Cannabis Legalization and Insurance in the United States

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Abstract

This paper examines the history of cannabis's legality in the United States, and analyzes the current status of this issue today with emphasis on the conflicts between various state laws and the federal Controlled Substances Act. A discussion of current property and liability insurance coverages is provided to highlight the various issues pertaining to covering (or excluding) cannabis. The markets for insurance on cannabis businesses are also discussed. Legal rulings that, to date, have involved marijuana and property and liability coverage are presented. Finally, there is a discussion on insurer obligations to pay cannabis claims under current federal and states laws.

Keywords: marijuana, cannabis, insurance, coverage

I. Introduction and Overview

Cannabis sativa, more-commonly known as cannabis or marijuana, is currently the subject of much discussion and legislation in the United States. The flowering cannabis plant contains almost 500 known compounds, and one of those is tetrahydrocannabinol (THC). THC, a psychoactive substance, produces a pleasurable "high" feeling when ingested.

Cannabis has been used as a psychoactive substance for thousands of years, with the first evidence of its existence dating around 2,700 B.C. A Gushi shaman's tomb unearthed in 2008 contained about two pounds of well-preserved and highly potent cannabis. The potency of the found cannabis led researchers to believe the cannabis was not for fibers or clothing, but rather for intoxicating consumption (Ancient, 2008).

The legal cannabis market in the U.S. totaled $6.9 billion in 2016, and is projected to be over $8 billion in 2017 (*The State*, 2017). To say that there is a legal cannabis market is somewhat of a misnomer, because although it is legal in many states for medicinal use, and in a handful of states for adult use, it is still illegal at the federal level. In the next section, the history of the cannabis legal environment is presented.

a. History in the United States (pre-1970)

Cannabis was not always illegal in the United States. George Washington's diaries indicate that he was a cannabis grower. In 1850 cannabis was included in the *United States Pharmacopeial*, the standard-setting publication for medication in the United States since 1820,[1] and was sold openly in pharmacies in the United States after the Civil War.[2]

With Prohibition came a trend away from cannabis use in the United States. A bias against Mexican immigrants in the United States, coupled with the economic pressures of the Great Depression, further escalated the war on cannabis:

[1] http://www.usp.org/about-usp/our-history/usp-milestones-timeline
[2] http://www.pbs.org/wgbh/pages/frontline/shows/dope/etc/cron.html

> *"During the Great Depression, massive unemployment increased public resentment and fear of Mexican immigrants, escalating public and governmental concern about the problem of marijuana. This instigated a flurry of research which linked the use of marijuana with violence, crime and other socially deviant behaviors, primarily committed by "racially inferior" or underclass communities. By 1931, 29 states had outlawed marijuana."*[3]

In 1937, the United States Congress passed the Marijuana Tax Stamp Act. This law prohibited the possession or use of marijuana and effectively outlawed the green flowering plant. Even though the LaGuardia Report of 1944 concluded that marijuana was not as dangerous as it had been previously assumed, the laws against it have remained unfavorable for decades.[4]

b. Federal Controlled Substances Act

i. Content of the CSA

The Controlled Substances Act (CSA) is the statute prescribing U.S. federal drug policy regarding certain drug substances. It was passed by the 91st United States Congress in 1970 and was signed into law by President Richard Nixon. The CSA is the current regulation pertaining to marijuana.[5]

The CSA classifies certain drugs as "controlled" because they are deemed to be dangerous and/or addictive. The classification of a drug as controlled is based on several factors:

(1) Its actual or relative potential for abuse.
(2) Scientific evidence of its pharmacological effect, if known.
(3) The state of current scientific knowledge regarding the drug or other substance.
(4) Its history and current pattern of abuse.
(5) The scope, duration, and significance of abuse.
(6) What, if any, risk there is to the public health.
(7) Its psychic or physiological dependence liability.
(8) Whether the substance is an immediate precursor of a substance already controlled.[6]

Under the CSA, controlled substances are classified into one of five schedules: I, II, III, IV, and V, with Schedule I including the most dangerous substances, and Schedule V containing the least dangerous. To be placed on a particular schedule, a drug must meet certain criteria as shown in Table 1.

Although the CSA was passed in 1970, in 1972 President Richard Nixon, at the direction of Congress, appointed the Shafer Commission to study marijuana and to make recommendations about its legality. The commission concluded that small quantities of marijuana for personal use should be decriminalized; however, Nixon ignored the commission's recommendations.

