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# **Insurance Risk in Cannabis Operations: Theory versus Practice**

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## Insurance Risk in Cannabis Operations: Theory versus Practice

By Tyler Scott

Generally speaking, disputes between carriers and insureds are not infrequent; however, coverage disputes in the cannabis industry can be of a different caliber altogether. There is ample evidence suggesting that, on a very basic level, cannabis industry participants face heightened risks when purchasing and using insurance products, with the end result being that many operators believe they have adequately insured potential risks when in fact they haven't. With this in mind there are several key areas for cannabis industry operators to consider when purchasing insurance.

### Make Sure All Risks Are Insured

Cannabis operations span many different business models and range from very simple to very complex. When considering insurance products, operators need to carefully consider the components of their operations—i.e., manufacturing, transportation, wholesale or retail sales—as each of these will affect the types of coverage needed. Some coverages are universal, like property insurance, which covers damage to the operator's equipment, and commercial general liability coverage, which protects the business against claims brought by third parties for personal injury or property damage. But even those universal policies should be purchased with operations in mind. For example, property insurance should probably include inventory to protect theft or damage to an operator's products. Similarly, regardless of whether your operations involve cultivation, manufacturing or retail sales, commercial general liability coverage should include products liability and completed operations hazard coverage to protect against claims for damages from individuals allegedly caused by the cannabis products manufactured or sold,

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or services provided. Claims for product liability have been asserted against cultivators and retail stores alike. Other more specialized coverages should also be considered: given the prevalence of cash as the primary method of exchange in the cannabis industry, some degree of crime/theft coverage is a smart way to manage the associated risks. Other forms of insurance will be required depending upon the makeup of the underlying business; for example, some operators will find that they need crop coverage if cultivation is part of their business.

On the retail side of the industry the product mix one offers may well dictate the kinds of coverage required. If an operator has both medicinal and recreational sales, this has implications for insurance. The operator's policy needs to expressly insure both the medicinal and recreational products and portions of the business.

## Be Wary of Exclusions

Development of insurance products tailored to the specific needs of the cannabis operators is limited. Because tailored policies are rare, some policy terms or coverage exclusions common in standard insurance policies may effectively void coverage for cannabis operators.

One standard exclusion that has been relied upon to deny coverage is the illegality exclusion, which excludes coverage for conduct illegal under state or federal law. While the operator may be located in a state in which cannabis is legal, the growing, manufacturing and sale of cannabis is still illegal under federal law (the Controlled Substances Act). The legal status of cannabis in federal law is not likely to change in the immediate future, and the conflict between federal and state law presents a dilemma for carriers and insureds alike. The safest course for a cannabis industry operator is to discuss the illegality exclusion with its broker or insurer to address the concern and confirm that it will not apply to cannabis business activities legal under state law.

Operators must also be wary of how their property insurance policy defines covered property, because it will often exclude coverage for contraband (which cannabis could be considered due to its illegality under federal law), growing crops and plants. Such a definition could eliminate or significantly limit coverage.



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There are other exclusions that sometimes appear in commercial general liability policies worthy of mention:

- Exclusions for injuries arising out of the performance of a criminal act or caused by a person under the influence of intoxicants (cannabis may be considered an intoxicant and ingesting it is technically a criminal act under federal law).
- The “Smoking Products Hazard” Exclusion — this hazard is often used to protect the insurer from covering nicotine products such as cigarettes or vapes, but would apply to exclude injuries arising out of a large part of a cannabis business (smoking) if interpreted broadly; this exclusion often includes other language that is not beneficial, such as exclusions pertaining to claims or damages arising out of marketing, distribution or other sales practices and exclusions for damages arising out of the design and or failure to warn regarding the product.

## Choice of Law Provisions

Certain policies will provide that the law of the state where the insurer is located governs the policy. As of this writing, only 10 states have legalized recreational use of cannabis; many more are governed by a patchwork of state laws allowing for various levels of medicinal use. The applicable state law controlling an insurance policy can greatly impact coverage and recovery of damages: If the insurer is located in a state that does not permit the sale or production of cannabis, it increases the risk that a court will deny coverage based upon one of the policy exclusions or provisions discussed above.

## Choose Advisors & Business Partners Carefully

When it comes to cannabis operations, the coverage provided by a standard insurance product may not be as robust as it appears. To avoid harmful surprises, operators should consider working with specialized insurers with specifically tailored cannabis industry policies. These policies may be more expensive, but they are particularly tailored to the industry and reduce the likelihood that the insurer will refuse to insure cannabis as illegal, or use some other exclusion that voids or limits coverage. At a minimum, cannabis operators should work with knowledgeable advisors as they look to acquire comprehensive insurance programs for their businesses to ensure they fully understand the coverage such insurance will provide, and to help identify potential coverage gaps and pitfalls.



*Tyler Scott is a partner with Husch Blackwell and is based in the firm's Kansas City office. He advises both insurance companies and their insureds and regularly counsels businesses regarding policy coverage and exposures, as well as strategies that minimize risk and possible litigation.*