The Marijuana Legalization Trend in the U.S.—Thoughts About the Potential Impact on Claims

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Following the 2014 mid-term elections, marijuana (also commonly known as cannabis) has been legalized in 23 states, plus the District of Columbia, for medical and in some cases recreational use. Reflecting widespread changes in public perception, more states are joining the group.

According to the Insurance Journal, Washington state regulators received nearly 1,700 business applications to grow, process or sell cannabis when the application window opened in late 2013 through late 2014. It has become big business. One journal reported that the industry is worth $1.43 billion and will increase tenfold over the next four years. A variety of entrepreneurs, investors, growers and retailers are joining the ranks every day.

The legal marijuana industry is growing rapidly—like a weed, one might say—and despite regulatory and political challenges, the upward trend appears clear. What does that mean for Property/Casualty insurers and claims? We take a look at the potential exposures and claim questions likely to arise as insurers come to grips with the marijuana trend.
Laws and Insurance

On the federal level, marijuana is classified as a Schedule 1 controlled substance and deemed to have no currently accepted medical use with a high potential for abuse. Ownership is therefore illegal and technically uninsurable based on federal law. However, this could change should the classification change. As federal law supersedes contrary state regulation, some insurers may take the position of denying payment of certain marijuana-related claims based on federal illegality. This has happened and disputes have reached the courts, as we note later.

The state legalization trend may ultimately force change at the federal level. For now the two are in conflict with little guidance on how enforcement will be resolved. This legal limbo is reflected in the uncertainty within the insurance industry, both in underwriting new risks and handling claims. As one legal writer quipped, “legal marijuana isn’t exactly legal.”

Legalization has led to significant growth in marijuana businesses as well as demands on marijuana production and distribution, with growers, processors and dispensary owners seeking business partners in the traditionally conservative industries of banking and insurance. Still, credit card issuers have been reluctant to work with certain cannabis businesses, such as dispensaries, that often conduct most of their transactions in cash. A combination of large cash amounts on premises, with zoning restrictions in some jurisdictions to less-than-ideal industrial areas, may create a source of concern to carriers, regulators and tax authorities.

In view of this uncertainty, few insurers have emerged to meet the needs of the marijuana industry or consumers. When coverage is offered, the scope may be limited. But what of existing policies, and the potential claims that may be generated where the insurer was not aware of marijuana-related exposures? How might the wording on these policies address such claims, and what might insurers do to clarify coverage on previously unanticipated exposures? We offer a few thoughts on the potential impact of marijuana legalization on standard policies in the market.

Before diving in, we note that legalization need not lead to greater long-term usage. While the relatively low cost of producing legal marijuana will increase accessibility and probably increase consumption, at least in the short term, the degree and duration of future consumption levels are speculative. A study of Dutch law found that the removal of criminal prohibitions did not necessarily increase the prevalence or use of marijuana or any other drug. Another study found that adult cannabis use is no higher in the Netherlands than in the United States and inconsistent with the demand theory that strict law and enforcement prevent adolescent cannabis use. Time will tell.

Overview of Marijuana Laws

As of May 6, 2015

Homeowners

On the subject of property claims, the decision of Tracy v. USAA Cas. Ins. Co. affirmed the federal prohibition and lack of insurability on marijuana regardless of state laws that had legalized usage. In this Hawaii case, Tracy asked her Homeowners insurance company to pay approximately $45,000 for the theft of 12 marijuana plants, based on the policy language pertaining to “trees, shrubs and other plants.” She had been permitted by the state of Hawaii to cultivate these plants for her own medical use. USAA paid $8,800 but she sued for the remaining amount. USAA argued that it was not obligated to owe coverage as marijuana was illegal according to federal law, regardless of state law. The U.S. District Court agreed with USAA that the insurer had no obligation to pay for these plants as they were illegal according to the Controlled Substances Act, and that enforcement of the policy coverage would be against public policy.

The Tracy case provides precedent; however, future cases may be decided differently should the FDA change the Schedule 1 classification. While the price of marijuana is expected to decrease with legalization, the present cost of one ounce can range from $150 to $400. In vast quantities, this would result in significant exposure to theft or fire.

What about when the claim concerns marijuana causing or contributing to bodily injury or property damage? Marijuana’s status as a controlled substance makes it subject to standard liability exclusions for bodily injury and property damages arising from the use of controlled substances. In reviewing the exclusion of “controlled substances,” ISO HO3, Section II, Exclusion #8 notes:

“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 physician.”

