

**BLOGS**

Cannabis Insurance

Don't Let Your Insurance Coverage Go Up in Smoke: Hot Topic Advice From a Cannabis Insurance Broker

Interviewed by Alana McMullin and David Scheidemantle of Lathrop Gage's Insurance Recovery & Counseling Group.

In a recent decision, the United States Court of Appeals for the Sixth Circuit considered whether a "criminal acts" exclusion in a first-party commercial insurance policy barred coverage for damage to leased property caused by the insured's tenant in the operation of a marijuana cultivation business. *K.V.G. Properties, Inc. v. Westfield Insurance Co.*, 2018 U.S. App. LEXIS 232296, 2018 FED App. 0178P, 2018 WL 3978211 (6th Cir. Aug. 21, 2018). Marijuana remains illegal as a Schedule 1 drug under federal law but is protected in certain circumstances under the law of Michigan, where the insured property was located. Fatal to the insured's case, it had pleaded in an eviction proceeding that the tenant's activities were illegal, which the Sixth Circuit took as an admission that the tenant's conduct was illegal under Michigan as well as federal law, landing the claim within the confines of the criminal acts exclusion. While paying lip service to black letter law that the insurer bears the burden of establishing the applicability of an exclusion, the court nevertheless ruled against the insured because it had provided no evidence that the tenant had complied with Michigan's marijuana laws. The court left open whether the exclusion still would have applied had the insured made such a showing (and hinted the outcome might have been different had the insured done so).

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Taking into account the results of November's elections, 31 U.S. states have legalized marijuana for medicinal use, and ten have legalized recreational use. As long as federal law remains out of step with the national trend, the circumstances

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of the *K.V.G. Properties* case are bound to repeat themselves, and insurers may attempt to deny coverage under the standard criminal acts exclusion for claims arising out the operation of marijuana businesses even if those businesses are lawful in the states and localities in which they are located. We'll see how the courts react. In the meantime, to insure their potential losses, those who invest in or operate marijuana businesses – and those, like *K.V.G. Properties*, who lease or provide goods or services to them – need to look beyond their standard commercial policies and consider procuring cannabis-specific insurance policies.

For an insurance broker's perspective, today we sit down with Bill Lewis, Executive Vice President of Bolton & Co., a true pioneer in the field of cannabis insurance. Over the last two years, Bolton has amassed 75 clients for which the company has brokered cannabis insurance policies, for a total of \$4 million in premiums.

Alana: Bill, thank you for joining us this afternoon. Our clients operating in the cannabis space are certainly fortunate to have the opportunity to obtain insurance specific to their business as a result of your work at Bolton, so let's jump right in. How do the policies you are marketing deal with pitfalls highlighted in *K.V.G.*?

Bill: Well, the biggest difference between that case and the policies Bolton is marketing is that KVG had a standard commercial landlord contract. Those policies have standard exclusions, language, and endorsements that can make it difficult for marijuana businesses have coverage for their claims because they are not specifically tailored to the needs of the cannabis company. In contrast, the cannabis insurance policies we're now seeing don't have blanket "criminal acts" exclusions because both insurers and insureds are aware that marijuana is still federally illegal, even if the state has legalized it. So, if a company is complying with state and local cannabis regulations and laws, coverage under a cannabis insurance policy shouldn't be denied simply because the claim relates to cannabis. To me that's the best way to deal with the concerns of that case.

Alana: The KVG court left an unresolved issue, that is, the court declined to answer the "difficult" question of if cultivating marijuana in a state that has legalized it is still "criminal conduct" under that standard insurance language. The opinion appears to be intentionally narrow, stating that only when marijuana cultivation violates *both* state and federal law, and the insurer has a Dishonest or Criminal Acts Exclusion, coverage is barred. Are insurance companies taking that into account?

Bill: Yes, they are. On the one hand, I've seen companies that issue standard insurance policies adopt endorsements or exclusions specific to the cannabis trade. For example, Admiral Insurance Group, LLC, issued a cannabis extraction and processing business a "Health Hazard Exclusion" specific to marijuana and THC because the business already had a commercial general liability policy with the insurer. Insurers like Admiral are aware that insureds are participating in the cannabis industry and want to prevent paying for specific types of injury or damage that only such businesses may have. On the other hand, cannabis-specific insurance policies are completely transparent to the fact that they are covering marijuana related businesses. Policies may even define the types of marijuana covered, as some products and THC levels may be treated differently by different policies. This transparency avoids the difficult question you mentioned because the policies are specifically tailored to insureds who are manufacturing, distributing, and selling marijuana in a state that has legalized it.

David: Bill, what types of clients are you working with in this space?

Bill: They really run the gamut: investors, venture capital and private equity firms, cultivators, extractors, processors, harvestors, pharma compounders, equipment manufacturers, wholesalers and distributors, branding companies, transporters, dispensaries, franchisors, labs that test the products, property managers, landlords, tobacco stores, garden stores, undoubtedly others I'm just not thinking of just now. So, basically, if you're a company that in any way touches the cannabis industry, you may be subject to local and state marijuana laws and there is likely an insurance policy out there specific to your coverage needs.

David: You've included landlords, like *K.V.G. Properties*. A notable fact in the case was that *K.V.G.* was not even aware of the activities of its tenant – didn't know it was operating a marijuana business. How can you protect the landlord in that circumstance?

