



ed and Adjusted?

by Chantal Roberts

Abstract

Marijuana is illegal at the federal level, and insurance policies do not cover illegal activities. This article will discuss how some states have amended personal and commercial policies to overcome these issues. It cannot enumerate all the perils faced by insureds in the cannabis industry, but it will help underwriters and agents understand their insureds' risks to provide better coverage. The article will also help claims adjusters communicate with underwriters to properly protect insureds from uncovered losses—and to protect insurers from legal issues.

As more states legalize medicinal and recreational marijuana use, perceptions of the drug must change, regardless of political beliefs. Although marijuana is still illegal at the federal level, and insurance policies do not cover illegal activities, some states have amended personal and commercial policies to overcome these issues.

So how is marijuana insured, and what happens when a covered loss occurs? Generally speaking, assuming that insureds are in a state where cannabis is legal and that they have the required license or prescription, marijuana is covered property. Things get more complicated, however, when adjusters must answer questions about which coverage applies, the value of the property, and liability, among other factors.

Valuation

In several states, not only is selling cannabis legal, but growing a certain number of plants is as well. Alaska, for example, allows residents to grow up to six plants per person, but no more than three may be flowering at one time. An adjuster may be tempted to consider these plants a crop and deny the claim—as crops that can be grown and harvested are not covered under the Insurance Services Office, Inc. (ISO) Homeowners 3—Special Form (HO-3).

And while the HO-3 contains other restrictions, its Trees, Shrubs and Other

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Plants Additional Coverage applies to cannabis plants. It lists seven named perils, but the most common claims involve theft.

Care must be taken that the plant not be used for business purposes as defined in the policy. And insureds must remember that this coverage offers a sublimit of only \$500 per plant, which may be adequate because a single plant—often a clone from another—typically costs about \$10 to \$20. Insureds, however, may become confused about the value of the plant because the equipment, nutrients, and yield (all of which would be classified as personal property) may be worth \$100 to \$500 per plant. This is akin to policyholder confusion about a home's insured value versus its real estate value—the Marshall & Swift value versus the listed value. Adjusters need to take the time to explain to insureds what the value is and how it was determined, which may be difficult.

The price of marijuana is not in the contents list of Xactimate's claims-estimating software. *Forbes* uses data from PriceOfWeed.com, a crowdsourcing method of determining marijuana's street value. When determining the value of a high-end object, such as art or a new vehicle, adjusters often contact the sales person or experts in the field, and marijuana should not be any different. Adjusters should realize, though, that insureds may be

hesitant to provide specific figures because of the legal environment and that street value is not likely an appropriate basis for determining legal marijuana's worth.

One of the most important factors to consider when determining the value of marijuana is quality. In a routine contents claim, the adjuster could call the vendor and verify the insureds' purchases and purchase price, but dispensary records are deliberately kept vague because of the very real possibility of a federal raid, which could put the dispensary's suppliers at risk. Further, even in states where marijuana is legal, the majority of dispensaries operate on a cash basis because federal law prohibits banks from taking so-called drug money. In a cash-based transaction with no receipts or proof, insurers may have to pay for whatever the insureds claim they had, which is where things could get sticky.

Wikileaf is another source of pricing information. It is being likened to Priceline or Yelp because it compares prices of different dispensaries and provides reviews of strains, employees, and services. It lists a price of \$22.00 per gram of marijuana.

Going back to Alaskans and their three budding plants: Under ideal conditions, an average plant can yield four harvests with up to one pound (453.6 grams) each harvest.¹ Using the Wikileaf figures, those three plants could produce nearly \$120,000 in contents after a year.

Because Alaska allows residents to have up to six plants per person, a resident's spouse may also have three flowering plants, so one dwelling could contain several pounds at the time of loss. And while the exact methodology of determining yield is beyond the scope of this article (and likely beyond the scope of the claim), the easiest method is to divide the number of grams of dried product by the total hourly wattage of the lighting used to grow it.

Personal property limits are expressed as a percentage of the Coverage A (building)

limit. If the median home value in Fairbanks, Alaska, is \$225,000, and the Coverage C limit is 50 percent of that of Coverage A, then the typical personal property limit would be \$112,500. An insured's marijuana plants could account for the entire contents limit, leaving the insured with no coverage for other contents such as clothes, furniture, and appliances. And if marijuana does not entirely exhaust the limits, the insured may face a coinsurance issue.