Given the Controlled Substance status of marijuana on the federal level, liability damages related to its use would appear not to be covered. However, in a state where medical marijuana has been legalized and legitimately recommended by a physician, coverage could be argued.

It should be noted that given the Schedule 1 classification, doctors are technically not allowed to prescribe marijuana, but they can provide patients with a medical marijuana recommendation, in compliance with state law, that allows them to purchase from a dispensary or grow it themselves in specified amounts.

In the event of federal re-classification, insurers may wish to consider clarifying the exclusions to confirm circumstances under which marijuana use would be covered.

Extraction and Fire Loss

Of concern for insurers is the increased incidence of property loss and liability exposure due to explosions and fires from amateur hash oil production in the home. Colorado has seen a dramatic increase in related fires since legalization, and many view the hash oil fires in the same light as the well-established problem with fires from home-based methamphetamine labs. Both present extreme dangers and financial exposure, which includes clean-up and lost income (in the case of a rental property).

As with meth, coverage questions can arise regarding criminal acts as well as fire following a claim.

According to Insure.com:

“You could argue that while you knew you were committing a crime (just like with a DUI), the explosion was an accident. Two major home insurance companies have differing opinions on the matter. One insurer says, ‘If the insured was the one who was involved in the meth lab, and a fire ensues when the lab explodes, there would be coverage for the peril of fire. If the lab exploded, explosion is a covered peril and again coverage would apply.’ But another insurance company sees it differently: ‘The homeowner should not expect to be covered for damages resulting from his/her criminal act.’ You could be on your own for this one.”
One recent Michigan decision involved hash oil extraction and resulted in no homeowner coverage on the basis of an increased hazard endorsement. The federal versus state or accident issues never arose, and the court did not need to answer the accident question.5 Michigan law permits medical marijuana and the homeowner had the necessary licenses. However, the insured increased facilities and production to serve additional customers. He also expanded his lab for butane extraction to generate a more lucrative marijuana product. Following a fire during extraction work, the homeowner filed a claim. The insurer first paid and later litigated coverage based on several arguments. The Sixth Circuit Court of Appeals relied on a Michigan “change in hazard” endorsement to deny coverage. Under that endorsement, the homeowner had a duty to notify the insurer of any “change which may affect the premium risk under the policy” including “changes…in the occupancy or use of the residence premises.” The court had no trouble finding that a basement with 28 marijuana plants and over $20,000 in lab equipment increased the insured hazard.

Here are a few other angles concerning homeowners as landlords and manufacture of banned substances: What of the homeowner who rents his home, does not notify his carrier that the property is now tenant-occupied, and does not pay the appropriate premiums? A change from owner-occupied to tenant-occupied could be enough of a material fact or circumstance to raise coverage questions. Also, renting a property even after it has been certifiably cleaned can be a challenge for owners as many states require landlords to disclose whether or not a rental property has been the site of previous methamphetamine contamination. Similar requirements may be made of landlords who are renting property following a hash oil fire.

Commercial Policies
It is speculative at this time to project how marijuana legalization will increase business liability exposures under Businessowners and General Liability policies. Certainly any experience with alcohol-related claims may offer a blueprint. Employees under the influence of marijuana, whether medical or recreational, pose an increased risk to their employer for “bodily injury” or “property damage” claims. The issues here might be no different than they are for employees driving drunk and injuring co-workers, customers or others.

The ISO Businessowners Form (BP 00 03 01 10) excludes coverage for the marijuana itself, as “Property Not Covered” in Section 1. In the event the “contraband” label is removed from marijuana through changes in federal law, the outcome may change.

Processing, Production and Growing Exclusions
When meth lab claims hit the radar screen, clients asked us about policy wordings available to address the exposure for rental properties. As much as 95% of meth lab-related claims involve rentals and the same trend may hold true for marijuana. ISO offers an optional exclusion for commercial policies, but it is aimed at smoke and by-products of processing operations. The exclusion does not apply to loss or damage by fire or explosion that results from the release of such by-products. See CP 10 34 10 12 for a sample.

