What Insurers and Cannabis Businesses Need to Know About Federal Legislation

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By **Robin Dusek** | May 18, 2021 at 11:25 AM

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Every new business looking to manage risk must consider what insurance it needs to protect its assets. But state-legal cannabis businesses have been forced to manage risk without widely available and affordably-priced insurance to suit all of the operational demands. Due to federal illegality of cannabis, insurers (and brokers and reinsurers) have been reluctant to wade into an industry that remains federally illegal. But this means members of the insurance industry who see working with state-legal cannabis as a logical part of their business plans are left out of working with the industry. And it also means that cannabis businesses have to navigate their own risk management with often expensive and inadequate insurance due to lack of competition in the insurance marketplace.

Members of Congress have recognized that insurers need more certainty regarding the legality of working with state-legal cannabis businesses than can be provided by Department of Justice policies that have the potential to shift as agency leadership changes. Certainty that can only come by way of legislation is a must for many insurers. In addition to more widely reported efforts to legalize or decriminalize cannabis, two separate (and overlapping) bills have been introduced that, if passed and signed into law, would provide safe harbors for insurance

industry. This article will briefly describe those bills and also highlight issues and open questions that will remain, even if those efforts succeed.

SAFE Banking Act

On April 19, the SAFE (Secure And Fair Enforcement) Banking Act passed the House of Representatives with a bipartisan vote of 321-101. The bill is in front of the Senate as of the date of this article where a Senate-filed version of the bill has 36 co-sponsors from both parties' caucuses. While most reporting on the bill has focused on the safe harbor provisions for financial-services organizations working with state-legal cannabis businesses, the bill also includes an often overlooked safe harbor for those engaged in the Business of Insurance (as defined by the Dodd-Frank Act (12 U.S.C. 5481)) who wish to work with state-legal cannabis businesses. H.R. 1996, 117th Cong., Section 14.

The SAFE Banking Act states that "an insurer that engages in the business of insurance with a cannabis-related legitimate business or service provider or who otherwise engages with a person in a transaction permissible under state law related to cannabis" will not be held liable under federal law or regulation. H.R. 1996, 117th Cong., §4 (2021).

House passage is by no means a guarantee that the bill will pass the Senate and be signed into law. The SAFE Banking Act first passed the House of Representatives with bipartisan support in 2019. However, it then stalled in the Senate where, despite bipartisan co-sponsorship, it never progressed out of committee. Again, in 2020, the bill was folded into the legislation for COVID-19 relief, the HEROES Act, and passed the House. But the SAFE Banking Act provisions were negotiated out of the bill that ultimately passed in December 2020. Whether a Senate with new leadership breathes fresh life into the bill remains to be seen.

The CLAIM Act

The CLAIM (Clarifying Law Around the Insurance of Marijuana) Act was introduced on a bipartisan basis in the Senate in March 2021 and provides a broader safe harbor for the insurance of cannabis. An earlier version of the bill was introduced in 2019, but stalled as the SAFE Banking Act picked up momentum. However, at present, the CLAIM Act does not appear to be a focus of the Senate, so the newest version of the bill may face the same fate as earlier versions.

Along with a broader safe harbor provision, the CLAIM Act would prohibit penalizing insurers for working with the state-legal cannabis industry and would also prohibit the termination of policies simply because a business is involved in state-legal cannabis. The bill also ensures that non-cannabis businesses who work with cannabis businesses would not jeopardize their own insurance coverage by virtue of working with state-legal cannabis businesses.

The conventional wisdom has been that bills such as those described above have a better chance of passing Congress than does a bill legalizing or decriminalizing cannabis. With rapidly evolving politics relating to cannabis, whether conventional wisdom holds remains to be seen. That said, the insurance industry and cannabis businesses should be aware of what they need

to know relating to insurance of cannabis businesses, should a safe harbor bill proceed while cannabis remains federally illegal.

Major Pitfalls and Questions Relating to a 'Safe Harbor' World

Policies that are not industry specific: Nearly all insurers willing to insure cannabis businesses are operating on a surplus-lines basis, which means that most policies issued are not written specifically for the cannabis industry. Typical policy exclusions may be problematic when cannabis-related claims do arise. While this could change with an influx of insurers willing to work with cannabis businesses, policies are currently circulating with confusing exclusions for the businesses covered and this will likely remain the case. For instance, exclusions for illegality, smoke, or pollution (among others) could theoretically could apply to many, or even all, claims that arise.

Courts offer little guidance as to whether these types of exclusions will be enforced. Two cases involving similar issues, but with dramatically different results illustrate the current state of the law. In 2012, the Hawaiian District Court sided with an insurer who had used federal illegality as its basis for declining coverage for the loss of state-legal medical cannabis plants under a homeowner's policy. See *Tracy v. USAA Casualty Insurance,* NO. 11-00487 LEK-KSC, 2012 WL 928186 (D. Hawaii, Mar. 16, 2012). A few years later, a Colorado court sided with the insured in a coverage dispute where the CGL carrier had relied on a public-policy exclusion to decline coverage for its insured cannabis business. The court pointed out that the insurer, "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." See *Green Earth Wellness Center v. Atain Specialty Insurance*, 163 F. Supp. 3d 821, 831 (D. Colo. 2016). So what will other courts do when faced with exclusions that could exclude most, if not all, claims under a policy? Time will tell.

Enforcement of contracts involving federal illegality: Whether courts will even enforce contracts relating to cannabis businesses adds an additional layer of complication for those looking for clarity. In 2020, courts repeatedly cited the federal illegality of cannabis when denying relief in commercial disputes. See *Bart St. III v. ACC Enterprises,* No. 217CV00083GMNVCF (D. Nev. Apr. 1, 2020); *Polk v. Gontmakher*, No. 2:18-CV-01434-RAJ, (W.D. Wash. May 21, 2020; *J. Lilly, v. Clearspan Fabric Structures International,* No. 3:18-CV-01104-HZ (D. Or. Apr. 13, 2020) Whether this is a full-blown trend remains to be seen. However, insurers and cannabis businesses alike would be advised to seek guidance from competent legal counsel regarding how best to position their company in a world of uncertain enforcement of contractual relationships involving cannabis.

Insurance is a worldwide market, but cannabis is illegal in many parts of the world: Insurance is a world-wide market and many businesses turn to insurers from all of the world to meet their business needs. But it should come as no surprise that cannabis remains illegal in many countries around the world. Some countries have legalized medical but not recreational cannabis; others have legalized certain cannabis products but not products sold in certain state-legal medical or recreational dispensaries. This could have consequences relating

to the enforceability of any award. For instance, often European courts will not enforce judgments from US courts that are contrary to their country's public policy. Likewise, the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards, 21.3 U.S.T. 2517, will not require enforcement of arbitration awards that are contrary to public policy. Whether courts in other countries will find enforcement of cannabis-related contracts to be contrary to their public policy is currently unknown.

While a safe harbor for the insurance industry would be a welcome policy change for the insurance industry and the cannabis industry, it does not solve for all potential complications that could arise. It is critical for cannabis businesses and members of the insurance industry to carefully evaluate their potential business partners. If trends continue, many of these issues will be sorted out in the not too distant future. Until then, legal counsel and careful planning can lessen the risks involved for all participants.

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