CANNABIS AND INSURANCE

by
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Although many states have decriminalized or legalized cannabis, it remains a Schedule 1 drug under the federal Controlled Substances Act. The conflict between federal and state law presents many complicated issues, including problems relating to insurance coverage. Insurance law seeks to balance competing policy interests. On one hand, public policy supports reading insurance policies broadly to indemnify policyholders for their losses. On the other hand, public policy counsels against permitting insurance to indemnify (federally) illegal activity. In this Article, we explore some pressing issues arising from the conflict between these policy considerations and offer some analysis of the conflict in the context of liability, property, and employment-related insurance. We also explore emerging cannabis insurance policy options in states where cannabis is legal and discuss the advantages, but ultimate inadequacy, of those options. We conclude that policyholders are likely to find that their reasonable expectations of insurance coverage are unmet at this point in the emerging market.

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INTRODUCTION

Insurance is a critical risk management tool used by individuals and business entities of all sizes. Insurance is so prevalent in modern economies that it is easy to forget that insurance has been deemed a respectable product that can legally be offered to the public only recently. Life insurance, for example, was regarded as an affront to divine providence. Purchasing a policy amounted to hedging one's bets against the deity, so to speak. Eventually, England permitted life insurance to develop, primarily because the Protestant clergy had to find some means of providing for their families in case of an untimely demise. Religious motivations finally stripped life insurance of its taint, but a culture soon developed of using life insurance products to wager on the life of third persons, including those accused of capital crimes. Parliament responded by enacting the Life Assurance Act of 1774, which required a policyholder to have an "insurable interest" in the life of the insured. Thus began the modern regulatory balance of permitting insurance to obtain socially beneficial results, but strictly regulating the industry to minimize undesirable externalities.[1]

The historical roots of insurance embody fundamental principles that continue to guide contemporary insurance regulation through legislative, administrative and

[1] *See generally* GEOFFREY CLARK, BETTING ON LIVES: THE CULTURE OF LIFE INSURANCE IN ENGLAND, 1695–1775 (1999) (examining in detail the growth of life insurance in England as described in this paragraph). Insurance has a long history reaching back to contracts of bottomry that protected traders. *See* ROBERT H. JERRY, II & DOUGLAS R. RICHMOND, UNDERSTANDING INSURANCE LAW § 11 (5th ed., LexisNexis 2012); C.F. TRENERRY, THE ORIGIN AND EARLY HISTORY OF INSURANCE (The Lawbook Exchange, Ltd. 2009) (1926). But insurance has always engendered controversies about the social effects of indemnity. Religious concerns about the impiety of insurance continue today, particularly among Muslim believers. *See* ALY KHORSHID, ISLAMIC INSURANCE: A MODERN APPROACH TO ISLAMIC BANKING 2 (2004) ("By studying the way Islamic banking has overcome the restrictions placed upon on it by the religion . . . we can recognize ways in which insurance can become legitimized while remaining within a strict Islamic framework."). Our point is that the history of insurance demonstrates that insurance coverage has never been regarded as simply another commercial contract.

judicial efforts to mitigate the undesirable effects that insurance can have on behavior. For example, a person who owns a life insurance policy insuring another person would have a motive to end the life of that person to recover the insurance proceeds. Addressing the problem of moral hazard by requiring that insureds have an insurable interest has been a fundamental theme of insurance regulation, even before Parliament introduced the Life Insurance Act.[2] On the other hand, the aleatory nature of an insurance policy provides insurers with a motive to deny coverage and exploit the policyholder's vulnerability following a loss or claim. The judicial development of the tort of "bad faith" has served as the primary regulatory response to insurer overreaching.[3] These fundamental touchstones for insurance law are deeply rooted in considerations of public policy that trump the freedom of parties to contract for insurance.

This is not to say that the existence of insurance only has the potential for negative social effects. Insurance provides a fund to compensate those who have suffered a loss, which is a positive public good.[4] First-party insurance products permit the policyholder to mitigate a loss by protecting herself with insurance.[5] Third-party insurance compensates a person who is harmed by the policyholder.[6] As a highly regulated industry, insurance is tolerated only to the extent that it provides a public benefit, and so the interpretation of insurance policies is deeply guided by considerations of the public good. For example, courts will interpret coverage provisions liberally and exclusions narrowly to protect the reasonable expectations of the insured and to vindicate the public interest in ensuring that the risk of fortuitous losses is spread and those persons suffering a loss can recover compensation.[7]

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[2] Robert H. Jerry II, *What is Insurance?*, *in* 1 NEW APPLEMAN ON INSURANCE LAW LIBRARY EDITION § 1.05[3] (Jeffrey E. Thomas & Francis J. Mootz III eds., 2018), LexisNexis (updated Dec. 2018). Professor Jerry notes that even maritime insurance, which had existed for centuries to protect traders, raised problems of moral hazard that were addressed by Parliament by means of a requirement of an insurable interest. *Id.* For an overview of the problem of moral hazard, see *id.* § 1.01[4][b]. For a more complete analysis of the origin of the doctrine, see Tom Baker, *On the Genealogy of Moral Hazard*, 75 TEX. L. REV. 237 (1996).

[3] *See* William T. Barker, *Bad Faith in the Context of First-Party Insurance*, *in* 5 NEW APPLEMAN ON INSURANCE, *supra* note 2, § 55.02[1]; William T. Barker & Ronald D. Kent, *Bad Faith in Liability Coverage*, *in* 3 NEW APPLEMAN ON INSURANCE LAW, *supra* note 2, § 23.01[1][d].

[4] Francis J. Mootz III, *E/Insuring the Marijuana Industry*, 49 U. PAC. L. REV. 43, 46 n.13 (2017) ("Courts generally emphasize the public policy in favor of insurance coverage in the context of cases involving mandatory insurance under automobile statutes, but application of the strong principle of *contra proferentem* evidences a more general public policy."). For specific case examples, see *id.*

[5] Jeffrey E. Thomas, *Spotting Issues in Particular Practice Areas*, *in* 3 NEW APPLEMAN INSURANCE LAW, *supra* note 2, § 29.22.

[6] *Id.*

[7] We are painting with a broad brush here, as some states take more restrictive approaches to interpreting coverage, and many states pay lip service to interpreting policy provisions according

Many of these fundamental principles of insurance law are brought into sharp relief when considering the emergence of the state-legal cannabis industry during recent years. In this Article, we explore the conundrums generated by competing public policies regarding insurance coverage of cannabis customers and businesses. Cannabis is a unique product because it remains illegal under federal criminal law at the same time that states have undertaken to legalize, regulate and tax cannabis businesses within their jurisdictions.[8] On the one hand, there is a fundamental public policy against insuring illegal conduct, because protecting against fortuitous losses arising out of the illegal conduct would tend to encourage the illegal behavior.[9] On the other hand, there is a fundamental public policy that insurance coverage protecting injured parties should be broadly interpreted, suggesting that participants in the state-legal cannabis industry—both suppliers and customers—should be indemnified for losses.[10] Indeed, some state-legal regulatory regimes require that some participants in the cannabis trade purchase liability insurance as a means of mitigating potential harms caused by the business.[11]

In this Article, we highlight these important questions of public policy by assessing how various types of insurance policies are being developed and interpreted with regard to state-legal cannabis risks. We divide our analysis into two parts. Part One considers issues of coverage for cannabis risks that arise under general insurance products, with a focus on various insurance programs that insure losses arising out of the employment relationship. Part Two considers insurance products specifically designed to cover risks associated with engaging in state-legal cannabis activity. Specifically, we consider whether these policies would be deemed enforceable if challenged in court, and if so, the availability of adequate and appropriate coverage given the absence of underwriting history and actuarial data for these types of risks.

We conclude that a number of complex issues arise regarding insurance coverage of state-legal cannabis, often by pitting fundamental public policies against each

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to their plain meaning just as with any contract. Any lawyer with experience representing insurance carriers will undoubtedly affirm that courts interpret insurance policies differently than contracts for the procurement of widgets, and that the court is guided by broad notions of public policy. *See generally* Thomas, *supra* note 5, § 29.22 (discussing the varying approaches to policy interpretation in the states, while acknowledging that insurance contracts are subject to a distinctly different set of interpretive rules than ordinary commercial contracts).

[8] 21 U.S.C. § 812 (2012); *see also* Ian Wagemaker, *The High Risk of Going Green: Problems Facing Transactional Attorneys and the Growth of the State-Level Legal Marijuana Industries*, 37 W. NEW ENG. L. REV. 371, 372 (2015).

[9] Mootz, *supra* note 4, at 57–63.

[10] *See id.* (describing the application of the public policy doctrine to state-legal cannabis risks).

[11] *See, e.g.*, CAL. CODE REGS. tit. 16, § 5308 (2019) (proposed regulations submitted by the California Cannabis Control Board to the California Office of Administrative Law in December 2018 establishing minimum general liability coverage for distributors).

other. As the state-legal market continues to grow and mature, these issues will only become more pressing. It seems clear that the conundrums will persist until the federal government takes definitive action to resolve the conflict with state-legal regimes. Until then, lawyers will need to offer skilled counseling and advocacy to assist their clients to secure and enforce insurance policies with regard to the risks of state-legal cannabis business activity.

I. CANNABIS RISKS AND GENERAL INSURANCE PRODUCTS

Typically, individuals purchase several insurance policies to protect them from fortuitous losses. Third-party insurance provides liability coverage when the insured injures another person.[12] First-party insurance provides reimbursement to an insured who suffers injury, such as damage to the insured's property.[13] In this Part, we briefly review examples of each form of coverage and the issues arising regarding cannabis risks. We then delve into greater detail to consider the insurance coverage of claims arising out of the employment relationship. There has already been significant litigation regarding the effect of state-legal cannabis on claims involving workers' compensation, unemployment insurance, and employer liability for failure to accommodate an employee's use of medical cannabis. Insurers and regulators have addressed in some detail the extent to which such general social insurance policies are permitted or required to cover losses relating to cannabis risks.

A. Liability Insurance

Liability insurance policies protect the insured against claims made by those who are negligently injured by the insured's conduct. Many individuals find it prudent to purchase homeowners or renters liability coverage, auto liability coverage, and perhaps an umbrella policy. Businesses generally carry Commercial General Liability coverage, business auto coverage, and a variety of other more specialized liability coverages, such as Directors and Officers coverage.[14] These liability coverages promote an important public policy because they provide an available fund to compensate persons injured by the policyholder's negligence. In the context of cannabis, however, there is a countervailing public policy against permitting parties to insulate themselves from liability for injuries arising out of illegal behavior generally, and specifically for injuries arising out of the illegal drug trade.

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[12] Thomas, *supra* note 5.

[13] *Id.*

[14] *See generally* T. C. Williams, Annotation, *Coverage, as Regards Causes of Injury or Damage, of Policy Insuring Owner, Occupier, or Operator of Premises Against Liability for Injury to Person or Property*, 148 A.L.R. 605 (1944) (discussing the different kinds of insurance policies and the scope of their coverages).

Liability policies regularly exclude losses that arise out of the sale, use, manufacture, delivery, transfer or possession of a controlled substance unless the injury arises out of the conduct of a person complying with a medical prescription written by a health care professional.[15] Similarly, auto liability coverages regularly exclude losses caused in any way by the insured's impairment or intoxication by illegal drugs.[16] Individual insureds may be surprised to find that injuries arising out of state-legal cannabis activities may be excluded from their liability coverages due to the continuing illegality of cannabis under federal law.

It is a bedrock of insurance law that the insuring provisions of a policy are read liberally and exclusions are read narrowly. These interpretive presumptions effectuate the public policy favoring coverage of fortuitous losses and respect the policyholder's reasonable expectations of coverage. However, courts have tended to read coverage for losses arising out of the use of illegal drugs somewhat narrowly, reflecting a general unwillingness to insulate parties from losses arising out of conduct connected with illegal drug use. Consider the case of an insured under his parents' homeowners and umbrella policies putting methamphetamine into a girl's drink, causing her death.[17] The policies excluded losses arising out of the use, sale, manufacture, delivery, transfer or possession of a controlled substance as defined under federal law, and the court found that this exclusion clearly barred coverage of the claim against the insured.[18] The policyholders might have expected a more narrow reading of the exclusion to provide coverage for their son's negligence, as would be the case if he spiked the girl's drink with grain alcohol and accidentally caused her death. However, the court was content to enforce a plain meaning that removed from coverage any injuries arising out of the use of a controlled substance.[19]

The willingness of courts to enforce exclusions related to controlled substances is illustrated by cases outlining insurance coverage when the loss arises out of the (mis)use of prescription drugs. Consider a case in which an 18-year-old visitor in the policyholder's home stole a prescription drug and committed suicide.[20] The policy contained the typical exclusion language for losses "arising out of the use, sale, manufacture, delivery, transfer or possession by any person of a Controlled Substance," except for "the legitimate use of prescription drugs by a person following

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[15] Leah R. Bartlome, *Insurance for the Marijuana Industry*, N.J. LAW., Oct. 2018, 38, 49; *see also* John G. Nevius, *Insurance Risks Surrounding Legal Cannabis*, LAW360 (May 26, 2015, 12:19 PM), https://www.law360.com/articles/659285/insurance-risks-surrounding-legal-cannabis.

[16] Bartlome, *supra* note 15, at 49.

[17] Westfield Nat'l Ins. Co. v. Long, 811 N.E.2d 776, 778 (Ill. App. Ct. 2004).

[18] *Id.* at 779–80.

[19] *Id.* at 780.

