

Cannabis Industry Has Bumper Crop Of Coverage Options

By **Shane Dilworth**

Law360 (August 29, 2023, 12:24 PM EDT) -- While insurance options for cannabis growers and businesses may not come from major carriers, there is already a budding variety of options for policies that provide protection against environmental hazards, product liability claims, property damage and other industry-specific risks.

The momentum of the cannabis industry's growth has spurred more underwriters to calculate risks and create policies for growers, processors, manufacturers and retailers, experts say, but there are gaps in currently available coverage that must continue to evolve.

Policyholder attorney Benjamin D. Tievsky, a partner at Pillsbury Winthrop Shaw Pittman LLP in New York, told Law360 that coverage options are still relatively limited due to the continued federal illegality of cannabis combined with the absence of federal protections from prosecution or enforcement for insurers doing business with cannabis companies, such as may be provided by the as-yet unpassed Clarifying Law Around Insurance of Marijuana Act, or CLAIM Act. .

"The insurance market is really a patchwork at the state level of nonadmitted carriers," Tievsky said. "In some instances, there are state sanctioned insurance offerings, like those in California, but they may not be like other lines of insurance, where your household name insurers sell at a national level."

Carrier-side attorney Ian A. Stewart, a partner at the Los Angeles office of Wilson Elser Moskowitz Edelman & Dicker LLP, told Law360 that the insurance market for the cannabis industry was rocked in 2015 when London syndicates exited the U.S. cannabis market, resulting in some coverage disruptions. The decision by the London syndicates, however, paved the way for other carriers to offer coverage, Stewart said.

Now, most policies are provided by excess and surplus suppliers, he said.

Room for Environmental Growth

Companies operating within the cannabis industry face a shortage of options for certain coverage lines, including pollution liability, but the number of available policies is steadily growing.

Pillsbury's Tievsky said environmental coverage could be the "next frontier" for the cannabis industry.

"It's an area where regulation and enforcement at the state and local level is increasing for cannabis companies, in California and Washington state, for example, and there may be risk and underwriting precedent for insurance companies," he said. "Growers especially should be aware that there is potential coverage for liabilities associated with environmental issues."

John Peiserich of the global consulting firm JS Held told Law360 that some of the biggest environmental concerns facing cannabis growing operations are the use of water and electricity, odor emissions and waste management. Growing cannabis requires large amounts of water and generates wastewater that a municipality may not be able to handle, he explained .

The use, storage and disposal of hazardous substances also poses a significant obstacle for processors and growers, Peiserich went on to say, noting that some states may not have the appropriate facility for the proper storage or disposal of chemicals such as hexane, which may be used to extract THC from the marijuana flower for inclusion in edibles .

Not having the appropriately permitted facilities in the state may require a business to transport the substance across state lines, resulting in potential criminal issues in an attempt to avoid environmental liability, he explained.

"You may have a plant material that has enough THC to be a regulated cannabis product, but if it's combined with something like hexane, then you may generate hazardous waste," he said. "If you don't have a waste management opportunity in that state for that chemical, you're going to have to cross state lines to treat it as a hazardous waste. So, that's one of those conflicting natures of state and federal law that we see."

Wilson Elser's Stewart said there is not "a lot of good environmental coverage out there," explaining that most policies have pollution exclusions as well as exclusions for violations of environmental regulations.

"I think there's very little coverage available in the industry right now for big toxic spills of cannabis waste or violations of the California Environmental Quality Act," he said. "That's an area that I know the industry is exposed to, particularly growers, but it's an area where they're definitely underinsured."

Much like common commercial general liability policies, Stewart pointed out, policies available to cannabis growers usually include pollution exclusions that bar coverage for occurrences caused by discharges, emissions or spills of hazardous substances.

Additionally, Pillsbury's Tievsky pointed out that traditional insurance policies generally have exclusions for illegal acts or illegal business activities.

"In the past, insurers have argued that cannabis is illegal federally," he said. "So, even though cannabis might be legal where the policyholder is operating, they take the position that the illegality exclusion applies to bar coverage for certain losses. Even at the state level, if there is a question about whether the policyholder is not in scrupulous compliance with reporting, product tracking, and other requirements, insurers may attempt to invoke an illegality exclusion."

Tievsky said that is one of the main reasons why there is a specialty insurance market for cannabis.

William Pritchard, the founder and chief executive officer of Beacon Hill Associates, told Law360 that environmental coverage is typically built around ensuring against the release of a contained substance that would be considered hazardous to the environment if released.

"You don't trigger an environmental insurance policy unless you've had a release that is required to be cleaned up or addressed by a regulatory agency," he said. "It is all about containment and control of hazardous substances. So, if you have a storage of a difficult chemical at a site, however it's done, that's the risk that we insure every day. That's what the site pollution insurance industry does, is figure out how to effectively provide coverage in the event of a breach or release from a containment method for the particular constituent you're talking about."