[3] http://www.pbs.org/wgbh/pages/frontline/shows/dope/etc/cron.html
[4] http://www.pbs.org/wgbh/pages/frontline/shows/dope/etc/cron.html
[5] See http://www.deadiversion.usdoj.gov/21cfr/21usc/index.html for a complete review of the entire act.
[6] http://www.deadiversion.usdoj.gov/21cfr/21usc/811.htm

Table 1: Schedules of the Controlled Substances Act of 1970

Schedule	Criteria for Inclusion	Examples of Drugs in this Schedule
Schedule I	• The drug or other substance has a high potential for abuse. • The drug or other substance has no currently accepted medical use in treatment in the United States. • There is a lack of accepted safety for use of the drug or other substance under medical supervision.	Heroin Peyote Ecstasy Marijuana LSD
Schedule II	• The drug or other substance has a high potential for abuse. • The drug or other substance has a currently accepted medical use in treatment in the United States or a currently accepted medical use with severe restrictions. • Abuse of the drug or other substances may lead to severe psychological or physical dependence.	Demerol Fentanyl Hydrocodone Oxycodone Cocaine
Schedule III	• The drug or other substance has a potential for abuse less than the drugs or other substances in Schedules I and II. • The drug or other substance has a currently accepted medical use in treatment in the United States. • Abuse of the drug or other substance may lead to moderate or low physical dependence or high psychological dependence.	Anabolic steroids Barbiturates Codeine cough syrup
Schedule IV	• The drug or other substance has a low potential for abuse relative to the drugs or other substances in Schedule III. • The drug or other substance has a currently accepted medical use in treatment in the United States. • Abuse of the drug or other substance may lead to limited physical dependence or psychological dependence relative to the drugs or other substances in schedule III.	Ativan Phentermine Ambien
Schedule V	• The drug or other substance has a low potential for abuse relative to the drugs or other substances in Schedule IV. • The drug or other substance has a currently accepted medical use in treatment in the United States. • Abuse of the drug or other substance may lead to limited physical dependence or psychological dependence relative to the drugs or other substances in Schedule IV.	Lomotil Phenergan Lyrica
Source: http://www.deadiversion.usdoj.gov/21cfr/21usc/812.htm		

ii. Enforcement of the CSA

Enforcement of the CSA rests with the United States federal Drug Enforcement Agency (DEA). The DEA's primary mission is to "enforce the controlled substances laws and regulations of the United States and bring to the criminal and civil justice system of the United States, or any other competent jurisdiction, those organizations and principal members of organizations, involved in the growing, manufacture, or distribution of controlled substances appearing in or destined for illicit traffic in the United States."[7]

While the DEA is charged with investigating and preparing for prosecution violators of the CSA, actions from the Obama administration have resulted in very inconsistent enforcement, and in states where marijuana has been declared legal, virtually no enforcement. In 2009, President Barack Obama ordered federal authorities not to target for arrest or prosecution medical marijuana growers and facilities that were in compliance with their respective state laws (Johnson & Lewis, 2009; Stout and Moore, 2009). This was communicated via "The Cole Memo." Then, in 2013, the Obama Administration noted that it would not interfere with Washington and Colorado's legalization of adult-use marijuana as long as the states took steps to strictly control possession and distribution of the substance. The U.S. Attorney General's office, in the Cole Memo, indicated that it would not target users of marijuana, but would rather focus on certain specific enforcement activities such as keeping marijuana away from minors and stopping the growth of marijuana on public lands (Dennis, 2013).

Next is an examination of the state laws that are in direct conflict with the CSA.

[7] http://www.dea.gov/about/mission.shtml

c. State Laws: Medical

Since 1996, two dozen states plus the District of Columbia have legalized the use and distribution of medical marijuana. The most recent state to legalize medical marijuana was Pennsylvania in 2016. A summary of the medical marijuana states and the possession limits that are allowed is provided in Table 2.