[20] Mass. Prop. Ins. Underwriting Ass'n v. Gallagher, 911 N.E.2d 808, 810 (Mass. App. Ct. 2009).

the orders of a licensed physician."[21] An insured might reasonably expect such a loss to be covered, since there was no illegal activity involved—yet the court read the exclusion fairly expansively.[22] As the court noted, even though a legal prescription caused the injury, it was not due to a "legitimate use" by the person to whom it was prescribed.[23] In a similar case, the court acknowledged that the insured would reasonably expect coverage:

> We sympathize with the Appellants' argument that they are entirely innocent of any connection between [the plaintiff] and his decision to steal and consume [the insured's prescribed] methadone. We acknowledge that the [insureds] justifiably believe that Western Reserve should defend them under these circumstances. Unfortunately for the [insureds], the language of the policy is clear and unambiguous that [the plaintiff's] injury, which arose out of his illicit use of a controlled substance, is excluded from liability coverage.[24]

Courts tend to read the broad controlled substances exclusion as written, implicitly acknowledging the legitimacy of withholding coverage in cases related to drugs.[25]

One may expect that liability insurance carriers will seek to avoid coverage in cases involving cannabis that fall within the controlled substances exclusion. Consider the case in which a group of teens went to a drug dealer's home to secure a pound of cannabis on "credit," and were prepared to steal the cannabis if the dealer refused.[26] During this ill-conceived visit, the dealer was shot and killed.[27] One of the teens plead guilty to a charge of conspiracy to commit armed robbery after he admitted hearing some of the other teens talking about stealing the cannabis if necessary to obtain it.[28] When that teen (who was insured under his parents' homeowners policy) was sued for wrongful death, the insurer sought a declaration that the potential liability for wrongful death was excluded by the controlled substances provision in the policy.[29] Given that the death was by gunshot, it might seem overly aggressive for the insurer to seek to exclude coverage under a provision relating to drugs. Nevertheless, the court concluded that the teens' "actions were wholly focused on the use and possession of illicit drugs," and that there was "a clear nexus between the fatal shooting . . . and [the insured's] attempt to obtain illegal drugs."[30]

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[21] *Id.*

[22] *Id.* at 811.

[23] *Id.* at 810.

[24] Forman v. Penn, 945 N.E.2d 717, 721 (Ind. Ct. App. 2011).

[25] *See, e.g.*, *id.*

[26] Prudential Prop. & Cas. Ins. Co. v. Brenner, 795 A.2d 286, 287–88 (N.J. Super. Ct. App. Div. 2002).

[27] *Id.* at 288.

[28] *Id.*

[29] *Id.* at 287.

[30] *Id.* at 289–90.

This conclusion certainly appears to depart from the notion of reading exclusions narrowly by bringing an unplanned shooting within the scope of provisions excluding losses arising out of the "use, sale, manufacture, delivery, transfer or possession" of illegal drugs.

However, other courts have exhibited more sophistication in dealing with cannabis exclusions. After a deadly car accident involving teens, an umbrella carrier invoked the controlled substances exclusion in the auto policy by claiming that cannabis was a cause of the loss.[31] The police discovered cannabis in the car, reported a "strange odor" in the car, and described the driver as "disorderly" and "glassy-eyed;" most importantly, the insured tested positive for cannabinoids in his bloodstream.[32] The court refused to give a broad reading to the controlled substances exclusion, noting that there was no real evidence that the use of cannabis was "the efficient and predominating cause of the injuries."[33] The officers failed to locate any smoking paraphernalia in the car; the blood test could only confirm that the driver had ingested cannabis at some point in the past, and not that he was under the influence while driving; the driver's physical condition after the accident could be explained by the fact that he was unconscious when police arrived on the scene; and the police never claimed that the odor was cannabis smoke.[34] The fact that the driver plead guilty to the crime of operating a motor vehicle with a controlled substance in his blood did not establish that he was under the influence when the accident occurred, given how long cannabinoids persist in the blood after using cannabis.[35] In short, the court refused to read the exclusion expansively to foreclose coverage due to the presence of cannabis.

More notably, the court rejected the carrier's argument that it would be against public policy to indemnify the insured for losses that occurred while the insured was violating the Controlled Substances Act. The court noted that the controlled substances exclusion in the policy vindicated the public interest, but that it was not triggered by the facts of the case.[36] Rather than imposing a broader exclusion by judicial fiat, the court emphasized "that insurance companies are fully capable of drafting exclusionary clauses to their liking."[37]

Liability insurance policies often seek to exclude losses arising from particularly risky behavior, such as illegal activity. As a general rule, courts will respect these choices as being grounded in sensible policies and serving the public interest. However, the unique situation of state-legal cannabis still being illegal under federal law

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[31] Keckler v. Meridian Sec. Ins. Co., 967 N.E.2d 18, 19 (Ind. Ct. App. 2012).

[32] *Id.* at 20.

[33] *Id.* at 23–24.

[34] *Id.* at 24–25.

[35] *Id.* at 24.

[36] *Id.* at 27.

[37] *Id.* at 28.

puts the public policy favoring insurance coverage of fortuitous losses into conflict with the public policy disfavoring incentives to engage in illegal or risky activity that can cause injury.

B. Property Insurance

We now turn to an example of first-party insurance, which is purchased by an insured to indemnify the insured's losses. For example, the property insurance component of a homeowners policy reimburses the insured if her real or personal property is damaged. Property insurance becomes more complicated when the personal property in question is cannabis, or the real property in question is used to cultivate cannabis. The most difficult problem arises when courts consider the continuing federal ban on the production, sale, and use of cannabis as evidencing a strong public policy that should trump otherwise available insurance coverage. A federal court in Hawai'i held that an insured growing cannabis for personal use in compliance with state law could not recover under her homeowners policy because the federal public policy against cannabis trumps the express terms of an insurance policy.[38] After her twelve plants were stolen, the insured filed a claim based on policy language that covered the theft of "trees, shrubs, plants or lawns, on the residence premises."[39] The carrier moved for summary judgment on the ground that the insured could not have an insurable interest in contraband, arguing that state cannabis laws merely provided an affirmative defense to state criminal charges but did not "legalize" the ownership of cannabis.[40] The carrier argued that enforcing coverage under the plain terms of the policy would violate federal public policy because it "presupposes that the insured will purchase, sell, and/or distribute marijuana plants with insurance proceeds."[41] The court found this rationale persuasive.

> The rule under Hawai'i law that courts may decline to enforce a contract that is illegal or contrary to public policy applies where the enforcement of the contract would violate federal law. . . .
>
> . . . The Court therefore assumes, for purposes of the instant Motion, that the "Trees, Shrubs and Other Plants" provision of the Policy covered the loss

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[38] Tracy v. USAA Cas. Ins. Co., No. 11-00487 LEK-KSC, 2012 WL 928186, at *13 (D. Haw. Mar. 16, 2012). The Court cited to a general public policy against enforcing contracts or agreements based on illegal conduct. *Id.* at *2.

[39] *Id.* at *1, *6.

[40] *Id.* at *2. For an analysis of the property issues relating to state-legal cannabis, see John G. Sprankling, *Owning Marijuana*, DUKE J. CON. L. & PUB. POL'Y (forthcoming 2019) (arguing that states may recognize property rights even if the federal government considers cannabis to be contraband in which no ownership rights may exist). The fact that an insured cannot own cannabis as property would not necessarily preclude the existence of an insurable interest for purposes of interpreting an insurance policy.

[41] *Tracy*, 2012 WL 928186, at *2.

> of Plaintiff's medical marijuana plants. Even in light of that assumption, this Court cannot enforce the provision because Plaintiff's possession and cultivation of marijuana, even for State-authorized medical use, clearly violates federal law. To require Defendant to pay insurance proceeds for the replacement of medical marijuana plants would be contrary to federal law and public policy. . . . The Court therefore CONCLUDES that, as a matter of law, Defendant's refusal to pay for Plaintiff's claim for the loss of her medical marijuana plants did not constitute a breach [of] the parties' insurance contract.[42]

Despite the insured's cultivation of cannabis plants in conformity with state law, and the express provision of coverage in the policy, the federal district court found that the federal illegality precluded enforcement of the policy terms as written.[43]

In contrast, a federal court in Colorado refused to absolve the carrier of its coverage obligation when the property insurance policy was written for a state-legal cannabis business and expressly covered "inventory," while also excluding "contraband."[44] When its attempt to enforce the exclusion failed, the carrier invoked the federal public policy against cannabis, albeit in an indirect manner.[45] This argument

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[42] *Id.* at *13.

[43] A federal court in New Mexico followed the *Tracy* rationale in holding that an insurer could not be compelled to reimburse a policyholder for the cost of cannabis used to treat her injuries. *See* Hemphill v. Liberty Mut. Ins. Co., No. Civ. 10-861 LH/RHS, 2013 WL 12123984, at *1, *3 (D.N.M. Mar. 28, 2013). The insured sought coverage for injuries suffered in a violent car collision from the uninsured motorist coverage in her auto policy, including reimbursement for medical cannabis that she used in conformity with state law to treat her severe neck and back pain. The court refused to require the insurer to compensate her for this medical expense:

> This federal court, even sitting in diversity, cannot force Defendant to recompense Plaintiff for medical expenses that are contrary to federal law and federal policy, even if the contract generally provides for the payment of future medical expenses. Such payment violates federal law, as clearly expressed by Congress, and New Mexico state law prevents the enforcement of an illegal contract. New Mexico citizens must follow the laws of both the state and federal governments.

Id. at *2.

[44] Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co., 163 F. Supp. 3d 821, 833–34 (D. Colo. 2016) (enforcing coverage despite an exclusion for "contraband").

[45] Responding to the court's conclusion that the contraband exclusion was rendered ambiguous by the federal de jure policy against cannabis, despite the federal de facto policy not to interfere with state legal cannabis activities, the carrier obliquely sought "some direction and assurances from this Court," leading the court to conclude that the "unarticulated sub-text to this argument appears to be a request that the Court declare the Policy unenforceable as against public policy." *Id.* at 834. The court needn't have been equivocal, given the clearly stated basis for the carrier's motion for summary judgment: "Whether, in light of [Colorado's Medical Marijuana Act], federal law, and federal public Policy, it is legal for [the carrier] to pay for damages to marijuana plants and products, and if so, whether the Court can order [the carrier] to pay for these damages . . . ." *Id.* at 824 (first alteration in original).

held no sway with the court, given that the surplus lines policy was written specifically to provide coverage for the insured's state-legal marijuana business:

> Atain chose to insure Green Earth's inventory, without taking any apparent precautions to carefully delineate what types of inventory would and would not be covered. Atain's newfound concerns that writing such a Policy might somehow be unlawful thus ring particularly hollow and its request for an advisory opinion appears somewhat disingenuous.[46]

The court expressly rejected the approach of the court in *Tracy*, given the "continued erosion of any clear and consistent federal public policy," and the significance that the carrier expressly assumed the risk of insuring a cannabis business "of its own will, knowingly and intelligently."[47]

One could reconcile these divergent results by noting that the carrier in *Tracy* wrote a general homeowners policy without the expectation that it would cover reimbursement for expensive cannabis plants, whereas the carrier in *Green Earth* knowingly undertook precisely this risk. However, this distinction fails to address the doctrinal reality that the public policy doctrine is applied to overcome even the express, unambiguous agreements of the parties to a contract. In this respect, these two cases illustrate that courts have leeway under the public policy doctrine to show disapproval of cannabis activities even when conducted in compliance with state law.

Even when not invoking the doctrine explicitly, public policy considerations certainly inform how courts interpret policy language. In effect, the general public policy favoring insurance coverage might be overcome by the public policy against facilitating activities involving cannabis. Enforcing coverage for damage to real property caused by lessees converting the facility into a cannabis grow house without the policyholder's knowledge presents this issue in sharp relief. For example, one state appellate court read the terms of policy in favor of coverage for the injury caused to the rental property.[48] The homeowners policy on the rental property covered losses caused by "vandalism," but specifically excluded losses caused by "mold."[49] The carrier argued that the intentional changes to the property could not be considered acts of vandalism, and that the mold damage resulting from the physical use of the property was clearly excluded.[50] However, the court found that the policy provided coverage by construing the actions in disregard of the integrity of the property to be vandalism, and by finding that the vandalism directly caused the loss, with the mold being a secondary effect of the damage to the property.[51]

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[46] *Id.* at 834 n.8.

[47] *Id.* at 835.

[48] Bowers v. Farmers Ins. Exch., 991 P.2d 734, 735–36 (Wash. Ct. App. 2000).

[49] *Id.* at 736.

[50] *Id.* at 737.

[51] *Id.*

In contrast, another court construed a policy covering a commercial property that had been damaged by modifications to create a grow house.[52] The court rejected the claim that the damage resulted from vandalism, noting that state law defines vandalism as the "deliberate destruction or damage to . . . property."[53] Moreover, the commercial real estate policy had an "entrustment" exclusion that withheld coverage if the policyholder entrusted the property to someone engaged in illegal behavior, as well as an "unauthorized construction or remodeling" exclusion.[54] The court reasoned that a commercial landlord was in the best position to protect the property from illegal uses, and that the insurer properly declined that risk.[55] The court distinguished *Bowers*, which concerned a homeowners policy for a rental property rather than a commercial real estate policy, and therefore did not have the same exclusions.[56]

These cases demonstrate that courts exercise some discretion in interpreting policies, and that context matters. An individual purchasing a standard homeowners policy will not be held to the same terms or interpretations as a commercial real estate entity, given the differences in their abilities to prevent or minimize losses, and to bear those losses. On the other hand, even an innocent homeowner growing cannabis in full conformity with state law may be precluded from recovery despite the clear terms of the policy, based solely on the federal public policy against any use of cannabis.

C. Employment-Related Insurance Coverages

Courts have regularly dealt with the implications of state-legal cannabis for insurance coverages in the context of the employment relationship. Workplaces have been sites for policing drug use reaching back to the temperance movement, when employers began to demand that immigrant workers, primarily German and Irish, not drink alcohol with their meals.[57] In a similar vein, after years of doctors and pharmacists using cannabis for a variety of ailments, legislatures began to ban the drug when it became associated with use by Mexican economic immigrants after the turn of the last century.[58] More recently, federal and state legislatures have required

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[52] K.V.G. Props., Inc. v. Westfield Ins. Co., 296 F. Supp. 3d 863, 864 (E.D. Mich. 2017).

[53] *Id.* at 867.

[54] *Id.* at 867–68.

[55] *See id.* at 868 (citing United Specialty Ins. Co. v. Barry Inn Realty, 130 F. Supp. 3d 834 (S.D.N.Y. 2015)).

[56] *Id.* at 867.

[57] Paul E. Reckner & Stephen A. Brighton, *"Free from All Vicious Habits": Archaeological Perspectives on Class Conflict and the Rhetoric of Temperance*, 33 HIST. ARCHAEOLOGY 63, 65 (1999).