Obtaining environmental coverage is also not high on a cannabis business owner's list of priorities after acquiring a general policy, Pritchard said.

Permitting Nuances Pose Challenges

JS Held's Peiserich said, however, that cannabis growers and processors should be aware that they may need to apply for permits for emissions and wastewater discharges. In some cases, a state oversees the permits issued to comply with its equivalent of federal laws such as the Clean Water Act.

However, nuances to complying with state environmental regulations can stump even sophisticated growers, he noted. And depending on how growers' insurance policies are worded, they may or may not cover claims tied to alleged regulatory violations.

Peiserich pointed out that in March 2021, cannabis cultivator NCA Management agreed to pay \$125,000 to the Colorado River Basin water board for illegally diverting 94,200 gallons of wastewater into its septic tank, which potentially threatened the drinking water supply of residents of Needles, California. According to an article by the Regional Associations Information Network, or RAIN, the diversion of the wastewater to the septic system violated state water quality requirements and posed a potential health risk to the drinking water supply.

Similarly, growing operations and processing facilities must consider if they are required to obtain permitting under the Clean Air Act for odors emitted during the drying process, which some may find noxious.

Those businesses can face odor complaints from nearby residents, who may allege that their homes have suffered a diminution in value and that the operations present a public nuisance.

In 2019, a Pennsylvania hemp drying facility was ordered to pay a \$29,000 fine and was **temporarily shut down** after nearby residents complained about the smell of marijuana. Patriot Shield, a Colorado-based company, opened the location outside Pittsburgh without first obtaining approval from the Pennsylvania Department of Environmental Protection for an air quality plan prior to installing any equipment.

Pritchard said there are typically no provisions in environmental or pollution policies that are specific to the cannabis industry. While some policies may have language limiting coverage for odor from a growing operation's facility, exclusions and other provisions are often not unique to cannabis.

"If you look at the definition of a pollutant in an insurance policy, it very often includes language about airborne or thermal irritants, contaminants, smoke vapors, et cetera," Pritchard said. "That language is generally part of an Insurance Services Office Inc.'s pollution exclusion language and part of the definitions that are designed to fill that gap in general liability coverage."

Pillsbury's Tievsky said that though regulatory actions and enforcement-related costs could be covered under a traditional pollution liability policy depending on the circumstances, cannabis businesses are advised to scrutinize the policy language to ensure it provides adequate coverage and determine whether they might be better served by a cannabis industry-specific policy with environmental liability coverage.

Emerging Product Liability Concerns

In addition to environmental issues arising from the growing and processing of cannabis, experts say the industry will need to keep up with the potential for product liability risks that can emerge with expanded recreational use and growing medical research.

Product liability is "an issue the industry is grappling with right now," Stewart said, even though coverage options are good and plentiful.

"It's a competitive market," he said. "There are probably 10 or 12 options available that are really good. They're all a little different, though. Each is going to have different exclusions, such as health hazards, specified disease, and specified product exclusions."

Tievsky said product liability insurance for cannabis businesses is not much different from that available to other companies in that the policies also contain "products and completed operations coverage." That prong applies to claims of bodily injury or property damage stemming from the policyholder's finished products or operations, provided they occur away from the insured's premises

As a result, Tievsky said, there could be some overlapping coverage between a standard commercial general liability policy and a cannabis-specific liability policy, depending on the claim involved and the coverages purchased.

Legislation Could Expand Insurance Market

Two pending pieces of legislation could open the floodgates for major insurance carriers and lending institutions to freely provide coverage and financing to cannabis businesses, experts say.

The CLAIM Act would provide a "safe harbor" for insurance companies from penalties or adverse agency actions for providing coverage to legitimate cannabis-related businesses in states where it is legal.

And the Secure and Fair Enforcement, or SAFE, Banking Act of 2021 would prohibit a federal banking regulator from penalizing a bank for providing services to a legitimate cannabis-related business would also be a boon for the industry.

While the federal government still classifies marijuana as a Schedule I narcotic under the Controlled Substances Act, the passing of the bills would remove the stigma insurers and bankers may have when considering working with a cannabis business, experts say.

Pillsbury's Tievsky said that though the federal government's continued prohibition of marijuana continues to be a "big ticket issue" for the cannabis and insurance industries, passing the CLAIM and SAFE Banking acts would ease tension among the industries and potentially open up the insurance market to offer broader forms of coverage and competitive pricing.

Insurance coverage attorney John W. Sinnott, a partner at Irwin Fritchie Urquhart Moore & Daniels LLC in New Orleans, said that though there is a growing current for legalization of cannabis at the state level, the federal government is not appearing to budge.

"I think amongst the public there's an increasing appetite for some legalization at least for medical marijuana," Sinnott said, noting that Colorado's legalization of cannabis for medical and adult recreational use has spurred tourism to the Centennial State.

"At the state level, the trend is increasing towards acceptance of cannabis operations," Sinnott went on to say. "But at the federal level, I don't know."

--Editing by Roy LeBlanc.