Table 2: States that Have Legalized Medical Marijuana (as of 2/7/2017)

State	Year Legalized	How Passed	Maximum Amount Legal to Possess
Alaska	1998	Ballot Measure 8 (58%)	1 ounce usable; 6 plants (3 mature, 3 immature)
Arizona	2010	Proposition 203 (50.13%)	2.5 ounces usable; 12 plants
Arkansas	2016	Ballot Measure Issue 6 (53.2%)	3 oz. usable per 14 day period
California	1996	Proposition 215 (56%)	8 ounces usable; 6 mature or 12 immature plants
Colorado	2000	Ballot Amendment 20 (54%)	2 ounces usable; 6 plants (3 mature, 3 immature)
Connecticut	2012	House Bill 5389 (94-51 H, 21-13 S)	One month supply
DC	2010	Amendment Act B18-622 (13-0 vote)	2 ounces dried; limits on other forms to be determined
Delaware	2011	Senate Bill 17 (27-14 H, 17-4 S)	6 ounces usable
Florida	2016	Ballot Amendment 2 (71.3%)	Amount to be determined
Hawaii	2000	Senate Bill 862 (32-18 H; 13-12 S)	4 ounces usable; 7 plants
Illinois	2013	House Bill 1 (61-57 H; 35-21 S)	2.5 ounces of usable cannabis during a period of 14 days
Maine	1999	Ballot Question 2 (61%)	2.5 ounces usable; 6 plants
Maryland	2014	House Bill 881 (125-11 H; 44-2 S)	30 day supply, amount to be determined
Massachusetts	2012	Ballot Question 3 (63%)	60 day supply for personal medical use
Michigan	2008	Proposal 1 (63%)	2.5 ounces usable; 12 plants
Minnesota	2014	Senate Bill 2470 (46-16 S, 89-40 H)	30 day supply of non-smokable marijuana
Montana	2004	Initiative 148 (62%)	1 ounce usable; 4 plants (mature); 12 seedlings
Nevada	2000	Ballot Question (65%)	2.5 ounces usable; 12 plants
New Hampshire	2013	House Bill 573 (283-66 H; 18-6 S)	2 ounces of usable cannabis during a 10 day period
New Jersey	2010	Senate Bill 119 (48-14 H; 25-13 S)	2 ounces usable per month
New Mexico	2007	Senate Bill 523 (36-31 H; 32-3 S)	6 ounces usable; 16 plants (4 mature, 12 immature)
New York	2014	Assembly Bill 6357 (117-13 A; 49-10 S)	30 day supply of non-smokable marijuana
North Dakota	2016	Ballot Measure 5 (63.7%)	3 oz. per 14-day period
Ohio	2016	House Bill 523 (71-26 H; 18-15 S)	Maximum of a 90-day supply, amount to be determined
Oregon	1998	Ballot Measure 67 (55%)	24 ounces usable; 24 plants (6 mature, 18 immature)
Pennsylvania	2016	Senate Bill 3 (149-46 H; 42-7 S)	30 day supply
Rhode Island	2006	Senate Bill 0710 (52-10 H; 33-1 S)	2.5 ounces usable; 12 plants and 12 seedlings
Vermont	2004	Senate Bill 76 (22-7) HB 645 (82-59)	2 ounces usable; 9 plants (2 mature, 7 immature)
Washington	1998	Initiative 692 (59%)	24 ounces usable; 15 plants

Source:http://medicalmarijuana.procon.org/view.resource.php?resourceID=000881&gclid=Cj0KEQjw09C5BRDy972s6q2y4egBEiQA5_guv0pnR1qEczitr_4DZsUCGQxjwDWtVbp3N5u3DXHgt8YaAnr08P8HAQ

d. State Laws: Adult Use

Beginning in 2012 with Colorado and Washington, states began legalizing what is known as adult-use marijuana. Also known as recreational use cannabis, these states do not require a medicinal need to consume marijuana. Table 3 summarizes the state laws pertaining to adult-use cannabis possession. It should be noted that the growth in sales in this market have been explosive; from 2014 to 2015, adult use sales in the U.S. increased by 232% (*The State*, 2016).

Table 3: States that Have Legalized Adult-Use Marijuana (as of 2/7/2017)

States	Year Passed	How Passed	Age Required to Possess	Maximum Amount Legal to Possess
Alaska	2015	Ballot Measure 2 (52%)	21+	1 ounce usable; 6 plants (3 mature, 3 immature)
California	2016	Proposition 64 (57%)	21+	1 ounce; 6 plants
Colorado	2012	Amendment 64 (55%)	21+	1 ounce or less; 6 plants (3 mature, 3 immature)
DC	2014	Initiative 71 (65%)	21+	2 ounces 6 plants (3 mature, 3 immature)
Maine	2016	Question 1 (50.15%)	21+	2.5 ounces, 6 plants
Massachusetts	2016	Question 4 (53.66%)	21+	10 ounces, 6 plants per person and 12 plants per household
Nevada	2016	Question 2 (54%)	21+	1 ounce
Oregon	2015	Measure 91	21+	8 ounce usable and 4 plants; 1 ounce in public
Washington	2012	Initiative 502 (56%)	21+	1 ounce