[58] Francis J. Mootz III, *Ethical Cannabis Lawyering in California*, 9 ST. MARY'S J. ON LEGAL MALPRACTICE & ETHICS 2, 12 (2018).

drug testing for certain safety-sensitive occupations, and have adopted general "drug-free workplace" policies that require companies doing business with the government to ensure that their workplace is free of illegal drugs.[59] As one scholar concludes, employers who are concerned about employee drug use are motivated by their sense of who are considered reputable persons and a desire to exert control, as opposed to wanting to implement data-based strategies to increase workplace safety and productivity.[60] As a consequence, the workplace has become one of the primary sites that gives rise to litigation regarding the effect of cannabis use on monetary recovery under social insurance programs, such as workers' compensation and unemployment compensation.

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[59] The Omnibus Transportation Employee Testing Act of 1991 requires Department of Transportation agencies to implement drug and alcohol testing of safety-sensitive transportation employees. *See* 49 U.S.C. § 5331 (2012). The Code of Federal Regulations provides rules for how to conduct testing and how to return employees to safety-sensitive duties after they violate a DOT drug and alcohol regulation. 49 C.F.R. §§ 40.1–40.413 (2018). The Drug-Free Workplace Act of 1988 requires organizations doing business with the federal government to undertake comprehensive steps to ensure that the workplace is free of drugs, although it does not mandate drug testing of employees. *See* 41 U.S.C. §§ 8101–8106 (2018). Many covered employers respond by refusing to hire candidates who test positive for cannabis use, even if there is no evidence that they have brought cannabis into the workplace or have been under the influence while at work. Although many employers subject applicants and employees to drug testing, the problem of workers under the influence in the workplace is relatively small. *See* Stacy Hickox, *It's Time to Rein in Employer Drug Testing*, 11 HARV. L. & POL'Y REV. 419, 422 (2017). Given the inability of blood tests to determine with specificity when a person was impaired by cannabis, and the increasingly prevalent use of cannabis for medical reasons, many have called for employers to focus on performance rather than private use of cannabis:

> Drug testing is a common tool used by employers to screen applicants and identify risky employees, but it lacks the accuracy and reliability to predict future performance or identify risks to safety. Focus on performance rather than reliance on drug testing in both selection and retention of employees will provide more accurate information to employers while protecting the interests of those who may test positive based on their use of a prescribed medication or medical marijuana.

Id. at 462.

[60] Hickox, *supra* note 59, at 423 ("Expansion of drug testing while drug use among employees remains low suggests that employers are relying on drug testing as a relatively easy way of 'distinguishing the reputable from the disreputable,' particularly in larger organizations. Drug testing may be seen as a way to address immorality and restore the image of an employer's control, or even a broader form of social control. Hence, employers rely on testing to deter drug and alcohol use among their employees, or to discourage drug users from applying. However, comparisons of drug use in companies that do or do not test have not established a lower usage rate among testing employers, and industries with higher rates of testing also have higher rates of drug usage." (footnotes omitted)).

1. Employers Generally Do Not Have to Accommodate Employee Use of Medical Cannabis

As a general rule, employees are "at will," meaning they can be terminated for any reason or no reason, just as the employee may quit for any or no reason. Certainly, employers are free to have a "zero tolerance" policy for employees who use (federally) illegal cannabis, even if they do so on their own time and are not under the influence at work.[61] Some states have expressly provided employees with protection under state anti-discrimination laws for cannabis use that is fully compliant with state law, and the courts have accordingly recognized that employers must reasonably accommodate employees who use cannabis on their own time.[62] Some courts have done so even in the absence of an express anti-discrimination provision in the state cannabis laws. For example, an employee who was fired for using medical cannabis to treat Crohn's disease was permitted to recover under the Massachusetts anti-discrimination statute based on the general provision in the state's medical cannabis act that no person shall be denied any right or privilege based on state-legal use of cannabis.[63] The court did not recognize a general "right" for employees to use cannabis, but rather found that medical uses of cannabis trigger the obligation of an employer to make reasonable accommodations under the state's general handicapped discrimination act.[64] The court explained:

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[61] Many states have statutory protections that prohibit employers from terminating employees who engage in "lawful activities" on their own time. Because cannabis remains illegal under federal law, courts do not consider the use of medical cannabis in full conformity with state law to be a "lawful activity." Thus, when an employee with a serious illness was fired solely because he used medical cannabis on his own time, even though he was never under the influence in the workplace, the court held that he could not recover damages under Colorado's "lawful activities" statute. Curry v. MillerCoors, Inc., No. 12-cv-02471-JLK, 2013 WL 4494307, at *6 (D. Colo. 2013); *see also* Coats v. Dish Network, LLC, 303 P.3d 147, 149 (Colo. App. 2013).

[62] *See, e.g.*, Noffsinger v. SSC Niantic Operating Co., LLC, 273 F. Supp. 3d 326, 330, 334 (D. Conn. 2017) (holding that the express anti-discrimination element of the medical cannabis statute that applies to schools, landlords and employers is not preempted by federal law); Callaghan v. Darlington Fabrics Corp., No. PC-2014-5680, 2017 WL 2321181, at *30–31 (R.I. Super. Ct. May 23, 2017) (holding that the anti-discrimination-in-employment provision under the state's medical cannabis statute is not preempted by federal law); Barrett v. Robert Half Corp., No. 15-6245, 2017 WL 4475980, at *1–2 (D.N.J. Feb. 21, 2017) (dismissing complaint without prejudice to permit the plaintiff to replead expressly that he requested accommodation for use of cannabis to address severe back pain due to herniated discs).

[63] Barbuto v. Advantage Sales & Mktg., LLC, 78 N.E.3d 37, 45 (Mass. 2017). However, because the medical cannabis statute did not expressly protect users against adverse actions by employers and other parties, the court held that there was no implied right of action under the act itself. *Id.* at 49–50 (distinguishing the statutes in Rhode Island and Maine that expressly prevent employers from penalizing a person for using cannabis as a qualifying patient); *see also* MASS. GEN. LAWS ch. 94I § 2 (2017).

[64] *Barbuto*, 78 N.E.3d at 45; *see also* MASS. GEN. LAWS ch. 151B, § 4(16) (2016).

> Where no equally effective alternative exists, the employer bears the burden of proving that the employee's use of the medication would cause an undue hardship to the employer's business in order to justify the employer's refusal to make an exception to the drug policy reasonably to accommodate the medical needs of the handicapped employee.[65]

The majority of courts have rejected claims by medical cannabis users when the state cannabis program does not address employment rights, defaulting to the assumption that cannabis use deserves no protection in the workplace without some kind of affirmative legislative action.[66] This trend is illustrated in a recent New Jersey case.[67] After an employee hit his head on the jobsite, he refused to take a mandatory post-accident drug test because he was using Percocet and medical cannabis to ease the pain of a previous neck and back injury.[68] The employee offered to wean himself off Percocet, a powerful prescription drug, but the employer admitted that their concern was with his cannabis use.[69] The employee sued, claiming that his indefinite suspension for failing to take the drug test amounted to disability discrimination, and the employer removed the case to federal court.[70] The district court recognized that discriminating against a form of treatment can amount to disability

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[65] *Barbuto*, 78 N.E.3d at 45. The court observed that there would be a potential undue hardship if the employee's use of cannabis would violate the employer's legal or contractual obligations, as might be the case if the employer is subject to a drug free workplace requirement. *Id.*

[66] *See, e.g.*, Casias v. Wal-Mart Stores, Inc., 695 F.3d 428, 436 (6th Cir. 2012) (the Michigan medical cannabis statute does not prevent employers from firing employees who use medical cannabis); James v. City of Costa Mesa, 684 F.3d 825, 833 (9th Cir. 2012) (a suit under the Americans with Disabilities Act against localities not permitting medical cannabis must fail because the ADA does not protect cannabis use); Lambdin v. Marriott Resorts Hosp. Corp., No. 16-00004 HG-KJM, 2017 WL 4079718, at *10 (D. Haw. Sept. 14, 2017); Coles v. Harris Teeter, LLC, 217 F. Supp. 3d 185, 188 (D.D.C. 2016) (the statute "legalized the use of marijuana for certain medical purposes, but did not otherwise explicitly mandate that employers must tolerate that use."); Garcia v. Tractor Supply Co., 154 F. Supp. 3d 1225, 1229 (D.N.M. 2016) (federal law preempts the claim that the employer must accommodate cannabis use under the disability statute); Ross v. RagingWire Telecomm., Inc., 174 P.3d 200, 207 (Cal. 2008) ("In conclusion, given the Compassionate Use Act's modest objectives and the manner in which it was presented to the voters for adoption, we have no reason to conclude the voters intended to speak so broadly, and in a context so far removed from the criminal law, as to require employers to accommodate marijuana use"); Emerald Steel Fabricators, Inc. v. Bureau of Labor & Indus., 230 P.3d 518, 535 (Or. 2010) (holding that the state disability statute exemption for using "illegal" drugs applied to cannabis); Roe v. TeleTech Customer Care Mgmt. (Colo.) LLC, 257 P.3d 586, 591–92 (Wash. 2011).

[67] Cotto v. Ardagh Glass Packing, Inc., No. 18-1037 (RBK/AMD), 2018 WL 3814278, at *1 (D.N.J. Aug. 10, 2018).

[68] *Id.*

[69] *Id.*

[70] *Id.* at *2.

discrimination—for example, discriminating against an employee for using a wheelchair—but the court found that the employer may distinguish between use of a legal drug such as Percocet, and use of a (federally) illegal drug such as cannabis.[71] The court predicted that New Jersey state courts would follow the majority rule, noting that unless "expressly provided for by statute, most courts have concluded that the decriminalization of medical marijuana does not shield employees from adverse employment actions."[72] The import is clear: cannabis is highly suspect in the workplace and employees are not perceived as having any "right" to use medical cannabis if their employer disapproves.

We now turn to two social insurance programs that provide coverage for employees in case of injury or termination of employment. A number of courts have had to address the conflict between the public purpose of providing relief to workers who suffer an injury or loss, and the public purpose of discouraging the use of illegal drugs. The issues are brought into sharp relief when an employee using state-legal cannabis on her own time seeks recovery of workers' compensation or unemployment compensation benefits.

2. Workers' Compensation Insurance

Every state has a workers' compensation statutory scheme that pays benefits to workers who suffer injury arising out of and in the course of their employment. Workers' compensation statutes were enacted in response to the problems faced by employees who suffered workplace injury without an easy and available remedy, and the risks that employers faced under general tort law for negligence that led to an employee's injury.[73] Employers generally contract with an insurance company to cover this mandatory obligation. The insurance premiums are set, in part, based on the employer's loss experience,[74] and so it is in the employer's interest to contest claims that are not within the statutory terms of the insurance.

Workers' compensation programs typically establish a presumption that an injured worker who tests positive for illegal drugs was injured as a result of the use of such drugs, subject to the employee rebutting the presumption by proving that the use of illegal drugs did not proximately cause the loss.[75] This can pose a difficult

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[71] *Id.* at *5.

[72] *Id.* at *7.

[73] *See* Christopher F. Baum, *Uncovering the Roots: A Brief Discussion of the History, Policy and Purposes of Delaware's Workers' Compensation Act*, 16 DEL. L. REV. 1, 1–2 (2016).

[74] *How Is Your Workers' Comp Rate Calculated?*, PRIMEPAY (June 6, 2018), https://primepay.com/blog/how-your-workers-comp-rate-calculated.

[75] One might assume that the legality of the drug is irrelevant to the question of whether the claimant's injury arose out of intoxication, but courts have acknowledged the public policy against the use of illegal drugs in the workplace while respecting the need for employees to use prescription drugs that may also contribute to an injury. In *Kendrix v. Hollingsworth Concrete Prods., Inc.*, 553 S.E.2d 270, 271 (Ga. 2001), the court held that there was a rational basis to distinguish illegal

obstacle to recovery, particularly regarding alleged cannabis use. Consider the case in which an employee climbed onto a tree that had dropped into a creek before it could be dragged ashore for trimming, and was injured when he subsequently fell off the tree.[76] A mandatory post-accident drug test revealed 111 nanograms of cannabinoids, which was above the threshold limit of 100 nanograms.[77] The employee claimed that he was exposed to passive cannabis smoke that resulted in the low reading, and that he was not under the influence at the time the accident occurred.[78] The statute provided simply that no compensation shall be paid "if the intoxication of the employee was the proximate cause of the injury," and so the drug test did not give rise to a presumption of intoxication.[79] The court ruled that benefits were properly denied based on the combination of the drug test, an expert's testimony that cannabinoid levels wouldn't be above the threshold limit solely due to passive exposure, the claimant's previous conviction of two cannabis-related offenses, and the claimant's habits of spending break times by himself down the creek.[80] Given the inability of cannabinoid metabolites to establish intoxication at a particular point in time, it appears that a de facto presumption was at work in the court's decision.

A recent case shows the power of a statutory presumption that cannabis was the cause of the accident when an injured worker tests positive for cannabinoid metabolites.[81] A hospital employee fell and dislocated her shoulder, but the carrier denied coverage on the ground that she had failed to overcome the statutory presumption of intoxication triggered by the presence of cannabis metabolites in her body on the day of the accident.[82] The claimant called two experts who testified that the presence of metabolites does not prove impairment but, in the face of the presumption, this was insufficient because the experts could not establish from the drug test that she *wasn't* impaired.[83] The court rejected the dissenting judge's reasoning that the presumption should not arise without some showing of impairment, and that

drugs from prescription drugs which have dosages, limits on the duration of use, and limitations on activities permitted while taking the drugs. The court also acknowledged that public policy favored eliminating the use of illegal drugs. *Id.* ("We further conclude that distinguishing between legal and illegal drug use bears a direct and real relationship to the legitimate government objective of promoting a safe work place. The presumption . . . furthers the state's legitimate goal of reducing workplace accidents and increasing productivity by discouraging illegal drug use.").

[76] Edwards v. World Wide Pers. Servs., Inc., 843 So. 2d 730, 732 (Miss. Ct. App. 2002).

[77] *Id.*

[78] *Id.*

[79] *Id.*

[80] *Id.* at 733–34.