Causes of Loss

The peril of fire is always imminent. The National Fire Protection Association found that smoking materials (cigarettes, pipes, cigars, etc.) caused \$621 million in direct property damage in 2011. Of deaths that resulted from these fires, 40 percent were caused by fires that started in the bedroom, with sleep a factor in 31 percent of cases.²

With this in mind, underwriters in states where marijuana is legal should consider fire-protection safeguard warranties. For example, an insurer could require the insured to install smoke alarms that alert the fire department.

Finally, because many insureds grow plants indoors in warm, damp conditions, underwriters and agents must be aware of the possibility of mold growth. Mold claims may be denied because the HO-3 excludes certain mold losses.

Liability Claims

Underwriters, agents, and adjusters must also consider possible cannabis-related liability claims that may be covered under Section II of the HO-3. In some respects, these liability claims may be easier to adjust than cannabis-related Section I claims because either the insured breached a duty and caused harm, or it did not. And if the insured did not breach an owed duty, Coverage F—Medical Payments to Others would pay for bodily injury without having to determine fault.

Although paying claims under Coverage F is almost a knee-jerk reaction to bodily injury

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claims, whether or not the insured is liable, cases are not always that simple. Take this example:

The parents of teenage siblings in Washington, D.C., where recreational marijuana is legal for adults age twenty-one and older, are out of town for the weekend. The standard no-parties-while-we-are-gone rule has been laid down. Nonetheless, the teenagers decide that this is in fact an ideal time to host a party, complete with their parents' marijuana. Things go awry when the cannabis reacts poorly with a prescribed drug an underage guest takes, causing that guest to lapse into a coma for weeks. Consider the following policy language:

Section II—Liability Coverages

We will pay the necessary medical expenses that are incurred or medically ascertained within three years from the date of an accident causing “bodily injury.” ... As to others, this coverage applies only:

1. To a person on the “insured location” with the permission of an “insured”

Coverage F is not available for occurrences on the property involving people who are there without the insureds' permission. The underage children are insureds under the policy; therefore, they may be able to grant permission to the partygoers without their parents' authorization. If the parents did not secure their marijuana, they could be considered negligent. And aside from the fact that teenagers are notoriously shortsighted, in part because of a lack of life experiences, the Expected or Intended Injury exclusion might not apply because neither group of insureds (adults or teenagers) foresaw the reaction of marijuana and an unknown prescription drug. In light of situations such as this, insurers should consider including a rider that requires insureds to keep drugs in a locked safe away from children and pets.

Controlled Substance Exclusion

To address some of these changes in the insurance landscape, ISO has added the Controlled Substances exclusion to its HO-3. Controlled substances include but are not limited to cocaine, LSD, marijuana, and all narcotic drugs. The exclusion “does not apply to the legitimate use of prescription drugs.” Unfortunately, the Washington, D.C., insureds were not prescribed cannabis, so this fictitious claim might be denied. And if that is the case, Coverage F would not be available because the policy cannot respond to an excluded loss.

A chilling trigger for liability involves children and medication, regardless of its scheduled classification. Arkansas legalized medical marijuana in 2016 when its voters passed Issue 6, the Arkansas Medical Marijuana Amendment, which allows patients to use medical marijuana for seventeen conditions. The introduction of marijuana edibles, such as gummy bears, alarmed opponents of Issue 6, who believed that children would mistake the edibles for regular candy. In a March 2017 report, two doctors describe the death of an

Continued on page 8

eleven-month-old boy who was exposed to cannabis.³ Skeptics dispute the relationship, but underwriters in states where marijuana is legal should reflect on the potential liability triggers: Could having edibles be considered an attractive nuisance? Or even a matter of strict liability?

Because marijuana is still a Schedule I drug, even when listed for medicinal use, and doctors are not technically allowed to prescribe it, insurers should confirm the circumstances under which cannabis is covered. In addition, adjusters must know their state laws regarding impaired driving. Indiana, for example, considers drivers guilty of driving under the influence if they have a controlled substance with them, even if they show no impairment.⁴

Parts A and D of the ISO Personal Auto Policy have no exclusions concerning marijuana. Losses caused by a driver in an altered state, whether or not induced by cannabis or alcohol, should be adjusted in the same manner as loss caused by a driver whose mental state was altered by an opioid.