e. State Laws: Decriminalization

After the Shafer Commission completed its study in 1972, several states proceeded to decriminalize the possession of small amounts of cannabis. A summary of those state laws is provided in Table 3. In some states, such as Alaska, there is no fine or penalty for possession of small amounts. In other states, the possession of marijuana is still a crime, but it is a misdemeanor with a very low fine and no threat of jail time, at least for the first offense. Table 4 summarizes the various states' approaches to decriminalization.

Table 4: States that Have Decriminalized Marijuana Possession (as of 2/7/2016)

State	Age Required to Possess	Maximum Amount Legal to Possess	Terms/Penalties/Fines for possession
Alaska	21	1 ounce	$0 fine without penalties. $0 fine without penalties up to 4 ounces in a personal residence. 1-4 ounce misdemeanors with $1000 fine and 1 year jail time.
California	18	28.5 ounce	$100 infraction. Offenses depend based on age, location, and amount.
Colorado	21	1 ounce	$0 fine without penalty. If amount is more than 1 ounce, $100 fine and petty offense. Amounts between 2-6 ounces is a misdemeanor with $700 fine and up to 1 year in jail.
Connecticut	18	½ ounce	$150 fine and civil penalty, second offense is between a $200 to $500 fine and civil penalty. More than 4 ounces is a felony.
Delaware	18	1 ounce	$100 fine, $200 fine for public use and 5 jail days. Civil and not a criminal offense with no threat of jail time for first offense. Second offense is a misdemeanor.
DC	21	2 ounces	$0 fine without penalties; more than 2 ounces is a misdemeanor with jail time.
Maine	21	1.25 ounce	$350-$600 fine for a civil violation without jail time. 2.5 ounces and above will face jail time.
Maryland	21	>10 grams	$100 fine for first offense, $250 for second, $500 fine for third. Third time offenders or offenders under 21 will be looked at for abuse problems and education classes.
Massachusetts	18	1 ounce	$100 fine for a civil offense, under 18 offenders pay $100 fine and attend a drug awareness program. Amounts greater than 1 ounce first offense is a misdemeanor with a $500 fine and 6 months jail time.
Minnesota	18	42.5 grams	$200 maximum fine and misdemeanor without jail time and possible drug education course. Amounts greater than 42.5 grams are a felony and $10,000 fine.
Mississippi	18	30 grams	$250 fine without penalty or jail time, second offense is $250 fine with 4-60 days jail time.
Missouri*	21	10 grams	Reduced to class D misdemeanor with jail time still possible. Possession of >35 grams could face 1 year in jail or max fine of $1000.
Nebraska	21	1 ounce	$100 fine for an infraction without the chance of jail time. Second offense is a misdemeanor with a $500 fine and third offense is a misdemeanor with $500 fine and 7 days jail time.
Nevada	21	1 ounce	$600 fine for a misdemeanor without the chance of jail time. $1000 fine for the second offense and $2000 fine for the third offense with 1-year jail time. Fourth offense is a felony.
New York	n/a	25 grams	$100 fine for first offense, $200 fine for second offense, and $300 fine for the third offense and 15 days jail time. 25 grams to 2 ounces is considered a misdemeanor.
North Carolina	18	½ ounce	$200 fine; still considered a misdemeanor, but with no threat of jail time for first offense. Subsequent offenses may carry more severe penalties.
Ohio	18	>100 grams	$150 fine for a misdemeanor without the chance of jail time.
Oregon	21	1 ounce	$0 fine without penalty
Rhode Island	18	1 ounce	$150 fine for a civil violation and without the possibility of jail time.
Vermont	21	1 ounce	$200 fine for civil violation for the first offense without jail time. $300 for second offense and $500 for third offense without jail time.