[81] Brinson v. Hosp. Housekeeping Servs., LLC, No. 1D17-505, 2018 WL 3079426, at *1 (Fla. Dist. Ct. App. June 22, 2018).

[82] *Id.*

[83] *Id.* at *1–2.

the presence of metabolites, as opposed to the drug itself, did not indicate impairment.[84] The majority indicated that the claimant would have had to submit evidence that her past cannabis use was not affecting her at the time of the accident, effectively requiring her to prove a negative.[85]

Some cases appear to interpret the presumption to mean that the claimant is denied benefits if he was under the influence at the time of the accident, even if the accident did not result from the intoxication. In one case, the employee was electrocuted while clearing downed trees when a nearby power line was suddenly energized.[86] The court denied benefits based on the presence of metabolites in the claimant, cannabis and related paraphernalia on his person, and an expert opinion that the claimant was under the influence at the time of the accident.[87] These facts obviously triggered the presumption, and the court upheld the Commission's finding that cannabis use rendered the claimant less "nimble" than the other workers who ran away from the energized line.[88] While facially reasonable, the dissenting judge emphasized that the circumstances of the accident effectively rebutted the statutory

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[84] *Id.* at *5; *see also* Graham v. Turnage Emp't Grp., 960 S.W.2d 453, 455 (Ark. Ct. App. 1998). The court deferred to a denial of benefits based on the presence of metabolites that the expert admitted could be consistent with the claimant not being impaired at the time, and rejected the claimant's testimony that he had not ingested cannabis for more than two weeks. *Id.* The dissent argued that there was "no proof that marijuana metabolites *are* marijuana, or that marijuana metabolites are even a drug, let alone an 'illegal drug.'" *Id.* at 458 (Griffen, J., dissenting). Judge Griffen reasoned:

> The General Assembly knew the difference between a drug and a by-product produced after a drug has been metabolized. The General Assembly made the rebuttable presumption dependent upon proof by a preponderance of the evidence that an illegal drug, and nothing less, was present in connection with an injury for which workers' compensation benefits are sought. . . .
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> . . . If an injury must be substantially occasioned "by the use of illegal drugs" in order to disqualify a worker from receiving workers' compensation benefits, it makes no sense to deny benefits based on that defense when the parties who assert the defense are unable to prove that "illegal drugs" are present, let alone that they substantially occasioned the injury.

Id. at 459.

[85] *See Brinson*, 2018 WL 3079426 at *1. The dissenting judge emphasized that the claimant:

> like similarly situated injured employees with inactive metabolites in their system—couldn't have done anything more than she did to rebut the statutory presumption. . . . Beyond no evidence of impairment or recent drug use and no suspicion of either, [the claimant] presented unrebutted and supportive expert medical testimony that was fully consistent with the medical literature on marijuana detection and impairment.

Id. at *5 (Makar, J., dissenting).

[86] Wood v. W. Tree Serv., 14 S.W.3d 883, 884 (Ark. Ct. App. 2000).

[87] *Id.* at 885–86.

[88] *Id.* at 887.

presumption.[89] The power line fell directly onto the claimant after suddenly becoming energized.[90] It was only after striking him and hitting the wet ground and "sparking" that the crew recognized the danger.[91] No matter how intoxicated the worker may have been at the time, cannabis would not appear to have been the proximate cause of the fatal injury.

In contrast, other courts have refused to conflate evidence of past cannabis use with proof of incapacity at the time of the accident. One case involved an orderly who injured his back while attempting to rescue a struggling quadriplegic who slipped out of his whirlpool chair.[92] After testing positive for cannabis use, the orderly testified that he stopped using cannabis before starting the job, and that he was not under the influence at the time of the accident, although he had been exposed to passive smoke.[93] The court upheld the finding that the claimant had rebutted the presumption:

> In finding that Kennedy rebutted the presumption of intoxication, the workers' compensation judge held that this was not the sort of accident which was caused by intoxication. He stated that the accident was caused by Lee flailing around in the chair, which was confirmed [by coworkers] . . . . After reviewing the record, we cannot say that the workers' compensation judge erred in finding that Kennedy rebutted the presumption of intoxication.[94]

Similar cases suggest that not all courts interpret the statutory presumption as nearly impossible to rebut.[95]

In some states, a strong statutory presumption may be subject to procedural requirements regarding drug tests that may provide some relief to a claimant who tests positive for cannabis metabolites. In one case, the statutory presumption was particularly strong:

> If *any* amount of marijuana . . . is in the employee's blood *within eight hours* of the time of the alleged accident, as shown by chemical analysis of the employee's blood, urine, breath, or other bodily substance, there shall be a *rebuttable presumption* that the accident and injury or death were *caused* by the ingestion of marijuana.[96]

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[89] *Id.* at 886.

[90] *Id.* at 887.

[91] *Id.*

[92] Kennedy v. Camellia Garden Manor, 838 So. 2d 99, 100 (La. Ct. App. 2003).

[93] *Id.* at 104.

[94] *Id.*

[95] *See, e.g.*, Hogg v. Okla. Cty. Juvenile Bureau, 292 P.3d 29, 35 (Okla. 2012).

[96] Lingo v. Early Cty. Gin Inc., 816 S.E.2d 54, 57 (Ga. Ct. App. 2018) (quoting OCGA § 34-9-17(b)(2)) (emphasis added).

The claimant worked at a loading dock where he helped trucks back into bays.[97] While sweeping a bay, the claimant was struck by a truck backing up without a warning beeper, and was crushed against the loading dock.[98] There was conflicting evidence whether the sound of the backing truck without a beeper could be heard above the din of the loading dock.[99] A lab technician was sent to the hospital to gather a urine sample from the injured employee who was in emergency surgery.[100] A nurse emerged from the operating room with a sample that tested positive for cannabis, but there was no indication of who obtained the sample or the procedures used to do so.[101] Because the employer could not demonstrate that it adhered to the statutory requirements for obtaining the sample for a drug test, the court held that the statutory presumption that cannabis use caused the accident was not triggered and the case was remanded.[102]

It is clear that it would be extremely difficult to overcome the statutory presumption in this case in the absence of the drug testing procedure issue. The claimant's expert testified that "only a blood plasma test accurately reveals the extent to which marijuana is currently affecting cognition," because the metabolites in the urine sample could persist for weeks after ingestion.[103] The claimant admitted smoking cannabis, but testified that he was never under the influence on the job and no cannabis or related paraphernalia was found on his person after the accident.[104] Most courts would find this evidence insufficient to prove that cannabis was not the cause of the accident.

These cases illustrate the conundrum raised if an employee uses state-legal cannabis but then confronts a presumption in the workers' compensation program that denies benefits on that basis alone, without affirmative proof that intoxication proximately caused the accident. Because employers are legally able to insist on a drug free workplace, and in some instances are compelled by federal rules to do so, workers' compensation programs that express disapproval of employee cannabis use are

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[97] *Id.* at 56.

[98] *Id.*

[99] *Id.*

[100] *Id.*

[101] *Id.* at 57.

[102] *Id.* at 58–59. The court emphasized the remedial nature of workers' compensation laws and the need to read the procedural requirements for drug testing strictly before denying benefits to an injured worker. *Id.* This amounts to the court elevating the public policy of compensating a severely injured worker above the competing public policy of presuming drug users to be at fault in workplace accidents.

[103] *Id.* at 57.

[104] *Id.* A co-employee testified for the employer that he regularly smoked cannabis with the claimant at the job site and that they had smoked prior to the accident, but the ALJ found the testimony to have "significant discrepancies" and deemed him to lack credibility. *Id.*

not particularly surprising.[105] As the cases above demonstrate, courts vary in their interpretation of the strength of the statutory presumption. There is likely to be pressure on legislatures and courts to ease the conflict with the state's cannabis laws.

The conflict of policies is heightened when the question is not about eligibility for benefits, but rather the ability of the injured employee to receive reimbursement for medical cannabis used to treat the workplace injury. In some instances, employers have successfully argued that requiring them to reimburse an injured employee for purchases of medical cannabis amounts to making them complicit in illegal behavior under federal law. In one case, the opioids prescribed for the injured worker's chronic back pain caused side effects, and so the worker switched to medical cannabis on his doctor's recommendation.[106] The Hearing Officer ordered the employer, Twin Rivers, to pay for the cannabis treatment, but Twin Rivers argued that the federal Controlled Substances Act preempted any obligation under state law to reimburse the injured worker.[107] The court noted that Twin Rivers would be exposed to criminal charges for aiding and abetting a violation of the Controlled Substances Act.[108] The court concluded that "a person's right to use medical marijuana cannot be converted into a sword that would require another party, such as Twin Rivers, to engage in conduct that would violate the CSA."[109] The low probability that the federal government would actually bring charges in this case was irrelevant to the court's legal analysis.[110]

Two members of the court dissented vigorously. Justice Jabar contested the analysis that merely reimbursing a person for the cost of medical cannabis amounted to having the requisite *mens rea* for aiding and abetting the federal crime of purchasing the cannabis.[111] Additionally, the use of cannabis was deemed "reasonable and

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[105] Jay M. Zitter, *Propriety of Employer's Discharge of or Failure to Hire Employee Due to Employee's Use of Medical Marijuana*, 57 A.L.R. 6th 285, at *2 (West 2010).

[106] Bourgoin v. Twin Rivers Paper Co., LLC, 187 A.3d 10, 13 (Me. 2018).

[107] *Id.*

[108] *Id.* at 19. The court explained:

> Were Twin Rivers to comply with the hearing officer's order and knowingly reimburse Bourgoin for the cost of the medical marijuana as permitted by the [state medical cannabis law], Twin Rivers would necessarily engage in conduct made criminal by the CSA because Twin Rivers would be aiding and abetting Bourgoin—in his purchase, possession, and use of marijuana—by acting with knowledge that it was subsidizing Bourgoin's purchase of marijuana.

Id.

[109] *Id.* at 20.

[110] *Id.* at 21–22. Congress has withheld funding to the Justice Department to prosecute cannabis crimes against individuals acting in full compliance with state-legal medical cannabis programs under what is known as the Rohrabacher-Farr amendment. *See id.* at 28, n.12 (Jabar, J., dissenting).

[111] *Id.* at 25, 27 (Jabar, J, dissenting); *see also* Transcript of Oral Argument at 11, McNeary v. Freehold Township, No. 2008-8094 (N.J. Workmen's Comp. Div. June 28, 2018) ("Certainly I [the judge] don't understand how a carrier, who will never possess, never distribute, never intend

proper" by the treating physicians and proved to be effective in addressing the chronic pain.[112] Justice Alexander highlighted this last point:

> [In] the extensive discussion of the law of preemption, we must not lose sight of the injured worker whom this opinion is really about.
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> Gaetan Bourgoin has endured chronic, disabling pain from a workplace injury that he sustained three decades ago. The result of the Court's opinion today is to deprive Bourgoin of reimbursement for medication that has finally given him relief from his chronic pain, and to perhaps force him to return to the use of opioids and other drugs that failed to relieve his pain and may have placed Bourgoin's life at risk.[113]

The opinions in this recent case succinctly illustrate the dilemma of addressing state-legal cannabis under insurance policies.

In contrast, the New Mexico Court of Appeals has fully embraced the availability of medical cannabis as a treatment for workplace injuries under the workers' compensation program. In 2014, the court held that the workers' compensation act, properly interpreted, permits reimbursement of medical cannabis to treat workplace injuries.[114] The case involved a worker who had undergone numerous surgeries to address a lower back injury, resulting in intense pain that could not be controlled by narcotics, leading the workers' compensation judge to approve the use of cannabis.[115] The employer argued that cannabis is not a "prescription drug," nor is it dispensed by a "health care provider," as required under the workers' compensation program requirements, but the court read the act consistent with the medical cannabis act to find that cannabis could be a "service" for which reimbursement is provided under the program.[116] The court upheld the clear public policy favoring medical cannabis under state law and declined "to reverse the order on the basis of federal law or public policy."[117]

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to distribute these products . . . is in any way complicit with the distribution of illicit narcotics."). One commentator, discussing *McNeary*, explained that "[t]he court further reasoned that ordering payment for medical marijuana would not require an insurer to violate federal law because the insurer would not be required to possess or distribute marijuana" and noted the benefits of cannabis when compared to opioid drugs. Bartlome, *supra* note 15, at 40.

[112] *Bourgoin*, 187 A.3d at 31.

[113] *Id.* at 32 (Alexander, J., dissenting).

[114] Vialpando v. Ben's Auto. Servs., 331 P.3d 975, 976 (N.M. Ct. App. 2014).

[115] *Id.* at 976–77.

[116] *Id.* at 978–79.

[117] *Id.* at 980.

The following year, the court addressed whether a claimant had demonstrated that the use of cannabis was "reasonable and necessary" after the workers' compensation judge ruled against the claimant.[118] The claimant had been prescribed multiple pain killers and spinal injections to no avail, and he began using cannabis on his own.[119] His doctor urged him to obtain a license to use cannabis or he could no longer prescribe narcotics, although the doctor made clear that he was not advocating the use of cannabis.[120] Given this context, the employer argued that the cannabis use was "tolerated" rather than "reasonable and necessary" medical treatment, but the court found sufficient evidence to overturn the initial ruling by the workers' compensation judge: "The facts that Dr. Reeve did not initiate or recommend to Worker such care are not dispositive. Regardless of whether he took such action or was merely 'passive' as Employer contends, Dr. Reeve adopted a treatment plan that called for medical marijuana."[121] The court further concluded that the claimant did not refuse reasonable and necessary treatment with painkillers, because the evidence showed that this treatment had failed.[122]

When courts permit workers' compensation carriers to reimburse the cost of cannabis, difficult questions arise due to the lack of reliable data regarding dosage and effectiveness. For example, in a recent case a court had to determine whether the claimant was entitled to reimbursement for the use of "prodigious amounts" of cannabis in the first six months of treatment, and $21,000 worth of cannabis in the first year.[123] The employer argued that this amounted to "drug abuse, pure and simple" and refused to reimburse this amount.[124] On the other hand, the claimant had suffered a serious back injury that required three surgeries and left him in pain.[125] He argued that it took some amount of experimentation with different ratios of THC and CBD content to find the optimum treatment, and he moderated his use after determining the right mix.[126] The court upheld the order to reimburse the claimant, finding that the need to experiment with dosages was unavoidable:

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[118] Maez v. Riley Indus., 347 P.3d 732, 733 (N.M. Ct. App. 2015).