Bill: David, too often, insurance is the tail that wags the dog, or, in the *K.V.G.* case, at least initially, maybe just a forgotten flea on the tail. The loss in the case was \$500,000 because the tenant had essentially gutted the property: removed walls, cut holes in the roof, altered ductwork, and altered and severely damaged the HVAC. With a loss of that magnitude, insurance should have been a first priority alongside eviction. While I'm sure I'm preaching to the choir on this one, with a good insurance coverage advisor at the outset, the landlord could have avoided a head-on collision with the criminal acts exclusion, and the Sixth Circuit's decision might have been different. But even more prophylactically, I would advise landlords who have property for rent in areas the state allows for cannabis operations consult with their legal counsel in structuring their lease agreements to protect them financially from a tenant operating illegally. There is no insurance endorsement for a standard policy available to address this situation. The intent of the carriers is to not cover criminal acts. The landlords may also ask for a copy of the cannabis license from the tenant that was issued allowing them to operate legally.

David: What insurers are you working with who offer cannabis-insurance, and what distinguishes them from insurers who fear to tread into the territory?

Bill: We are working primarily with three insurance carriers – Next Wave Insurance, James River Insurance, and Evanston Insurance – offering a broad range of coverage types, including workers compensation, commercial property coverage, products liability coverage, product recall and withdrawal coverage, commercial crop coverage, general liability coverage, and excess liability coverage. These carriers see an opportunity and need and are stepping up to the plate. Underwriters at Lloyd's of London began offering cannabis insurance in Canada as soon as it became federally legal there, and I'm sure we'll see more carriers coming into the space as progress is made at the federal level in the U.S. You may have seen the Los Angeles Times piece a week or so ago commenting on the positive impact on marijuana investment that has been going on since the departure of Jeff Sessions [<https://www.latimes.com/nation/la-na-sessions-marijuana-movement-2018-story.html>], and I would not be surprised if we experienced a similar relaxation in the insurance market. We are starting to see more carriers enter the space along with those I mentioned above. We are working with Goldenbear (an admitted carrier in California), Kinsale, Hallmark, Berkshire, Protective, Admiral, Atlas, Canopus, NICO, and Progressive, and we have a couple of exclusive programs writing for our agency. We are also seeing captives formed in specific states.

Alana: What hurdles are your clients encountering in procuring the types and extent of coverage that you recommend and that are essential to their businesses?

Bill: The single biggest hurdle for these businesses would be the applications they must fill out before being eligible for coverage. These applications can be burdensome, inquiring deeply into compliance issues. To help these companies prepare to apply, we've compiled some of the questions found on Next Wave Insurance, James River Insurance, and Evanston Insurance marijuana policy applications, such as:

- Whether a quality assurance or product recall plan is in place?
- Whether the cannabis products are tested prior to distribution? How?
- Whether the applicant is using software to track sales and transaction data?
- Whether all Consumer Product Safety Commission regulations will be followed?
- Whether there is a complaint handling procedure in place?
- Whether pesticides are being used? If so, are there safeguards for pesticide issues?
- Whether the applicant offers delivery of marijuana products?
- Whether any part of their product originates from outside the United States?



- Whether an applicant consulted an attorney to determine labeling requirements?

The information provided in the applications forms one of the bases for establishing the premiums to be charged. And of course inaccuracies in the applications can put coverage at risk in the event of a claim.

These policies are not ones that should be purchased and placed in a drawer. They have detailed on-going warranty requirements the insured must comply with or run the risk of a claim denial. For example, the insured must obtain MVRs – motor vehicle records – and background checks on employees, and there are very detailed warranties for the transportation of the insured’s money and cargo.

Another important thing is that a different policy is required for each state in which the insured is doing business, as the terms and warranties differ depending on applicable state law.

Alana: So, because it’s vital that the applications are filled out accurately and fully, how are you working with your clients to avoid pitfalls?

Bill: I would first recommend businesses look over the insurance applications thoroughly before deciding to apply to a specific insurer. The questions in these applications force businesses to think about their experience or lack thereof in the industry what their company may look like in the coming years. The questions really make you think, what am I doing to make sure that the quality of my product won’t be tampered with or depleted, how experienced are my employees when it comes to handling cannabis, what types of products can we sell in what states, and whether there is a structure in place to make sure only those who are legally allowed to buy or use your product are the ones who actually are.

Second, I recommend consulting with attorneys such as yourselves who can assist in providing guidance on full compliance with all state laws, regulations, administrative codes, and any other governmental orders governing cannabis and their business.

David: Along those lines, Bill, we are now offering a Corporate Hygiene in the Cannabis Fields program to assist cannabis businesses in moving in the right direction. The program focuses on adherence to corporate formalities, regulatory compliance, insurance coverage, and employment practices. Since each state that has legalized marijuana treats different plant strains, THC levels, and products differently, complying with state and more specifically, county and city regulations, is extremely important, especially since being out of compliance with any regulatory body could put your coverage at risk. We’d welcome the opportunity to put on the program for your clients and prospective clients.

Bill: That sounds like a great opportunity for your firm, Bolton, and our respective clients!

Alana: Bill, thank you very much for joining us today. It is good to know where we and our clients can turn for an evaluation of the current and ever-evolving state of the cannabis insurance market, for premium management, and for brokering an appropriately protective insurance program. We’ve covered a lot today, but there is more to discuss, so perhaps we can meet with you again in 2019 for your additional insights at that time.

Bill: My pleasure, and thanks to the two of you.