*Not really "decriminalized" since jail time is still possible.
Source: http://norml.org/aboutmarijuana/item/states-that-have-decriminalized

II. The Current Insurance Environment for Cannabis Coverage

Like any other commercial enterprise, a cannabis business faces numerous loss exposures that can threaten its ongoing survival. The financial consequences of those loss exposures are very often handled via the purchase of insurance. In addition, each state has its own regulations and requirements for licensed cannabis businesses operating within its borders. For instance, Washington requires recreational cannabis operators to carry a minimum of $1 million in general liability coverage provided by an insurer rated at least "A-" by A.M. Best's (Jones, 2014). Where do these businesses obtain their insurance?

a. Standard Lines / Admitted Market

In the standard insurance marketplace, forms and rates are filed with the state regulator, and policyholders typically have guaranty fund protection. The typical forms used by standard lines carriers are those published by the Insurance Services Office (ISO). Wells (2014) analyzes the various standard ISO forms, and concludes that these forms do not contain adequate language to preclude insurers from being required to pay for property and casualty marijuana-related claims. A representative of the ISO, in 2016, communicated to this author that the ISO is working on an endorsement to exclude marijuana from coverage, but as of this writing it has not been made available for public inspection. Ultimately, though, the current language in ISO forms simply does not explicitly exclude coverage for marijuana related losses, both property and liability.

The admitted market for insurance is typically for "standard" risks that are commonplace, such as homes in residential areas, typical personal automobiles, and small retail and mercantile businesses. Cannabis-related businesses are not included in this market because they are still considered too risky. Instead, they are covered in the non-admitted market, described next.

b. Nonstandard Lines / Non-admitted Market

In the non-admitted market, also called the excess and surplus lines market, forms and rates are not filed with the regulator. The excess and surplus lines carriers participating in this market have the freedom to charge whatever they wish, and, to word their policies in most any way they deem appropriate. There are no standard policy forms used. This market is appropriate for risks that are deemed to be outside the scope of the admitted market: coastal beach houses, exotic automobiles, and high-risk business operations.

It is typical for new, fledgling industries to have coverage available only through the excess and surplus lines market. This was the case with Native American gaming facilities back when they were first developing. This is where marijuana businesses find coverage for their operations today, in part because they are relatively new, and in part because of the unique risks associated with the business. For instance, the marijuana industry is largely a cash-based one because marijuana businesses do not generally have access to banking services in the United States. The U.S. Department of Justice has made it clear that the CSA, coupled with federal anti-money laundering statutes, prohibit banks from transacting business with marijuana organizations (Cohen, 2015). With the massive amounts of cash on hand, these businesses become easy theft, robbery, and kidnapping targets.

Lloyd's of London provided cover for the cannabis industry for awhile, but has pulled out of the market. Other insurers in the U.S. are responding with coverage options for cannabis businesses. Coverages are available for growers of the plant, dispensaries, infused edibles manufacturers, ancillary businesses, landlords, and prescribing physicians. Everything from liability coverage to business income coverage is available.

Of course, the most valuable asset for a cannabis business is its plant material. This is also insurable. Indoor crop coverage is available, but outdoor crop coverage as of this writing is not. Indoor crop coverage can be purchased on any/all of these growth stages:

- **Living Plant Material:** Seeds, marijuana plants in the stage of vegetative growth, immature marijuana seedlings, and flowering mature plants in the growing medium.
- **Harvested Plant Material:** Mature marijuana plant material that is not situated inside the growing medium, but is in the drying and curing process.
- **Finished Stock:** Mature marijuana plant material no longer in the growing medium, which has been completely processed and is ready for sale.

Coverage against the most common perils, including fire, lightning, theft, hail and windstorm, is typically offered, but only under specific terms and conditions. For example, businesses are required to have buildings inspected by a licensed electrician to ensure that the wiring in the building is adequate to run a growing operation.

Also, coverage requires the installation of a security system monitored by an outside party, and, the installation of a safe for storing and protecting harvested products.[8]

The insurance market for the cannabis industry is surprisingly well-developed given its infancy. Nonetheless, there is still a massive conflict between state and federal laws on whether or not it is even legal to possess cannabis, much less engage in cannabis commerce. As we'll see in the next section, the courts have had mixed results in terms of supporting coverage for the marijuana exposure.

III. Legal Precedents and Responses: Is Cannabis Covered by Insurance?

To date there are three[9] court cases that examine property and liability coverage for cannabis as valuable property. These cases test the question of whether or not insurance must cover marijuana in states where the green plant is legal. Detail about each of these three cases is provided subsequently.

a. Green Earth v. Atain Specialty (2016)

Green Earth operated a retail medical marijuana dispensary and a growing facility in Colorado Springs, Colorado. In April, 2012, Green Earth sought and purchased insurance on its business from Atain. The insurance took effect June 29, 2012.