[119] *Id.* at 734.

[120] *Id.*

[121] *Id.* at 737.

[122] *Id.* at 738. A short time later, the court reaffirmed the holding in *Vialpando*. After the treating physician recommended cannabis when numerous pain drugs had failed, the court approved the expenses as reasonable and necessary. "In view of the equivocal federal policy and the clear New Mexico policy as expressed in the Compassionate Use Act, we decline to reverse the [workers' compensation judge's] amended compensation order." Lewis v. Am. Gen. Media, 355 P.3d 850, 858 (N.M. Ct. App. 2015).

[123] Giles & Ransome v. Kalix, No. N17A-10-001 CEB, 2018 WL 4922911, at *2 (Del. Super. Ct. Oct. 9, 2018).

[124] *Id.*

[125] *Id.* at *1.

[126] *Id.* at *2.

> It may well be that as the science of medical marijuana develops, there will develop a more precise dosage and modality for specific symptoms that would permit a more limited range of prescribed dosages. But given the novelty of medical marijuana and the statutorily authorized dosage parameters set by the General Assembly, the Court cannot conclude that the Board abused its discretion in requiring the employer to reimburse the claimant for his experimentation phase of this new treatment.[127]

Similar issues will continue to arise, given what the court terms the "novelty" of cannabis.

In the past several years, the advent of state-legal cannabis has raised difficult legal questions under workers' compensation programs with regard to the claimant's qualification to receive benefits and whether cannabis may be a covered treatment. These emerging issues reflect the conflict between public policy favoring coverage and (federal) public policy disfavoring the use of cannabis. We turn now to a similar social insurance program where these same issues are beginning to arise: unemployment compensation.

3. Unemployment Compensation Insurance

Unemployment compensation programs were authorized by the Social Security Act of 1935 to address the great hardship suffered by millions of workers fired during the Great Depression, with the federal law setting the baseline, but leaving the details and administration to individual states.[128] This social insurance initiative is meant to provide a source of replacement income on a temporary basis after an employee loses a job and serves several important purposes.[129] First, of course, the program mitigates the economic distress caused by the employee's loss of a job.[130] Second, it mitigates the potential for a cumulative effect on large scale unemployment in a community by ensuring that laid off employees can continue to shop for necessities.[131] Finally, the program provides a disincentive to firing workers, because premiums are in part determined by the employer's experience rating.[132]

As with many social insurance programs in the United States, eligibility is often keyed to the idea of a "deserving" recipient.[133] For example, an employee fired for misconduct is not eligible for benefits because the termination of employment is

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[127] *Id.* at *4.

[128] Social Security Act of 1935, tit. III (codified as amended at 42 U.S.C. §§ 501–504 (2018)); *see also* 76 AM. JUR. 2D *Unemployment Compensation* § 6, Westlaw (updated Apr. 2019).

[129] Daniel N. Price, *Unemployment Insurance, Then and Now: 1935-85*, 48 SOC. SECURITY BULL., Oct. 1985, at 22, 24.

[130] *Id.*

[131] *Id.*

[132] *Id.* at 23–24.

[133] *Id.* at 24.

deemed to be "deserved" to some extent.[134] It should come as no surprise that the typical unemployment compensation program includes an exception for workers who are fired after testing positive for cannabis use.[135] As we discussed above, states typically require an employer to make reasonable accommodation for an employee's cannabis use off site only when the state statute expressly requires the employer to do so. The following cases illustrate how unemployment compensation programs address the issue of benefit eligibility after termination for cannabis use.

The Colorado Court of Appeals determined that a worker could be denied unemployment compensation when he was terminated for violating the employer's zero-tolerance drug policy.[136] The worker cleaned streets with a broom and dustpan and used medical cannabis outside the workplace to treat severe headaches.[137] Because cannabis is not "prescribed," it did not fall within the "medically prescribed controlled substance" exception to the disqualification for benefits for drug use.[138] Noting that the constitutional amendment legalizing medical cannabis merely protects citizens from criminal charges, and that the amendment specifically provides that employers are not obligated to accommodate medical use of cannabis in the workplace, the court determined that termination for use of cannabis did not qualify the employee for benefits.[139] The dissenting judge argued that off site use is protected by the constitution, and that the state could not deny unemployment compensation in an effort to deter the employee from exercising "his constitutional right to use medical marijuana."[140]

The Michigan Court of Appeals reached the opposite conclusion in three consolidated appeals that considered whether an employee registered for medical cannabis use may be disqualified from receiving unemployment compensation after being fired for failing to pass a drug test as a result of cannabis use.[141] The court began by noting the conflict between the unemployment compensation program and the protections afforded by the medical cannabis law. On the one hand, an employee is disqualified from receiving unemployment compensation benefits if he tests positive for drug use, and the medical cannabis statute makes clear that employers are not

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[134] *Id.* at 30.

[135] *See generally* Gavin L. Phillips, Annotation, *Employee's Use of Drugs or Narcotics, or Related Problems, as Affecting Eligibility for Unemployment Compensation*, 78 A.L.R. 4TH 180 §§ 3–9 (1990) (discussing scenarios in which employee drug use either on or off the job site premises affected recovery of unemployment compensation).

[136] Benoir v. Indus. Claim Appeals Office, 262 P.3d 970, 974–75 (Colo. App. 2011).

[137] *Id.* at 972.

[138] *Id.* at 974–75.

[139] *Id.* at 975–76.

[140] *Id.* at 982 (Gabriel, J., dissenting).

[141] Braska v. Challenge Mfg. Co., 861 N.W.2d 289, 291 (Mich. Ct. App. 2014).

required to accommodate use of cannabis in the workplace, nor working while under the influence of cannabis.[142] On the other hand, the medical cannabis statute provides that registered patients will not be subject to "penalty in any manner," and nothing in the law relieves the employer of having to accommodate medical use off site.[143] The court stated that the "issue is whether, by denying unemployment benefits . . . a state actor . . . imposed a penalty on claimants that ran afoul of the [medical cannabis statute's] broad immunity clause."[144] Given the broad protection against any manner of criminal and civil penalties, the court concluded that an employee cannot be disqualified for benefits solely because he engages in off-site use of medical cannabis.[145]

In this Part, we have illustrated some of the issues that arise under first-party and third-party insurance policies that were not written with the state-legal cannabis business in mind. Courts have balanced competing public policy interests in this space, leading to unpredictability for carriers and policyholders alike.

We now turn to consider the emerging insurance market for the state-legal cannabis industry that offers products specifically designed to protect cannabis operators and consumers from losses arising out of state-legal cannabis activities. Because this industry is still relatively new, carriers face significant challenges in underwriting the risks and policyholders face challenges in securing adequate and effective coverage.

II. CANNABIS INSURANCE POLICIES

In this Part, we analyze insurance products that have been designed specifically to provide coverage for businesses operating within the scope of state-legal cannabis regimes. Given the complexity of the different regulatory regimes, we concentrate on California, which is the largest state cannabis market. We discussed the celebrated *Atain* decision above, in which the court rejected the insurer's effort to avoid liability on the ground that insuring cannabis activities is against public policy, given that the insurer had knowingly and expressly undertaken this risk. This single opinion has set the stage for insurers covering participants in the state-legal cannabis industry. Whatever effect public policy may have in construing general insurance policies that were not written with state-legal cannabis in mind, insurers are unlikely to casually write insurance for cannabis businesses with the expectation that public policy arguments may let them escape their obligations. Perhaps as a result, the number of insurers that have been willing to enter the state-legal cannabis insurance

[142] *Id.* at 296–97.

[143] *Id.* at 298–300.

[144] *Id.* at 301.

[145] *Id.* at 302. The court distinguished the *Benoir* case, which considered a constitutional amendment that merely insulated medical cannabis users from criminal prosecution. *Id.*

markets has remained limited, and the policies have generally been narrow and cautiously drafted.

In this Part, we also discuss the availability and effectiveness of coverage options for operators in state-legal cannabis markets. Although insurance options remain far more limited than those available to similarly sized industries, the number of carriers serving the industry has increased steadily in recent years. However, the policies that are currently available to the industry are often unreasonably restrictive and at times render coverage illusory. Cannabis operators are best counseled to seek expert advice in choosing a carrier and program of coverage.

Coverage options will almost certainly remain relatively limited and unduly narrow until cannabis is legalized at the federal level. Some form of federal legalization of cannabis is likely to take place within the next five years, if not sooner, and we believe that carriers will then flock to an industry that presents significant growth opportunity. When this happens, carriers will begin competing in earnest with regard to scope of coverage, pricing, and affiliated services such as loss prevention programs. Until then, the availability and quality of insurance coverage in the cannabis industry will develop at a slow pace, but will continue to improve as a small group of carriers seek a head start in acquiring market share in the United States.

We conclude that the evident clash of public policies is destabilizing for the insurance market. Courts and regulators embrace the goal of protecting injured members of the public and they also embrace the goal of insurance not serving to motivate federally illegal behavior. Until a definitive federal solution presents itself, this tension will remain.

A. The Lack of Robust Competition in Cannabis Insurance Markets

1. Admitted Versus Surplus Lines Carriers

Until 2018, all of the insurance carriers knowingly selling insurance policies to cannabis businesses in California have been "surplus lines" carriers. Surplus lines insurance carriers must satisfy some regulatory requirements in the state,[146] but, unlike "admitted" carriers, they retain significant control and flexibility with regard to both the policy forms they use and the rates that they charge.[147] Surplus lines carriers generally fill the gap when insureds are seeking coverage that admitted insurance carriers are not willing to offer to satisfy the market.[148] Given federal illegality, most admitted carriers have long shied away from knowingly insuring cannabis-related businesses, leaving the market to entrepreneurial surplus lines carriers.

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[146] *See, e.g.*, CAL. INS. CODE § 1760.2 (West 2019); COLO. REV. STAT. § 10-5-105 (2016); NEV. REV. STAT. § 685A.090 (2011); WASH. REV. CODE § 48.15.040 (2017).

[147] Laura Zaroski, *Resolving the Confusion About "Admitted" and "Non-Admitted" Carriers*, INS. THOUGHT LEADERSHIP (Sept. 24, 2013), http://insurancethoughtleadership.com/admitted-v-non-admitted-whats-the-difference/.

[148] *Id.*

Recently, however, admitted carriers have begun to provide options for the state-legal cannabis industry in California. Much of the credit (or blame) for this milestone is due to former California Insurance Commissioner Dave Jones. Beginning in early 2017, Commissioner Jones began aggressively lobbying California's admitted insurers to begin serving the cannabis industry.[149] Just days before he began this push, California regulators had proposed a requirement on many of the state's cannabis operators that they carry insurance provided by a carrier "authorized to do business in California by the Secretary of State."[150] As some prominent legal commentators noted, this proposal was at odds with the reality of the cannabis insurance markets, which were exclusively served by surplus lines carriers.[151] Many, including the authors of this Article, suspected that the proposed rule was something of a "head-fake" directed at the insurance industry, deliberately timed to coincide with Jones's push for admitted carriers to jump into the industry.[152] Commissioner Jones was convinced that admitted carriers would introduce competition and stability to the state cannabis insurance market. Nevertheless, in a bow to reality, the final version of the regulations expressly stated that the cannabis operators subject to these insurance requirements could satisfy them through surplus lines carriers.[153]

Commissioner Jones was ultimately successful in persuading admitted insurance carriers to enter California's cannabis insurance market. He proudly announced the impending arrival of an admitted cannabis insurance product at the California Cannabis Industry Association's Business Conference in September of 2017.[154] At that time, 25 surplus lines carriers were serving the industry.[155] This is

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[149] Ian A. Stewart & Dean A. Rocco, *California's Insurance Commissioner Encourages Admitted Carriers to Insure Cannabis Risks*, NAT'L L. REV. (May 24, 2017), https://www.natlawreview.com/article/california-s-insurance-commissioner-encourages-admitted-carriers-to-insure-cannabis.

[150] BUREAU OF MARIJUANA CONTROL, PROPOSED TEXT OF REGULATIONS § 5108, https://www.bcc.ca.gov/law_regs/mcrsa_ptor.pdf.

[151] Stewart & Rocco, *supra* note 149.

[152] Jason M. Horst, *California's Cannabis Insurance Field of Dreams*, HORST LEGAL COUNS.: THC BLOG (June 8, 2017), https://www.horstcounsel.com/single-post/2016/05/08/Navigating-medical-malpractice-lawsuits-1.

[153] CAL. CODE REGS. tit. 16, § 5308 (2017).

[154] Jason M. Horst, *Admitted Carriers Offer Some Benefits, Some Dangers for Cannabis Industry*, HORST LEGAL COUNS.: THC BLOG (Oct. 2, 2017), https://www.horstcounsel.com/single-post/2017/10/02/Admitted-Carriers-Offer-Some-Benefits-Some-Dangers-for-Cannabis-Industry.

[155] Cal. Dep't of Ins., *Comments of Commissioner Dave Jones, Cannabis Public Hearing*, YOUTUBE (Oct. 19, 2017), https://www.youtube.com/watch?v=dXoI8sVGRXA&feature=youtu.be (comments made at 1:27:17).

only a fraction of the number of surplus lines carriers serving more traditional industries.[156] Additionally, only a handful of these surplus lines carriers offered the core property and casualty insurance policies that are critical risk management tools for a well-functioning business.[157] The lack of comprehensive coverage likely is due to the fact that these coverages force carriers to indemnify losses that directly relate to cannabis products. The same unusual risk factors that had kept admitted insurers away from the industry have led most surplus lines carriers to sharply restrict coverage.

On November 2, 2017, Golden Bear Insurance Company became the nation's first admitted insurance carrier to offer a policy to licensed operators in the cannabis industry.[158] In the year that followed, Golden Bear was joined by roughly a half-dozen other admitted insurers in serving the California cannabis market.[159] This was a major success for Commissioner Jones, but the issues related to cannabis insurance were not magically solved in one fell swoop. Admitted carriers certainly offer significant consumer benefits in established insurance markets. Admitted carriers file standard policy forms and rate information with the state.[160] These forms and rates must be approved by the state,[161] and thus an admitted carrier generally offers consumers solid policy terms for standard business risks and lower rates than are

[156] *List of Approved Surplus Line Insurers*, CAL. DEP'T INS. (Feb. 5, 2019), http://www.insurance.ca.gov/01-consumers/120-company/07-lasli/lasli.cfm. There are currently 126 surplus line carriers serving California.

