is not the only area where this exclusion can lead to coverage problems. For example, coverage questions could arise if the conduct resulting in a loss is interstate – perhaps from a state where cannabis is lawful to another state where it is not.

Conclusion

Insurance for CREs is a concern not only for those directly involved in the cannabis industry, but for investors, as well, who need protection for their investments. Although there are many factors investors consider when deciding whether to become involved in a potentially high risk/high reward industry, investors should not overlook the insurance limitations discussed above.

Nevertheless, as the demand for cannabis increases, there does seem to be some movement on the insurance front. According to an A.M. Best report, perhaps as many as two dozen insurers (mostly non-admitted) now are issuing insurance policies to CREs.⁶ They do so either directly or through subsidiaries dedicated to the cannabis industry. In fact, the Insurance Commissioner of the State of California, in May 2018, approved the first insurance coverage for commercial landlords leasing to the cannabis industry, seeking to address risks specific to renting to CREs.⁷ Specific commercial activities and businesses that this coverage addresses include cannabis labs, product manufacturing, cultivation, and dispensary operations. Additionally workers' compensation policies may also be obtained in states where cannabis has been legalized.

There has also recently been progress at the federal level as well. Earlier this year, the U.S. Department of Agriculture announced the availability of two programs to protect hemp producers' crops from natural disasters: A pilot hemp insurance program through Multi-Peril Crop Insurance to provide coverage against loss of yield because of insurable causes of loss for hemp

grown for fiber, grain, or cannabidiol oil; and coverage under the Noninsured Crop Disaster Assistance Program to protect against losses associated with lower yields, destroyed crops, or prevented planting where no permanent federal crop insurance program is otherwise available.⁸ (The deadline to participate in these programs was March 16, 2020.)

As the cannabis industry progresses and matures, it is likely that it will find more participating insurance carriers that offer an array of insurance lines to CREs.

Endnotes

1. New Dawn Risk Group Limited, "Understanding and opening up the US cannabis insurance market," *available at* https://www.newdawnrisk.com/wp-content/uploads/2020/05/Cannabis_report-FINAL.pdf.
2. A.M. Best, "Special Report: Cannabis: New Opportunities for Insurers, But with Burgeoning Risks" (March 12, 2019) (sub req.), *available at* http://www3.ambest.com/ambv/sales/bwpurchase.aspx?record_code=283604&URATINGID=2901794&MC-Token=14822122919091247221401062216212821423321333&auth=&tl%3d7%26fs%3d0%26altnum%3d0%26altsrc%3d22.
3. *See id.*, at p. 4.
4. *See id.*, at p. 1.
5. *See id.*, at p. 4.
6. *See id.*, at p. 1.
7. *See* "Insurance Commissioner approves first coverage to protect property owners leasing to cannabis industry," *available at* <http://www.insurance.ca.gov/0400-news/0100-press-releases/2018/release046-18.cfm>.
8. *See* "USDA Announces Details of Risk Management Programs for Hemp Producers", *available at* <https://www.usda.gov/media/press-releases/2020/02/06/usda-announces-details-risk-management-programs-hemp-producers>. ■

MEALEY'S: EMERGING INSURANCE DISPUTES

edited by Jennifer Hans

The Report is produced twice monthly by



1600 John F. Kennedy Blvd., Suite 1655, Philadelphia, PA 19103, USA

Telephone: (215)564-1788 1-800-MEALEYS (1-800-632-5397)

Email: mealeyinfo@lexisnexis.com

Web site: <http://www.lexisnexis.com/mealeys>

ISSN 1087-139X