On June 23, prior to the policy's inception, a wildfire started in Waldo Canyon outside of Colorado Springs. The fire burned for days, moving towards the city. Green Earth contended that although the fire did not touch or directly burn the building, that ash and smoke from the fire overwhelmed its ventilation system and damaged its growing marijuana plants.

In November of that year, Green Earth filed a claim for damages with Atain. After a lengthy investigation, Atain denied the claim in July of 2013 for the following reasons:

- The smoke and ash drawn into the building occurred before the policy's inception date,
- Green Earth misrepresented the date of the loss and that was a material misrepresentation,
- Green Earth did not take steps to mitigate the loss, and,
- Green Earth failed to give timely notice of the claim.

Separately, on June 7, 2013 (the following year), thieves entered the Green Earth facility and stole some of the plants. At some unspecified time after that, Green Earth filed a theft claim with Atain for damage to the building's roof and ventilation system. On September 13, 2013, Atain denied the claim because the damages were less than the deductible amount.

On December 20, 2013, Green Earth took legal action against Atain and made three claims:

- Breach of contract by failure to pay claims
- Bad faith breach of insurance contract
- Unreasonable delay in payment

Green Earth asserted that it lost more than $200,000 in damage to its grow operation due to the Waldo Canyon fire, namely its growing "mother" plants and clones[10], and approximately $40,000 in damage to harvested marijuana product that was being prepared for sale. Green Earth asked the court for a summary judgment of this claim, granting coverage for the loss because the marijuana plants were considered "stock." Atain argued that the term "stock" did not include growing plants, and that there was an exclusion in the policy for "growing crops." Atain also argued that the exclusion in the policy for "contraband" applied in this case since marijuana is illegal at the federal level under the CSA. Atain asked that the policy be declared null and void on the grounds that it was against public policy to cover a marijuana facility in the first place.

[8] http://www.cannassure.com/products/growers-crop/

[9] There is another case, *Barnett v. State Farm* (2011), which involves a claim for payment under a homeowners' policy. The judge's decision in the case had nothing to do with the legality of cannabis, but rather the definition of theft and whether or not the plants in question were actually "stolen" when seized by police.

[10] A mother plant is not cultivated to produce useable marijuana, but is instead maintained to produce a constant and reliable supply of genetically-identical "clones." A clone is a portion of the mother plant that is cut off and planted in a growing medium until it produces its own root, becoming a viable plant that can then grow to maturity. At the appropriate time the grower harvests the flowering mature clone, cutting off its flowers and buds, drying that material, and selling it.

Ultimately, the court made several important rulings that are pertinent to insurance. First, that the resolution of the suit would be determined by the law of the state in which the suit is brought (in this case, Colorado law), rather than by federal law. And, that per the proviso of a contract of adhesion, ambiguities in the wording of the contract would be construed against the maker, which in this case is Atain.

Second, the policy did indeed clearly exclude coverage for "growing crops" and thus did not apply to the mother plants and clones.

Third, and perhaps of most interest to the insurance field, is the ruling that the parties' mutual intention regarding coverage was to provide coverage for marijuana. Atain knew, based on Green Earth's application for coverage, that Green Earth operated a marijuana grow facility and would thus have marijuana in its possession. Thus, the court rejected Atain's argument that the insurance policy should be voided on public policy grounds. "Atain, having entered into the Policy of its own will, knowingly and intelligently, is obligated to comply with its terms or pay damages for having breached it" (*Green Earth v. Atain*).

b. Kochendorfer v. Metropolitan Property & Casualty Insurance Company

In *Kochendorfer v. Metropolitan*, the plaintiff owned a house that was used as rental property. The individuals renting the house operated a marijuana grow operation, and caused a fire by tampering with the electrical panel. The tenants "jumped" the electrical panel, tapping into power to fuel lights for a marijuana grow operation. The fire occurred on July 4, 2010.

Kochendorfer received an initial payment of $30,052.83 for the loss from the insurance company, and then submitted proof of loss in the amount of $323,823.49. Per the policy's conditions, the parties entered the appraisal process to resolve the dispute. The appraisal panel rendered its decision in March of 2011, awarding Kochendorfer $311,270.58 in replacement cost value ($240,077.05 in actual cash value), which accounted for repairs to the structure, clean-up and remediation of, among other things, Tetrahydrocannabinol (THC) residue, code upgrades and temporary repairs. The panel subsequently issued an appraisal award for loss of use, accounting for a four month reconstruction period upon receipt of the full actual cash value (ACV) payment.