[157] Such coverages include commercial general liability, products liability, and property insurance.

[158] Press Release, Cal. Dep't Ins., First Commercial Insurer to File Cannabis Business Insurance Is Approved by Insurance Commissioner, (Nov. 2, 2017), http://www.insurance.ca.gov/0400-news/0100-press-releases/archives/release119-17.cfm; *How to Cover the Cannabis Sector from a Broker Who's Deep in the Weeds*, GOLDEN BEAR (May 18, 2018), https://www.goldenbear.com/news/how-to-cover-the-cannabis-sector-from-a-broker-whos-deep-in-the-weeds/.

[159] Press Release, Cal. Dep't Ins., Cannabis Coverage Approved for Three Insurance Carriers, (Aug. 2, 2018), http://www.insurance.ca.gov/0400-news/0100-press-releases/2018/release088-18.cfm; Press Release, Cal. Dep't Ins., Commissioner Approves New Product Liability Program for Cannabis Industry, (May 16, 2018), http://www.insurance.ca.gov/0400-news/0100-press-releases/2018/release055-18.cfm; Press Release, Cal. Dep't Ins., Insurance Commissioner Approves First Coverage to Protect Property Owners Leasing to Cannabis Industry, (May 1, 2018), http://www.insurance.ca.gov/0400-news/0100-press-releases/2018/release046-18.cfm.

[160] *See, e.g.*, *Applications, Forms & Filings*, CAL. DEP'T INS., http://www.insurance.ca.gov/0250-insurers/0300-insurers/0100-applications/index.cfm (last visited Mar. 1, 2019); *Rate Filings*, CAL. DEP'T INS., http://www.insurance.ca.gov/0250-insurers/0800-rate-filings/ (last visited Mar. 1, 2019).

[161] *Surplus Lines*, 110 REG. SURVEYS 12, West (updated June 2018).

available through surplus lines carriers. Additionally, the financial stability of admitted insurance carriers is generally guaranteed by the states that admit them,[162] thereby protecting the insured against the possibility of the carriers' insolvency.

However, the advantages of an admitted carrier are not as obvious in the state-legal cannabis sector, which is different in material ways from the established markets typically served by admitted insurers. The rules under which cannabis licenseholders must operate are often being written and rewritten at the same time that businesses are seeking insurance coverage. In California, there have been several global changes to the actual and proposed cannabis laws and regulations since its voters approved cannabis for adult use in November of 2016.[163] Changes in rules and governing regulations have an impact on the scope of the risk being insured. It is also likely that state adult-use legalization, a relatively novel phenomenon, will increase the number and scale of claims against cannabis operators. This is so not only because there are more consumers and companies interacting, but also because cannabis companies now have greater perceived legitimacy and solvency than they did before adult-use legalization. Additionally, of course, cannabis remains illegal under federal law, subjecting those who interact with cannabis companies to potential criminal liability and asset forfeiture.[164] Indeed, the federal government has continued to frustrate cannabis operators and ancillary businesses through its pendulum-like movements between threats of enforcement against state-legal markets and movement toward some form of federal legalization.[165] All of this has an impact on the terms on which insurers are willing to offer coverage to cannabis businesses.

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[162] *See, e.g.*, CAL. INS. CODE § 1063.14 (West 2019).

[163] *See* CAL. BUS. & PROF. CODE §§ 26000–26250 (West 2019); S.B. 837, 2015–16 Leg. Sess. (Cal. 2016); *see generally* CAL. CODE REGS. tit. 16, div. 42 (2017) (Bureau of Cannabis Control final proposed regulations that are, at the time of this writing, under review by the California Office of Administrative Law).

[164] 21 U.S.C. § 812 (2012) (Schedule I drug); *Id.* § 812(c)(10) (criminal asset forfeiture).

[165] *See* 160 CONG. REC. H4982-85 (daily ed. May 29, 2014) (statement of Rep. Rohrabacher) (introducing and discussing House Amendment 748 to H.R. 4660, which would prohibit the Department of Justice from using federal funds to restrict states from implementing the legalization of medical marijuana); Memorandum from Jefferson B. Sessions, Att'y Gen., to U.S. Att'ys, Marijuana Enf't (Jan. 4, 2018), https://www.justice.gov/opa/press-release/file/1022196/download; Memorandum from James M. Cole, Deputy Att'y Gen., to U.S. Att'ys, Guidance Regarding the Ogden Memo in Jurisdictions Seeking to Authorize Marijuana for Med. Use (June 29, 2011), https://www.justice.gov/sites/default/files/oip/legacy/2014/07/23/dag-guidance-2011-for-medical-marijuana-use.pdf; David Downs, *San Jose Dispensary Landlords Threatened with 40 Years in Prison as Feds' Marijuana Crackdown Continues,* EAST BAY EXPRESS (Apr. 30, 2013), https://www.eastbayexpress.com/LegalizationNation/archives/2013/04/30/breaking-news-san-jose-dispensary-landlords-threatened-with-40-years-prison-as-feds-marijuana-crackdown-continues.

The turbulence and uncertainty involved with operating within the cannabis industry makes it more challenging for insurance actuaries and underwriters to reliably assess risks, determine appropriate premiums, and evaluate applicants. If frequent changes to governing rules require carriers to adjust their forms, insurers must be remarkably nimble. For example, if a risk previously perceived to be *de minimis* becomes more significant or more likely to occur due to a new regulatory requirement, premiums may have to be adjusted. Admitted carriers, however, lack flexibility. The state Department of Insurance must approve any changes to their forms or rates, a process that generally takes months. The practical result, as discussed below, is that admitted insurance carriers in the cannabis industry have tended to err on the side of high premiums, overly restrictive policy forms, or both.

The other significant traditional benefit of buying admitted insurance is also not necessarily present in the cannabis industry. Financial backstopping by the state is largely overrated because policyholders have access to rating services, such as AM Best's, that provide objective, non-biased analyses regarding the financial strength of most surplus lines insurers. In short, the entry of a handful of admitted insurance carriers is not likely to be a panacea for the lack of quality insurance forms designed for the cannabis insurance markets for sale at an appropriate price.

2. Lack of Complete Coverage for Cannabis Operators

The cautious entrance to the cannabis market by admitted and surplus lines carriers poses a significant challenge for many cannabis operators to obtain all of the lines of coverage critical to effective risk management. In particular, outdoor cannabis cultivators and companies that transport cannabis and cash from one cannabis operator to another have found that effective insurance products are difficult to find. For the outdoor cultivators, obtaining first-party property insurance for their crops against theft and damage remains largely impossible.[166] Carriers are unwilling to brave the risks of loss to a high value crop when grown in the high hazard manner that is characteristic of outdoor cultivation. In particular, outdoor cultivation exposes cannabis to the elements and lacks the protections from accidental adulteration of crops that four walls and a roof provide to indoor and greenhouse cultivators.[167] Pesticides strictly prohibited for use in cannabis operations may drift from neighboring non-cannabis farms.[168] Severe weather may ruin entire harvests. Additionally, as California growers over the past two years have tragically witnessed,

[166] Bethan Moorcraft, *Outdoor Cannabis Growers Lack Insurance Options—What Can Be Done?*, BUS. INS. (Oct. 17, 2018), https://www.insurancebusinessmag.com/ca/market-analysis/outdoor-cannabis-growers-lack-insurance-options—what-can-be-done-113996.aspx.

[167] *Id.*

[168] Mateusz Perkowski, *Marijuana Pesticide Contamination Worries Oregon Farmers*, CAP. PRESS (Dec. 10, 2018), https://www.capitalpress.com/state/oregon/marijuana-pesticide-contamination-worries-oregon-farmers/article_303327ce-fa5d-11e8-b01f-d3b7bdf5bfde.html.

farms in the California woods are far more susceptible to wildfire damage.[169] Moreover, the federal crop insurance program, which has supported the agricultural industry through heavily subsidized insurance rates, is unavailable to cannabis growers because of the continuing federal illegality of the crop.[170]

The ability to recover for crop damage is critical to the cannabis farmer, but such losses can also have a significant impact on cannabis consumers. Although much commercial cannabis cultivation has moved into warehouses and greenhouses, roughly one-third of the 3,490 cultivation licenses issued as of April 2018 were for small outdoor cultivation operations.[171] This includes companies that are "stacking" numerous small licenses to create large farms, some of which are as large as 26 acres.[172] If outdoor crop losses routinely cripple the outdoor growers, then there will be reverberations flowing along the companies in the supply chain, until the ultimate impact on consumers in the form of higher prices and shortages of product.

Cannabis operators have also found that it is incredibly challenging to obtain stock throughput insurance. Stock throughput is another type of first-party property coverage, but with a twist. It is a type of inland marine coverage, designed to protect against losses to property in transit. Cannabis distributors that transport hundreds of thousands of dollars of cannabis products from farms in Humboldt County in Northern California to manufactures or dispensaries in Southern California seek insurance for the cannabis traveling south and the cash transported back north.[173]

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[169] Aaron Smith, *Marijuana Farms Are Burning in California Wildfires,* CNN (Oct. 12, 2017, 10:23 AM), https://money.cnn.com/2017/10/12/smallbusiness/california-cannabis-fires/index.html.

[170] *See* Mootz, *supra* note 4, at 64–65.

[171] Brooke Edwards Staggs, *So Far, California Has 6,000 Licensed Cannabis Businesses. Here's What that Looks Like*, CANNIFORNIAN (Apr. 30, 2018), http://www.thecannifornian.com/cannabis-news/california-news/far-california-6000-licensed-cannabis-businesses-heres-looks-like/.

[172] *Id.*

[173] Because cannabis remains illegal under federal law, many banking institutions were reluctant to accept proceeds for deposit. This problem has eased over the past year, but many businesses necessarily have large amounts of cash on hand that must be protected. *See* B.U. Sch. L., *Developments in Banking and Financial Law: 2015*, 35 REV. BANKING & FIN. L. 1, 77–78 (2015); Julie Andersen Hill, *Banks, Marijuana, and Federalism*, 65 CASE W. RES. L. REV. 597, 597 (2015) (presenting a comprehensive review of federal laws, regulations, and guidance that would need to be changed to permit state banking cooperatives to satisfy the needs of the industry); James A. Kohl, *Nascent Marijuana Industry Struggles for Access to Normal Financing*, NEV. LAW., Nov. 2015, at 16, 16; Rachel Cheasty Sanders, *To Weed or Not to Weed? The Colorado Quandary of Legitimate Marijuana Businesses and the Financial Institutions Who Are Unable to Serve Them*, 120 PENN. ST. L. REV. 281, 306 (2015) (detailing the many legal issues and the inability of state cooperatives to replace the full services of a bank); Peter Fimrite, *Public Banking Plan for California's Marijuana Industry Takes Big Hit,* S.F. CHRON. (Dec. 28, 2018), https://www.sfchronicle.com/news/article/Public-banking-for-California-s-marijuana-13494432.php.

However, stock throughput insurance has been entirely unavailable at times, while at other times the only available coverage options were in policies that provided no coverage for the transportation of cash. Uninsured losses during the transportation of product and capital between operators, often via a third-party distributor or transportation company, has significant potential to disrupt the supply chain and ultimately add to the cost for cannabis consumers. These two examples demonstrate that the traditional insurance package available to businesses often must be cobbled together by cannabis operators, sometimes without being able to create a patchwork of coverage that provides full protection.

3. Unavailability of Occurrence-Based Products Liability Coverage

From an operational risk management perspective, products liability insurance represents perhaps the most critical insurance need for cannabis licensees throughout the supply chain. This coverage protects businesses that put products into the marketplace against claims by end consumers and others that are later harmed as a result of defects in such products. In California, products liability insurance is a must-have for businesses throughout a given supply chain because California law creates the potential for strict products liability for any business that manufactures, distributes, or sells a product that was either defectively designed or failed to sufficiently warn consumers of potential dangers associated with the product's foreseeable use.[174] With consumable products like cannabis, products liability claims present an acute risk that companies must manage with a variety of tools, including insurance coverage.

The risks inherent in cannabis consumption, however, often take time to manifest as an actual harm experienced by consumers or third parties. Products may sit in a cupboard for months before they are used. Likewise, the cannabis products may cause bodily injury or property damage that goes undiscovered for long periods of time before claims associated with the products are raised. It is certain that there will be many claims for defective cannabis products arising out of the consumption of products sold even years prior. A customer may complain to a retailer shortly after purchasing a vape pen that it burned his throat, only to disappear for years before serving the retailer with a complaint. This is not atypical for any industry, particularly those that produce consumable goods. For this reason, companies in these types of industries typically purchase liability coverage, including products liability, that insure them against all covered "occurrences" that take place during a policy period.

"Occurrence-based" policies are the gold-standard for products liability insurance coverage. They create a relatively straightforward analytical framework for determining whether a policy responds to a particular claim that is within the policy's

[174] Soule v. Gen. Motors Corp., 882 P.2d 298, 303 (Cal. 1994) ("A manufacturer, distributor, or retailer is liable in tort if a defect in the manufacture or design of its product causes injury while the product is being used in a reasonably foreseeable way."); CAL. CIV. JURY INSTR. § 1200 (2017).

scope of coverage: is the claim based on an "occurrence" during the policy period? If so, there is coverage, regardless of how much time has passed. For example, many insurance carriers that insured asbestos manufacturers under occurrence-based policies sold in the 1960s found themselves defending claims decades later.[175]

The alternative to occurrence-based policies is "claims-made" insurance coverage. Unlike occurrence-based policies, claims-made policies do not provide coverage into the indefinite future. Instead, claims-made policies cover only those claims that are both made and reported to the carrier during the policy period. This means that once a policy period expires without a third-party claim, that policy no longer provides any coverage. Were the insured not to renew its policy, it would have no insurance for a claim, even if the claim arose out of the sale of products during the policy period or an incident that occurred during the policy period.[176] Further, even if the insured *has* renewed the policy, many policies will not provide any coverage for claims related to injuries that occurred prior to the policy period. Even those that do not contain this exclusion typically limit coverage to incidents that occur after the policy's "retroactive date," which is generally the date on which an insured was first covered by its current insurer. This means that an insured who wishes to change insurance carriers may be forced to give up years of insurance coverage in the trade, unless it purchases highly expensive "prior acts" coverage.

