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Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

A Look At 1st-Party Insurance Coverage For Cannabis

By **Fiona Chaney and Pamela Woods**

Fiona Chaney

Pamela Woods

Law360, New York (May 18, 2017, 11:23 AM EDT) -- In 1996, California legalized the use of medical cannabis in limited situations and in November 2016, California voters approved the recreational use of cannabis, subject to certain limitations. As a result, the cannabis industry — particularly in California — continues to grow at an exponential rate. Obviously, the cannabis industry presents unique risks. Although some insurers have sidelined themselves and decided not to insure this burgeoning industry, others are creating new insurance products to match the industry's needs. As a result, a number of specialized cannabis-specific insurance products are on the market. It is important for entrepreneurs and cannabis enthusiasts seeking to cash in on this latest gold rush to properly insure cannabis-related risks and to understand the different types of insurance products available for the cannabis industry.

The insurance needs of cannabis-related businesses differ depending on the nature of the business. Businesses such as dispensaries, growers, cannabis-infused product (i.e., "edibles") manufacturers , landlords of cannabis businesses, medical cannabis physicians and even ancillary cannabis businesses such as tobacco shops and testing laboratories, all are subject to both first party losses (i.e., losses suffered by the business itself) and third party claims. This article focuses on insurance coverage for first party losses.

With respect to first party claims, the business should consider maintaining property insurance. This type of insurance generally covers inventory, permanently installed equipment, fixtures, the building itself (if owned by the insured), and certain personal property that is "usual or incidental to the occupancy of the premises" or "used by an insured while on the described premises." Here, keeping careful records of inventory, equipment and fixtures is important to maximizing insurance coverage in the event of a loss. Likewise, these policies may require the insured to warrant that it is taking certain measures to control risk,such as using locked and bolted safes to contain stock and inventory, using central station burglar alarms, and not displaying products in show windows without certain shatterproof or other theft-resistant glass or acrylic.

Many first party property policies are "open peril" and cover "all risks," meaning they cover all causes of loss unless expressly excluded. Such policies are beneficial because they shift the burden to the insurer to establish that a loss is not covered after the insured has demonstrated it has suffered a loss. Another type of property policy is known as a “named perils” policy, which, as the name suggests, provides coverage only for those perils expressly listed (e.g., fire, explosion, lightning and theft). Under a named perils policy, the focus is on whether the cause of loss was a named peril (e.g., fire). Thus, a “named perils” policy may provide more limited coverage than an “all risk” or “open perils” policy. Insureds in the cannabis industry should carefully consider and select which type of policy will best suit their needs.

Another valuable aspect of property insurance, if purchased, is time element coverage (sometimes called “business interruption” or “extra expense” insurance). This coverage protects against disruption of operations and lost income. For example, if a dispensary suffered a fire, the income that would have been realized if there were no fire should be covered. Similarly, if the dispensary had to move to a new or temporary location because of the fire, these “extra expenses” also may be covered.

It also is important to note that some insurance companies either will not provide property insurance to a landlord who owns buildings that are leased to cannabis facilities, or may attempt to cancel the insurance upon discovery of the building’s use as a cannabis facility. Thus, it is key to know — both as the landlord or the tenant — whether the pertinent policy contains such a condition to avoid a forfeiture of coverage. For example, the policy may include an exclusion for loss or damage caused directly or indirectly by dishonest or criminal acts. However, in states where cannabis is legal, an insured may be able to negotiate the addition of a provision that prevents using federal illegality as a defense to any claim arising from the lease, as well as an agreement that the parties waive the right to assert any such defense related to the status of cannabis under federal law. Courts are split on whether these provisions are enforceable.

Growers also may consider crop insurance, which can provide coverage for loss of crops from natural disasters such as hail, drought or floods, or from the loss of revenue because of decline in price. Crop policies typically provide specific sublimits setting forth the maximum amount of coverage available for each type of crop (e.g., seeds, immature seedlings, flowering plants and harvested plants). Further, because many cannabis cultivation operations take place in indoor grow facilities, many underwriters require an attestation from the insured that it will use a licensed, insured contractor for all electrical work at its grow facility. And, like property policies, these specialized grower’s insurance products also may require specific types of security systems and the use of bolted safes.

Given the value of cannabis and cannabis-related products and the fact that the industry operates on a cash basis, a commercial crime policy also may be advantageous. These types of policies provide coverage for risks such as employee dishonesty; forgery or alteration; computer fraud; funds transfer fraud; kidnap, ransom or extortion; money and securities loss; and money orders and counterfeit money loss. Some of these coverages, like kidnap, ransom and extortion, also are sold as standalone policies. Again, because transactions are conducted on a cash for product basis, and there is a high volume of cash involved, those involved may be at a higher risk for kidnap, ransom or extortion. These types of policies typically require an insured to immediately notify an insurer of the event and allow the insurer to conduct any necessary negotiations. In addition, these policies often include confidentiality provisions that preclude disclosure of the insurance in an effort to minimize targeting of insureds.

There are other specialized first-party insurance products including “raid coverage,” which is designed to protect legally operating medical cannabis-related businesses. This policy is described as providing reimbursement coverage of up to $5,000 per occurrence and $10,000 in the aggregate, which is payable after the insured pleads not guilty to all charges, the charges are dismissed, or the insured is found not guilty.

With all first party insurance policies, insureds need to pay close attention to and understand the contractual limitations of their policies. For example, the policy may specify when a loss is deemed to occur and require that the insured immediately notify the insurer of the loss. It may require that the insured submit a proof of loss[1] within a specific time period and in a specific form, or may require that the insured submit to an examination under oath[2]. Finally, the policy may require that the insured commence any lawsuit against the insurer by a certain date (e.g., one year after discovery of the loss). The insurer is likely to argue that coverage has been forfeited if the insured does not comply with each of these conditions.

Insureds in cannabis-related industries should carefully shop for their insurance policies and work with a qualified insurance broker — not surprisingly there are a handful of insurance brokers specializing in cannabis-related coverage — as well as insurance coverage counsel. When an insured incurs a loss, they also should immediately consider which policies may apply to maximize their insurance coverage and also consider involving insurance coverage counsel from the outset to help navigate the claims process.

Fiona A. Chaney and Pamela M. Woods are partners in Liner LLP's insurance recovery group.

[1] A proof of loss is a written description of the loss and the amount claimed together with backup documentation that is submitted to an insurance company following a loss usually within a specified period of time (e.g., 60 days after the insurer requests a proof of loss).

[2] An examination under oath is a formal interview of the insured conducted by a person designated by the insurer who may ask about any matter relating to the insurance or the loss and require that the insured produce books and records for examination.