On May 16, Metropolitan issued an ACV payment for the structure and temporary repairs, and denied coverage for the code upgrades and clean-up and remediation. Metropolitan also did not pay for loss of use. The court ultimately ruled that the cause of loss was tenant vandalism, and not the marijuana grow operation. The insurer was ordered to pay for all damages, including the costs of remediation to remove and remediate the cannabis grow.

c. Tracy v. USAA (2012)

Barbara Tracy, a resident of Hawaii, had marijuana plants stolen from her property. She filed a claim with her homeowner's insurer, USAA, to recover the value of the plants. Specifically, she claimed she had $45,600 worth of medical marijuana plants stolen from her premises.

USAA paid Tracy $8,800, which Tracy deemed to be insufficient. She demanded more money, and USAA refused on the grounds that she did not have a valid insurable interest in the plants under Hawaii Rev. Stat. § 431:10E-101, which states:

"No contract of insurance on property or of any interest therein or arising therefrom shall be enforceable except for the benefit of persons having an insurable interest in the property insured. Insurable interest means any ***lawful*** and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction, or pecuniary damage."

USAA argued that the plants were not lawful given their Schedule I status under the Controlled Substances Act of 1970, and, to enforce the contract of insurance in this instance would be against public policy. The court agreed and denied Tracy's claim for her plants and for bad faith damages.

i. State Responses to *Tracy v. USAA*

It is interesting to note that in Washington and Oregon, the subject of insurable interest specifically raised in *Tracy v. USAA* has been dealt with somewhat explicitly through legislation. In Washington, the law is as follows:

RCW 48.18.040:

> (1)No contract of insurance on property or of any interest therein or arising therefrom shall be enforceable except for the benefit of persons having an insurance interest in the things insured.
>
> (2) "Insurable Interest" as used in this section means any lawful and substantial economic interest in the safety or preservation of the subject of the insurance free from loss, destruction, or pecuniary damage."

Washington's Initiative 502, which passed in 2012 and legalized adult use of marijuana, declares that one ounce of marijuana is lawful under Washington law. It thus creates an insurable interest, at least according to state law.

In Oregon, Measure 91 specifically states that "no contract shall be unenforceable on the basis that manufacturing, distributing, dispensing, possessing, or using marijuana is prohibited by federal law." So, Oregon has taken a very direct approach to prevent insurers and other parties from voiding contracts based on the federal illegality of marijuana.

No discussion of the conflict between state and federal law would be complete without mentioning the **McCarran–Ferguson Act**, 15 U.S.C. §§ 1011-1015. This federal law exempts the business of insurance from most federal regulation, including federal antitrust laws. Passed in 1945, the law is designed to leave the regulation of insurance up to each individual state, rather than putting it in the hands of the federal government. The key provision of the McCarran-Ferguson act is as follows (bold print included for emphasis):

> *"**No Act of Congress shall be construed to invalidate, impair, or supersede any law enacted by any State for the purpose of regulating the business of insurance**, or which imposes a fee or tax upon such business, unless such Act specifically relates to the business of insurance: Provided, That after June 30, 1948, the Act of July 2, 1890, as amended, known as the Sherman Act, and the Act of October 15, 1914, as amended, known as the Clayton Act, and the Act of September 26, 1914, known as the Federal Trade Commission Act, as amended [15 U.S.C. 41 et seq.], shall be applicable to the business of insurance to the extent that such business is not regulated by State Law."*

If an insurer tried to deny payment of a claim for a property loss of marijuana, would McCarran imply that the CSA does not apply to the business of insurance? One could make that argument, although it does not yet appear to have been used in any precedent-setting cases.

IV. Conclusions Regarding Insurer Obligations to Pay Cannabis Claims

a. First Party Claims

The current case law provides a mixture of outcomes for cannabis property damage claims. One insurer has successfully made the argument that it is against public policy to require coverage for marijuana, given that it is still illegal at the federal level. One insurer has been unsuccessful in making that same claim, especially since the insurer knowingly entered into the contract of insurance with a marijuana production facility.