The most problematic aspect of claims-made policies is that an insured can inadvertently lose coverage if it lacks sufficient experience. If an insured does not report a claim raised during the policy period before the expiration of the policy's reporting period, the claim will not be covered under *any* policy. "Claim" is typically a defined term under a claims-made policy. As the California Supreme Court has discussed at length, the term "claim" is not synonymous with "suit" or "lawsuit."[177] Rather, claims-made policies typically define "claims" to include written demands for monetary damages, non-monetary damages, or injunctive relief. Consider a situation where a customer pens an angry letter to her dispensary noting that she "just didn't feel right" when she smoked the pre-rolled joint she'd purchased, and demanding a refund. The letter is received during the dispensary's claims-made policy period. The insured refunds the customer, never informs the products liability insurer about the letter, and forgets about the matter. The dispensary never informs

[175] Dan Levenson, *Asbestos Cases Illustrate Claims-Made vs. Occurrence Insurance Policies*, INSURE YOUR COMPANY (Apr. 7, 2016), https://www.insureyourcompany.com/blog/asbestos-cases-illustrate-claims-made-vs-occurrence-insurance-policies/.

[176] There is often some nuance to the manner in which claims-made policies operate that goes beyond the purposes of this hypothetical. Claims-made policies generally include at least some extended reporting period during which claims made later in the policy period may be still be reported to the carrier without losing coverage.

[177] Foster-Gardener, Inc. v. Nat'l Union Fire Ins. Co., 959 P.2d 265, 274 (Cal. 1998).

its products liability insurer of the letter. After the policy's reporting period, however, the same customer serves the dispensary with a lawsuit emanating from the same events addressed in her letter. By seeking monetary relief in writing, the customer had made a claim during the insured dispensary's policy period, and the dispensary's failure to report it to the relevant carrier before the end of the policy's reporting period eliminates coverage for the claim, despite the insured proactively responding to a customer's concerns in the exact manner requested.

Claims-made insurance coverage can drastically limit the extent to which a policyholder is covered against third-party liability claims. Unfortunately, however, virtually all products liability insurance policies currently available to commercial cannabis businesses are written on a claims-made basis. Because cannabis-focused insurance policies continually change to adapt to evolving regulations, cannabis operators are likely to have good reason to change carriers with greater frequency than most insureds. For the reasons discussed in this Section, these changes have the potential to carry catastrophic consequences. This, again, is among the reasons that we recommend cannabis businesses consult with experienced professionals before making significant decisions regarding their insurance coverage.

B. The Inadequacy of Available Coverage

Given the significant restrictions on traditional coverages that would be necessary to fully protect a cannabis business, some carriers underwriting in the cannabis space have attempted to respond. In this Section, we provide a detailed analysis of policy terms available on the market and conclude that there continue to be significant limitations in both admitted and surplus lines policy forms currently being sold to the cannabis industry. Cannabis policies tend to be constrained in three distinct ways. First, most of the policies include at least some standardized insurance language, the meaning of which becomes ambiguous in the context of cannabis's federally illegal status. Second, other standardized language in the policies applies in unduly (and often inadvertently) exclusionary ways, due to the practical realities of how cannabis businesses are operated and regulated. Finally, the policies being issued to the cannabis industry today typically contain numerous provisions specifically designed to exclude some of the most significant risks presented by operating in this industry. Unfortunately, the entrance of admitted carriers to the market has not mitigated these problems, despite the hope that increased competition would generate more comprehensive coverages at lower prices.

Given the unique context of insuring businesses that engage in federally illegal behavior, most of the policies insuring cannabis businesses are custom designed, or "manuscripted," by each separate insurer. Although many policies utilize certain standardized Insurance Services Office, Inc. ("ISO") form language, these standardized forms are interwoven with specially tailored policy endorsements that can sig-

nificantly alter the meaning of those standardized terms. We highlight a few categories of problems that arise in order to illustrate the types of specific problems under currently available policies; obviously, each manuscripted policy must be carefully examined by a knowledgeable professional in order to provide accurate advice to the applicant for insurance.

1. Standard Language Fails in the Context of Federal Illegality

Most insurance policies, even those issued by surplus lines insurance carriers, contain one or more standardized forms. The liability insurance policies issued to pharmaceutical companies likely share a number of forms in common with those policies issued to jewelry stores or trucking companies. Companies such as ISO and American Association of Insurance Services ("AAIS") create and market such standardized forms.[178] In many contexts, standardization provides both the predictability insurers crave and definable value for consumers who are generally far less familiar with the particularities of their insurance coverage than their insurers. When standardized forms are used in insuring the cannabis industry, however, there is significant potential for both ambiguity and undue limitations on the scope of coverage actually offered to cannabis operators.

All insurance policies generally include the same basic sections: (1) a "declarations" page that provides critical demographic policy information, such as the names of the insurer and insureds, coverage limits, deductibles, and premiums; (2) a main coverage form that includes coverage grants, coverage conditions, exclusions, and policy definitions; and (3) a series of "endorsements" that modify the coverage form, generally in response to the insured's particular situation.[179] While the declarations reflect factors specific to a particular insured, the coverage form and many policy endorsements for most insurance policies are drawn from ISO or AAIS forms. Even endorsements not written on forms available to the entire insurance industry tend to be standardized by individual carriers. So, all policies purchased by companies in a particular industry from such a carrier may include the same "non-standard" endorsements. In fact, insurers include many standardized endorsements in virtually all commercial policies, regardless of the industries in which their insureds work. Although insurance policies often run between 30 and 100 pages in length, it is not unusual to see only a few pages dedicated to coverage modifications tailored to an insured's specific industry.

It is unsurprising, then, that many insurance products offered to the cannabis industry contain some of the same insurance forms that carriers use in other industries. While this is an expected phenomenon, the federally illegal status of cannabis has a significant impact on the meaning of standard terms that have never been

[178] *Standard Form or Standard Policy*, IRMI, https://www.irmi.com/term/insurance-definitions/standard-form-or-standard-policy (last visited Mar. 3, 2019).

[179] Jerry, *supra* note 2, § 1.07.

considered in this new and unusual context. The *Atain* case,[180] discussed above, provides a clear example of this phenomenon. Atain argued that damage to harvested cannabis plants was excluded from coverage under section A.2.e. of ISO's widely used CP 00 10 form, which states that property covered under a policy does not include "[c]ontraband, or property in the course of illegal transportation or trade."[181] Although the exclusion appears to apply under its plain meaning, this result was unreasonable, given the fact that Atain knowingly insured a cultivation operation.[182] Nevertheless, the court did not dismiss the argument out of hand. Instead, the court noted that the policy did not define the term "contraband," accepted that trafficking cannabis remained illegal under the CSA, and examined both the dictionary definition of "contraband" and public statements by federal authorities reflecting "ambivalence towards enforcement of" the Controlled Substances Act, ultimately finding that the term, as applied in the case, was ambiguous.[183] The court further found that "the record suggests that the parties shared a mutual intention that the Policy would insure Green Earth's marijuana inventory and that the 'Contraband' exclusion would not apply to it."[184]

The court's interpretation of "Contraband" was reasonable and—the authors of this Article would contend—objectively correct, given the centrality of cannabis to the covered operations. Permitting insurers to avoid liability for an insured's losses under "contraband" exclusions, or for claims related to a suit against an insured under a "criminal acts" exclusion, would render coverage under commercial cannabis insurance policies illusory and reward insurers for making cynical bets by writing policies that they believe the courts will not enforce.

In addition to this obvious mismatch of form language and intended coverage, there are peripheral provisions of a commercial cannabis insurance policy that are potentially rendered ambiguous. For example, many insurers serving the cannabis industry continue to use standardized ISO additional insured endorsements ("AI" endorsements). An insured is often required by contract with its trading partners (such as upstream suppliers, vendors, landlords, and others) to ensure the inclusion of AI endorsements in the policies it purchases that will protect the trading partner. A contractual commitment to include an AI endorsement related to a contractual partner presumably includes an implied warranty that the coverage provided under the AI endorsement is effective. However, many standardized AI endorsements make clear that "[t]he insurance offered to such vendor only applies *to the extent*

[180] Green Earth Wellness Ctr., LLC v. Atain Specialty Ins. Co., 163 F. Supp. 3d 821, 821 (D. Colo. 2016).

[181] *Id.* at 832–34.

[182] *Id.* at 835.

[183] *Id.* at 832–33.

[184] *Id.* at 833–34.

permitted by law."[185] If the "law" includes federal law, there is a question whether the AI endorsement is illusory in the cannabis context.

It is far from clear whether courts will find it legally permissible to extend insurance coverage to a vendor that is also conducting commercial cannabis operations, especially if the intent of the parties to the insurance contract is not clear from the face of the agreement. As discussed above, if the legality of insuring cannabis businesses were more clear, it is likely that many more insurers would be serving the industry,[186] and courts tend to read insurance coverage more narrowly when insureds seek coverage for cannabis-related losses.[187] Given that it is highly unlikely that the provisions in question will have been discussed, let alone negotiated, by the insurer and the insured, courts may be sympathetic to carriers relying on continued federal illegality to advocate a literal interpretation of this standard policy language. Because this interpretation would not impact the core coverage an insured is purchasing, interpreting the phrase "permitted by law" to mean "permitted by *all* laws" would neither render the policy wholly illusory nor necessarily contrary to the intent of the parties to the insurance agreement.

Complicating matters further, the same phrase—"the insurance offered to such additional insured only applies *to the extent permitted by law*"—appears in AI endorsements for different types of additional insureds. While an insurer can plausibly assert that it was not made aware of which additionally insured vendors or contractors were themselves conducting cannabis operations—and that the insurer, therefore, should not be required to cover these additional insureds' otherwise covered, but federally illegal, cannabis activities—it would be far more challenging for a carrier to make this assertion plausibly with regard to an additionally insured landlord. The carrier knows that the landlord is leasing property to a tenant utilizing it to conduct cannabis operations, so the carrier cannot legitimately argue in that context that it unknowingly insured additional cannabis operations; and yet, its AI endorsement uses identical limiting language as those used to add vendors to the policy.[188]

We raise these questions to illustrate the potential for unforeseen gaps in coverage that are created by standard language hidden in forms that carriers have used thousands of times before in other industries, without thinking. If insureds are not careful and clear with their carriers in the insurance procurement process, then these coverage gaps could ultimately significantly devalue the policies they purchase and leave them open to claims for breach of contract should insurers later deny the additional insured's coverage.

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[185] *See, e.g.*, Ins. Servs. Office, Form CG 20 15 04 13, ADDITIONAL INSURED – VENDORS (emphasis added) (on file with authors).

[186] *See supra* Part II.A.1.

[187] *See supra* Part I.A.

[188] Ins. Servs. Office, Form CG 20 11 04 13, ADDITIONAL INSURED – MANAGERS OR LESSORS OF PREMISES (on file with authors).

2. Standard Language Fails in Light of Cannabis Business Realities

Novel and robust state regulatory regimes for cannabis operators often result in business operations that are unique. Familiar standard policy language that works well in other industries can wreak havoc in a policy issued to a cannabis operation. This is not a function of continuing federal illegality, but instead a matter of what businesses must do in order to remain compliant with state and local laws and regulations.

For an example, we return to the ISO AI endorsement that is used to extend coverage to an insured's vendors. Although some cannabis operations are vertically integrated, many state-legal operations are devoted to a single segment of the industry, in part due to the different licenses for each stage of the industry. Many cannabis cultivators, for instance, do not package their own products for the end consumer; instead, they use licensed distributors who are experts in the labeling requirements of state law. Cultivators can hand off their products to these distributors to facilitate the required testing, delivery to manufacturers who use it for concentrate, and packaging it for sale to retailers. A savvy distributor or manufacturer will often require its cultivator clients to add the distributor as an additional insured on the cultivator's products liability coverage. If these carriers for the cultivators use ISO Form CG 2015 04 13 to extend coverage to vendors, however, a distributor's and a manufacturer's coverage under the policy will include the following exclusionary language:

> 1. The insurance afforded the vendor does not apply to:
>
> * * *
>
> c. Any physical or chemical change in the product made intentionally by the vendor;
>
> d. Repackaging, except when unpacked solely for the purpose of inspection, demonstration, testing, or the substitution of parts under instructions from the manufacturer, and then repackaged in the original container;
>
> e. Any failure to make such inspections, adjustments, tests or servicing as the vendor has agreed to make or normally undertakes to make in the usual course of business, in connection with the distribution or sale of the products;
>
> * * *
>
> g. Products which, after distribution or sale by you, have been labeled or relabeled or used as a container, part or ingredient of any other thing or substance by or for the vendor. . . .[189]

[189] Ins. Servs. Office, Form CG 20 15 04 13, ADDITIONAL INSURED – VENDORS (on file with authors).

This policy language is standard and generally unexceptional, but it is highly problematic for insureds in the cannabis industry on multiple levels. For example, a manufacturer of concentrates may do little more than "intentionally" change the "physical and chemical nature" of cannabis flower. Certainly, the cultivator's product, after sale by the cultivator, is used as an "ingredient" in manufactured products such as vape cartridges. Distributors, meanwhile, are often charged with "repacking" cannabis products, including both flower and manufactured products, for sale to dispensaries. California distributors are also exclusively responsible for having cannabis and manufactured cannabis products tested at licensed testing facilities.[190] In this business context, then, the AI endorsement effectively eliminates insurance coverage for a number of manufacturers and distributors. Consequently, cultivators purchasing such a policy and adding their manufacturing and distribution partners as additional insureds subject themselves to potential liability for breach of contract unless they renegotiate this language carefully.

Taken together, the coverage gaps that standardized language can create due to federal illegality and the nuances of cannabis business operations have the potential to significantly limit the value of cannabis insurance policies. In particular, the presence of numerous issues in AI endorsements creates challenges for the cannabis industry in efficiently structuring its risk through contract. Standardized language may not render cannabis-related policies wholly illusory, but it has created problems for cannabis operators that often will not be understood until it is too late.