Commercial Insureds: Contraband and Seizure

Commercial insureds face similar perils as their personal lines counterparts. In most cases, dispensaries and grow operations are no different from any other business. But in addition to issues related to cannabis's uncertain legal status, there are a few other surprising differences.

One of the first differences a business owner will face is increased scrutiny from the government. It is easier to go after the larger target that allegedly sells illicit items than the multitude of individual insureds who purchase them.

Similar to homeowners policies, businessowners policies (BOPs) provide combined property and liability coverage in one form for small to midsize businesses. A BOP typically includes building and contents coverage, business income loss coverage, limited crime coverage, and

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equipment breakdown coverage. The benefit for insureds is that they may be able to avoid some of the coverage gaps found in cafeteria-type coverages, which consist of separate stand-alone coverage forms. Examples include commercial property policies (with applicable causes of loss forms), business interruption policies, crime policies, and equipment breakdown coverage.

The ISO BOP considers cannabis to be personal property, just like the homeowners policy. However, its Property Not Covered section excludes “contraband, or property in the course of illegal transportation or trade,” raising the specter of claims for property that may be legal at the state but not the federal level.

Under the McCarran-Ferguson Act of 1945, states have the right to regulate insurance. So, despite the fact that the U.S. government considers marijuana plants contraband, it is the states that determine insurance regulations and—in a roundabout way—whether cannabis is indeed contraband.

Insurers should therefore take care, because a good plaintiff's attorney could argue that the insured's cannabis is not illegal and that, under the HO-3, the coverage extension for shrubs and plants applies. The ISO Building and Personal Property Coverage Form, or BPP, is nearly identical to Section I of the BOP, but its sublimit is lower.

The BOP, BPP, and even commercial crime coverage forms bar recovery for seizure or destruction of property by order of governmental authority. Grow operations and dispensaries face the very real threat of government raids. Some commercial brokers offer so-called pot-raid insurance, which can cover dispensaries in accordance with relevant state laws. Generally, this endorsement is limited to insureds operating legally under state statutes. It provides coverage for court and defense costs if the owners are proven not guilty of all raid-related charges.⁵

Professional Services, Your Product, and Your Work Exclusions

The BOP specifically excludes professional services, but the ISO Commercial General Liability policy (CGL) must be specifically endorsed to exclude insureds who caused bodily injury or property damage by either providing or failing to provide medical advice or treatment, health or therapeutic services, or services in the practice of pharmacy.

CGL underwriters and adjusters may rely too heavily on the Products-Completed Operations, Your Product, and Your Work exclusions, but these exclusions only apply to the cannabis product itself. Coverage still applies for the sellers' representations and any implied warranties—and if not, a scintilla of coverage may be available under negligent hiring, so if a suit is filed, defense could be provided while coverage is determined.

Continued on page 32

How Can Cannabis Claims Be Covered and Adjusted?

Continued from page 8

Because marijuana dispensaries often characterize themselves as healthy and therapeutic alternatives to traditional medicine, insurers need to scrutinize the coverage they wish to bind because the CGL excludes coverage for professional services. Even in states where recreational cannabis is legal, the dispensaries' logos often use medical imagery, such as a green cross, references to medication, or the rod of Asclepius. But professional services may now be in the purview of dispensaries through their staff, often known as budtenders, who can act as marijuana pharmacists.

Budtenders are also known as dispensary agents, pharmacy technicians, or patient liaisons. Customers may assume that a budtender has superior knowledge about, for example, how other drugs can interact with cannabis; underwriters and agents should therefore be aware of the insureds' business model so that they can recommend appropriate coverage.

It seems logical that liability for injury or property damage caused by a person who bought marijuana can be attributed to the dispensary, similar to dram shop liability. The Liquor Liability exclusions in the BOP and CGL policies specifically refer only to alcohol—not to intoxication by drugs. Failure-to-warn claims may be a new cottage industry for the plaintiff bar.

Because of the murky legal status of cannabis, there is no standardized certification or license for budtenders. Most dispensary employees are self-taught. Because one budtender's knowledge may be less robust than another's, carriers should consider including a warranty in their BOP and CGL policies that requires completion of a training program, similar to the Texas Alcoholic Beverage Commission's (TABC's) Safe Harbor Act, which covers laws concerning alcohol sales to underage people and intoxicated adults.