It is clear to this author, though, that the existing policy forms in the admitted insurance market simply do not explicitly preclude coverage for marijuana property claims. Insurance is a contract of adhesion, with ambiguities in the wording construed against the insurer. The fact that these policies are silent on the issue of cannabis ultimately results in a presumption of coverage for damage to marijuana plants and supplies in spite of contract silence on the matter. The only relevant provision of the property policies that could limit coverage is the $500 limit (in most ISO policies) for losses to trees, shrubs or plants. There is absolutely no language that limits coverage for harvested supplies of marijuana. With harvested marijuana retailing for as much as $5,000 per pound in the United States,[11] this is a non-trivial loss amount.

b. Third Party Claims

Most ISO forms are silent on the subject of coverage for liability relating to cannabis (Wells, 2014). The ISO Homeowner form is one exception, however. Specifically, Exclusion 8 of Section II, Subsection E, states the following:

[11] See www.priceofweed.com for current market values.

> "Bodily injury" or "property damage" arising out of the use, sale, manufacture, delivery, transfer or possession by any person of a Controlled Substance as defined by the Federal Food and Drug Law at 21 U.S.C.A. Sections 811 and 812. Controlled Substances include but are not limited to cocaine, LSD, marijuana and all narcotic drugs. However, this exclusion does not apply to the legitimate use of prescription drugs by a person following the lawful orders of a licensed health care professional (*Homeowners 3).*

It is clear that insurers have no responsibility to cover any liability for damages caused out of the homeowner's illegal possession or use of marijuana, but what about the "legitimate use of prescription drugs?" That would seem to include medical marijuana in a state where it is legal, both in terms of harvested marijuana product and growing plants. Millions of patients a year are using and growing cannabis under the supervision and instructions of a licensed medical practitioner who is following the laws of his/her home state.

Also, what about the insured's liability for damage *to someone else's cannabis?* The language in the *HO* form does not address this issue at all.

In other ISO forms, there is no specific mention of cannabis or the CSA. For instance, the Commercial General Liability (CGL) form is completely silent on the subject of controlled substances. There are fundamentally two possible loss scenarios that could involve the CGL: the insured supplies someone with marijuana and is held liable for damages caused to a third party, or, the insured's activities damage someone's crops or supplies of marijuana, and the insured is expected to pay for that property damage. In either case, there is absolutely no language in the policy that precludes covering the insured's liability for losses to a third party.

The only hope insurers have of not paying such claims is to argue that it is against public policy to require payment for claims pertaining to a Schedule I controlled substance, and, given the relative inconsistency in DEA enforcement of the CSA as it pertains to marijuana, this argument is suspect. Again, insurance is a contract of adhesion, with ambiguities in the wording construed against the maker of the contract. The silence of the contract on the issue of covering losses to or caused by cannabis implies that coverage would ultimately have to exist. The simplest solution is the obvious one—if the insurance industry wishes to limit or exclude coverage for cannabis, an exclusion should be crafted to that effect and inserted into the coverage forms.

Further, *Green Earth Wellness* established that if an insurer knows that a contract of insurance is being issued to cover a marijuana exposure, then the insurer must fulfill its coverage obligations regardless of the CSA Schedule I classification of cannabis. The court ruled that to allow the insurer to deny coverage would ultimately be against public policy. Thus, when an insurer has knowledge of, or should have knowledge of, the marijuana exposure, coverage is very likely to exist.

V. Conclusions

This paper examined the current status of the legal cannabis market in the United States, and described insurer obligations to pay given current ISO policy language. Ultimately there is a conflict between federal and state laws over the legality of cannabis possession, production and distribution, and to date only three court cases have tested this conflict. *Tracy v. USAA* ruled that because cannabis was illegal at the federal level, the insurer did not have to cover the loss to marijuana plants. In *Green Earth Wellness v. Atain Specialty*, the insurer argued that it should not have to pay for marijuana because it is illegal at the federal level, and the federal district court judge disagreed with that argument. Finally, in *Kochendorfer v. Metropolitan*, the insurer was required to pay for a loss that stemmed from a marijuana grow operation.

In summary, it is anyone's guess how the next court may rule, but the policy language that exists today is almost universally silent on the matter of coverage for first-party and third-party marijuana-related insurance claims. This silence is an ambiguity in the wording that ultimately may be construed against the insurer when coverage disputes exist.

With public opinion now at 58% in favor of marijuana legalization (Jones, 2015), and with several states in 2016 determining whether to legalize adult-use of marijuana and/or medical marijuana (*The State,* 2016), the trend towards legalization appears to be a given at this point. As legalization expands, insurance claims pertaining to marijuana will surely increase in number, and regulators should be prepared for inquiries pertaining to insurer obligations to pay those claims.

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