3. Express Exclusions of Critical Risks for Cannabis Operators

The final major category of problematic limitations contained in policies issued to the cannabis industry relate to provisions specifically crafted for the cannabis industry. These provisions vary considerably from policy to policy, but virtually all liability insurance policies being offered to licensed cannabis operators contain at least one provision that arguably limits coverage in ways that we believe would shock most insureds purchasing the policies.[191] We describe several examples to provide a clear understanding of several common problems in the current cannabis insurance markets. The examples are all drawn from different policies, although some of the examples are certainly present in more than one of the policies referenced. We focus on key issues relating to general and products liability insurance products. Because only the forms for an admitted insurance product are available to the public, we do

[190] Hilary Bricken, *California Cannabis: What's in YOUR Distributor Services Contract?*, HARRIS BRICKEN: CANNA L. BLOG (Jan. 4, 2018), https://www.cannalawblog.com/whats-in-your-california-marijuana-distributor-services-contract/.

[191] Our discussion of the following examples should not suggest that we believe that the provisions supply a valid basis for denying claims made under such policies. Rather, we identify the types of arguments that insurers might make in an effort to deny coverage. Indeed, an insurer using one of the provisions discussed in this Part to vitiate coverage might be subject to a bad faith claim by its policyholder.

not identify the surplus lines carriers who underwrite the policies we use as an example.

The first example of problematic policy language is the health hazard exclusions. These exclusions are designed to limit the extent to which the policy will respond to claims associated with activities that the insurer deems too hazardous to insure. At one level, these exclusions are inherently reasonable. For example, "marijuana smoke" is recognized under California law as a carcinogen.[192] It would not necessarily be unreasonable for an insurer to exclude coverage for a "bodily injury" claim of cancer that is related to the ingestion of cannabis smoke. While carriers in the cannabis market are now attempting to narrowly tailor such exclusions, the forms typically offered to cannabis operators contain much broader exclusionary language. For instance, one products liability policy contains a health hazard exclusion that excludes:

> (1) Any actual or alleged development, emergence, contraction, aggravation or exacerbation *of any form of disease of the human body*; or
>
> (2) The impaired development of any part of the human body; arising out of or resulting from the consumption, ingestion, inhalation or other use of any "tobacco product", "electronic cigarette or vaporizer product", "marijuana product" . . . .[193]

While this exclusion expressly excludes "bodily injury" claims related to an illness "that is not gradual" or is "caused by acute poisoning as a result of the consumption, ingestion or inhalation of an adulterated product," it clearly does more than eliminate coverage for cancer.

Other health hazard exclusions limit coverage to an even greater extent. One policy contains the following language:

> EXCLUSION – SMOKING PRODUCTS HEALTH HAZARD
>
> * * *
>
> This insurance does not apply to "bodily injury" or "personal and advertising injury" arising out of:
>
> 1. The real or alleged emergence, contraction, aggravation or exacerbation of any form of cancer, carcinoma, cancerous or precancerous condition, arteriosclerosis, heart disease *or any other disease of the human body* as a result of the consumption, use or the exposure to the consumption or use of any "smoking product" that is manufactured, sold, handled or distributed by, for, or on behalf of any insured;
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> * * *

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[192] CAL. CODE REGS. tit. 27, § 27001 (2018).

[193] Surplus Lines Policy Form, Form AD 69 53 01 18, HEALTH HAZARD EXCLUSION (LIMITED) MARIJUANA BUSINESS (on file with authors) (emphasis added).

3. Any claim, "suit" or class action, whether or not certified as such and including but not limited to those:
    a. *seeking recovery of economic costs including costs for medical, police, or emergency services*;
    b. alleging interference with a right common to the general public, including but not limited to claims for nuisance;
    c. *alleging damages* or seeking injunctive relief *arising from marketing, distribution, or other sales or similar practices*; or
    d. *alleging damages* or seeking injunctive relief *arising from the design of "your product" or the failure to issue warnings or issuance of inadequate warnings*.[194]

Few business owners would expect a policy endorsement entitled "EXCLUSION – SMOKING PRODUCTS HEALTH HAZARD" to effectively eliminate coverage for *all* "bodily injury" or "personal and advertising injury" claims that they might face, but that is the practical effect of this endorsement for many cannabis operators. Section 1 broadly excludes coverage for all human diseases. Section 3, however, goes much further by eliminating coverage for emergency response costs that an insured may be liable for as a result of an otherwise-covered product defect. Moreover, Section 3.d. excludes all "bodily injury" claims arising out of defective design or warnings. Additionally, to eliminate any doubt regarding whether any "bodily injury" or "personal and advertising injury" claims remain covered under the policy, Section 3.c. provides that any claims related to "marketing, distribution, or other sales or similar practices" are excluded from coverage. This appears to provide a plausible basis for denying coverage for any claim brought against any cannabis operator in the supply chain, other than those claims alleging "property damage."

Not to be outdone, the final 2018 health hazard exclusion we discuss effectively eliminates "property damage" claims as well as those alleging "bodily injury" or "personal and advertising injury." This endorsement provides that:

1. *This insurance does not apply to any claim or "suit" for "bodily injury," "property damage" or "personal and advertising injury"* arising directly or indirectly out of, related to, or, in any way involving the real or alleged emergence, contraction, contribution to, aggravation or exacerbation of *any form of adverse health effect*, impairment of health, abnormal condition or conditions, disorder, sickness, ailment, unhealthiness, *symptom*, disease, illness or malady of the human body *as a result of the use, consumption or exposure to any product that is manufactured, sold, handled or distributed by, for or on behalf of any insured* and includes any:

[194] Surplus Lines Policy Form, EXCLUSION – SMOKING PRODUCTS HEALTH HAZARD (on file with authors) (emphasis added).

* * *

b. Cannabis sativa, cannabis indicia, hemp or marijuana or any of their derivatives. . . .

* * *

2. This insurance does not apply to any claim . . . arising directly or indirectly out of, related to, or, in any way involving the use or existence of item [1.b.] above and that:

b. Seeks recovery of economic costs including costs for medical monitoring or for medical, police or emergency services;

c. Alleges interference with a right common to the general public, including but not limited to claims for nuisance;

d. Alleges damages or seeks injunctive relief arising from the marketing, distribution or other sales or similar practice; or

e. Alleges damages or seeks injunctive relief arising from the design of "your product" or the failure to issue warnings or the issuance of inadequate warnings.[195]

The practical implications of this final example of an endorsement are staggering. Expanding the scope of the exclusion to "any form of adverse heath effect" or "symptom . . . as a result of the use . . . [of] Cannabis" provides the carrier with a plausible basis for asserting that any claim related to cannabis impairment—and any injuries or physical damage resulting from such impairment—will be excluded, along with all other "malad[ies] of the human body." Cannabis businesses do not currently have the same immunity from civil liability that bars and restaurants enjoy when they serve alcohol to patrons.[196] As a result, it is likely that any accidents involving cannabis-related inebriation will result in lawsuits against one or more licensed cannabis businesses. If one of those businesses have the misfortune of operating under a liability policy containing this endorsement, however, its carrier likely will deny coverage.

These endorsements were drawn from surplus lines insurance policies. Admitted insurance policies include similarly problematic provisions. When Golden Bear Insurance entered the California market with the first admitted cannabis insurance policy, it included an endorsement entitled "EXCLUSION – CANNABIS IMPAIRMENT," which provided:

> This policy does not apply to, and we will have no duty to defend or indemnify you against any claim or "suit" alleging "bodily injury" or "property dam-

[195] Commercial General Liability, Form CG 00 01 10 01, EXCLUSION – HEALTH HAZARD (on file with authors) (emphasis added).

[196] CAL. BUS. & PROF. CODE § 25602(b) (West 2019).

> age" for which any insured may be held liable by reason of causing or contributing to the mental or physical impairment of any person by means of that person's use, inhalation, ingestion, application of, contact with, or exposure to "cannabis" or "cannabis products."[197]

This endorsement, while more candid in its intent and impact on coverage than the final health hazard exclusion discussed above, has the same practical effect on coverage where cannabis-related inebriation plays a role in any claim. This provision drew immediate negative attention after the California Department of Insurance approved the policy.[198] Under pressure, Golden Bear sought and obtained approval for revised policy forms that removed its cannabis impairment exclusionary endorsement.[199]

Golden Bear is not the only admitted insurer to include extremely broad exclusionary provisions in its policy. Later in 2018, Continental Heritage Insurance Company received approval from the California Department of Insurance for a products liability insurance product. This policy contained what would seem—to those who are less familiar with the cannabis industry—to be a fairly benign endorsement entitled "COMPLIANCE WITH APPLICABLE LAW." It provides:

> It is a *condition precedent to the coverage afforded by this policy that the Named Insured must maintain compliance with all applicable state and local laws*, statutes, rules, regulations, ordinances, licensing requirements or restrictions within the "Coverage Territory" governing any lawful commercial "cannabis" operations, including, but not limited to, cultivation, harvesting, production, manufacturing, processing, distribution, testing, tracking, retail, or dispensing of "cannabis."
>
> *Coverage for any claim under this policy shall not apply if the Named Insured is out of compliance with any applicable state or local laws*, statutes, rules, regulations, ordinances, licensing requirements or restrictions within the "Coverage Territory" or any other state or local restrictions governing any

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[197] The admitted insurance forms referenced are on file with the authors and publicly available on the California Department of Insurance's Web Access to Rate and Form Filings website. Golden Bear Ins. Co., California Cannabis Form #17-5942, *Virtual Viewing Room*, CAL. DEP'T INS., https://www.insurance.ca.gov/0250-insurers/0800-rate-filings/0050-viewing-room/ (last visited May 14, 2019) (on file with authors).

[198] *See, e.g.*, Jason M. Horst, *Admitted Insurance Carriers Are Here: Cannabis Buyers Beware*, HORST LEGAL COUNS.: THC BLOG (Nov. 7, 2017), https://www.horstcounsel.com/single-post/2017/11/07/Admitted-Insurance-Carriers-Are-Here-Cannabis-Buyers-Beware.

[199] *See* Golden Bear Ins. Co., California Cannabis Form #18-3511, *Virtual Viewing Room*, CAL. DEP'T INS., https://www.insurance.ca.gov/0250-insurers/0800-rate-filings/0050-viewing-room/ (last visited May 14, 2019) (on file with authors) (crossing out and removing the cannabis-impairment provision).

> commercial "cannabis" operations, including, but not limited to, cultivation, harvesting, production, manufacturing, processing, distribution, testing, tracking, retail, or dispensing of "cannabis".[200]

This "COMPLIANCE WITH APPLICABLE LAW" endorsement arguably requires merely that licensed cannabis operators do what they are already required to do—comply with state and local laws and regulations. The problem is that state cannabis regulations in California, and elsewhere, are constantly shifting and incredibly complicated.[201] Complying with these voluminous and ever-changing rules is difficult. Perfection in this task is practically impossible. Under the clear language of the Continental Heritage "COMPLIANCE WITH APPLICABLE LAW" endorsement, a minor regulatory infraction (such as temporarily allowing a clone to be visible from an external window) could deprive a dispensary of all benefits of its products liability insurance policy, despite the absence of any nexus between the infraction and a subsequent claim.

C. Balancing the Interests: Do Cannabis Policies Provide Sufficient Protection to the Public to Justify Indemnifying Policyholders for Federally Illegal Behavior?

The details above, regarding the constrained availability and general inadequacy of the insurance policies available to cannabis business operators, are relevant to our ultimate question regarding the balance between the fundamental public policy against insuring illegal conduct and the need for these operators to manage their business risks and provide protections for end consumers of cannabis products. Arguably, the fact that available insurance options remain so constricted tilts this balance against sanctioning coverage for cannabis-related losses. The reality, however, is that the development of new insurance markets takes time, and the unique circumstances of the cannabis industry are simply making progress slower than normal.

Most of the insurance coverage available to the cannabis industry provides real value to cannabis businesses and their customers. Many of the problems identified above relate to issues that while important, are not necessarily central to a business's operational risk management. Certainly, some of the health hazard exclusions that we have discussed present fundamental concerns regarding the inherent value of the policies containing them, but many liability policies sold to the industry do not contain provisions so draconian. Insureds under these more favorable policies are likely to have coverage for third-party claims in a number of foreseeable circumstances. And, as cannabis legalization continues to expand state-to-state throughout

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[200] Continental Heritage Ins. Co., Cannabis Products Liability Form #18-1871, *Virtual Viewing Room*, CAL. DEP'T INS., https://www.insurance.ca.gov/0250-insurers/0800-rate-filings/0050-viewing-room/ (last visited May 14, 2019) (on file with authors).

[201] *See supra* note 163.

the country, more and more third parties are interacting with cannabis businesses, whether as customers or contractual partners.

The challenges for cannabis companies seeking effective risk management through available coverage options reinforces the need for expert assistance in wading through the muddy waters of cannabis-related insurance coverage issues. Advice from insurance and legal experts can assist businesses to purchase policies that best suit their operations, ensuring that the businesses receive the value of the insurance that they have purchased.

CONCLUSION

The unique situation in which cannabis businesses are legal under state law in many jurisdictions, but illegal under federal law for all purposes, has confounded a number of issues that ordinarily would be simple to resolve.[202] Insurance is a critical feature of modern life, and the impact of state-legal cannabis will have profound effects on coverage decisions regarding insurance products that were not designed with cannabis as a state-legal product in mind. More importantly, insurance products being marketed to cannabis businesses have gaps in coverage, sometimes as the unintentional result of recourse to standard forms rather than as the result of sharp dealing, that will be a challenge for the industry. One might assume that the implications for insurance of the emergence of state-legal cannabis businesses is of minor concern compared to other issues such as securing reliable banking services, but in fact the effect on insurance will be profound. From its infancy, the insurance industry has had to prove its worth with regard to controversial risks—and insurance in the time of state-legal cannabis is just the most recent example of this dynamic.

[202] For example, one might ask how lawyers can represent state-legal cannabis businesses ethically when the underlying conduct of their client amounts to serious violations of federal criminal law. Mootz, *supra* note 58, at 31.