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The TABC does not take administrative action against the license or permit provided that certain steps are taken—such as holding a current training certificate. In states that have legalized marijuana, insurance professionals should consider such training as part of their continuing education; educated employees are an asset to the insured and insurer through their knowledge of industry trends and regulations, dosing, and the effects of cannabis.

Theft

When discussing cannabis claims, adjusters often cite theft as a consistent peril for marijuana dispensaries. Laypeople may chuckle, imagining a Hollywood-inspired farce in which a pair of lovable rogues hatch an overly elaborate plan to rob a dispensary in order to throw an epic party. The reality is typically more mundane. As with the HO-3, insureds with a BOP or BPP face issues concerning contents coverage. Will they face a coinsurance problem? Will they exceed their policy limits? However, one significant peril is often given less attention: the theft of money, a serious concern for the largely cash-based \$7 billion cannabis business.⁶

The BOP and BPP do not cover money, cash, or securities. Unlike insurance, banking

is federally insured and backed, and the government can levy hefty fines if a bank participates in illegal activities such as money laundering. But despite cannabis's federal classification, some small, state-run banks and credit unions see the practicality of offering accounts for dispensaries and grow operations.

However, Attorney General Jeff Sessions caught these banking agencies by surprise with his January 4, 2018, memo, which stated:

These activities [cultivation, distribution, and possession of marijuana] also may serve as the basis for the prosecution of other crimes, such as those prohibited by the money laundering statutes, the unlicensed money transmitter statute, and the Bank Secrecy Act.⁷

While the impact on insurers may not be immediately evident, vandalism and breaking-and-entering claims are indeed covered. Before Lloyds syndicates left the American marijuana market, they placed warranties and safeguards on their policies requiring practices meant to discourage theft and vandalism, such as placing cash and product in a 300-pound safe that was bolted to the floor. Because an alarm system linked to an off-site monitoring facility is standard, the thought was that police could be alerted while a crime is occurring. But these warranties and safeguards only help after hours.

Most dispensaries are not as well-guarded as financial institutions, but banks are an excellent source of inspiration for protecting cash and stock. Of course, a commercial crime coverage form can indemnify insureds for loss of money inside the premises. Accordingly, insurers may wish to insist on deterrents.

For example, a dispensary could install a panic button that employees could use to trigger a silent alarm if a burglary occurs during business hours. A locking

mechanism on a double set of doors that could lock would-be burglars in or out could also be helpful. Finally, cameras are always useful in deterring and identifying criminals.

Transportation is another rising concern related to cannabis legalization (not least of all because crossing state lines may violate federal law). The highly lucrative nature of the marijuana business makes it a valuable target for thieves, and if dispensaries become harder to rob, criminals may turn to stealing cannabis in transit. Insurers should consider endorsing policies with specialized clauses that require strict security procedures, such as having two drivers in a vehicle, running criminal background checks on all drivers, and transporting the product in armored vehicles.

Business Income Losses

The most difficult aspect of a marijuana claim is verifying the loss. Dispensaries deliberately keep vague records, often not listing the names of suppliers because of the potential of a federal raid. Further, because the federal government discourages banks from conducting transactions with businesses it considers illegal, adjusters often have difficulty verifying how much cash was present at the time of loss.

Dispensaries, grow operations, and transporters must file federal tax returns, which may prove helpful in reverse-engineering loss-of-income claims, but agents and underwriters may wish to determine an agreed value for business income losses rather than attempt to determine the amount of loss after the claim is filed.

This article cannot touch on all the perils faced by the numerous insureds who work in and around the cannabis industry. Underwriters and agents should know and understand their insureds, and claims adjusters should communicate with underwriters to properly protect insureds

from uncovered losses—and to protect insurers from legal issues. ■

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Endnotes

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Chantal Roberts' career reflects over 20 years of accomplishments in the insurance industry, with specialization in commercial general liability, special investigations and fraud investigations, commercial auto insurance,

homeowners insurance, and cargo insurance. Roberts has held leadership roles with distinguished insurance companies, including Liberty Mutual Insurance Company and MetLife. She currently serves as director of claims for Affirmative Risk Management, a third-party administrator for certain syndicates of Lloyd's of London.