What about Homeowners?
> ISO does not have any endorsements filed to exclude processing and production operations as it does for commercial lines.
> To the extent that operations are a “business,” insurers could raise the business exclusion as they would for any home business enterprise, and face the same type of court interpretations.
> A few insurers have filed proprietary exclusions that do address both meth labs and growing marijuana. We saw an “Illegal Manufacturing, Production or Operation” exclusion that specifically applied to the illegal growing and sale of plants as well. There was no language excepting fire and explosion. In fact, anti-concurrent causation language was included, perhaps to address that issue.

For more on these forms and filings, see Gen Re’s Policy Wording Matters (December 2014).
licensed establishments (e.g., restaurants, bars and liquor stores) to be held liable for selling or serving alcohol to individuals who cause injuries or death as a result of their intoxication. On the other hand, many of those laws establish clear duties and liability rules, and in some instances damage caps. Establishments and insurers have relatively clear rules by which to do business. Will courts apply dram shop statutes to marijuana? Will legislatures use them as a model?

Before leaving this subject, Lessor’s Risk may also be considered for building owners that lease space to businesses selling cannabis. The chief concern is bodily injury or property damage on the covered property. However, depending on forms and the state, building owners might be dragged into claims for accidents that take place off the premises as they sometimes are in dram shop claims. Lessor’s Risk has been a major consideration with carriers declining to write buildings housing cannabis operations. While a few may write policies for a dispensary tenant, commercial cultivation presents a complex and untested set of risks for insurers.

**Personal Auto**

With the increased availability and use of marijuana for both medical and recreational use, we can anticipate an increase in impaired drivers—driving under the influence of drugs, or “DUID.” According to the National Institute on Drug Abuse, marijuana use more than doubles a driver’s risk of being in an accident, and the combination of marijuana and alcohol is worse than either substance alone. In contrast NORML.org, an organization that seeks the legalization of marijuana, points to a NHTSA study finding that drivers who test positive for THC (the active ingredient in marijuana) are no more likely to be involved in motor vehicle accidents than are drug-free drivers.

Regarding driving under the influence of alcohol or drugs, a perusal of several state laws reveals some similarities and differences. Generally, they recognize that a person is guilty of a DUI if he or she is driving under the influence of alcohol or a drug. In California, however, the state must show that the substance impaired the driver, not only that the driver ingested the drug and then subsequently drove. This includes users of medical marijuana. In contrast an Indiana driver is guilty of a DUI if found to have a controlled substance in his or her body, even without actual impairment being demonstrated.

The challenge is that cannabis can be detected up to 30 days after ingestion, which leads to many offenses for DUID that occurred weeks after marijuana was ingested. In Alaska, unless a motorist is involved in an accident that causes serious injury, that individual is not required to submit to a chemical test to check for the presence of a controlled substance. As such, there are no penalties for a driver refusing to submit for chemical testing for drugs.

The Personal Auto Policy’s Liability coverage (Part A) does not exclude driving under the influence of alcohol, or marijuana for that matter. Other liability that may result from the possession or use of marijuana is not addressed, although using the vehicle to transport marijuana for a fee (akin to a pizza delivery service) might not be covered. With regard to liability to third parties, there is no clear language regarding marijuana that precludes coverage. The auto insurance policy outcome could well be the same as for drunk driving.

One new twist is that some growers are using autos as mobile greenhouses. While personal property contained in the vehicle would not appear to be covered in Part D (Damage to Your Auto), a coverage argument could be made for those automobiles equipped with special features for growing marijuana.

Custom furnishings and non-factory-installed items are generally not covered in a pick-up truck or van, but forms may be silent with respect to private passenger autos. Special grow houses, grow lights and other items used for marijuana harvesting might ultimately be powered by the vehicle and presented as an auto claim. Fortunately, we have not actually seen any losses or cases testing this question.
Farm and Personal Umbrella
Crops grown for business are generally excluded, but trees, shrubs and plants within 250 feet of the dwelling are likely covered. What about legally allowed medical marijuana plants grown indoors? Indoor plants could fall outside the $500 per plant limitation and receive full coverage. There is no exclusion or limitation in the policy for a supply of marijuana that is not actively growing, so if full-blown legalization occurs, the insurer may be expected to cover marijuana property losses.

The farm liability coverage form is similar to the Homeowner (HO) editions in terms of the exclusion for controlled substances. However, the farm policy does not exclude business pursuits that involve farming. If marijuana is regarded as legal, there could be liability coverage arising out of growing activity.

Umbrella policies provide broader coverage than primary policies, and to the extent they vary from the underlying, dropdown scenarios could emerge. What about personal injury or property in the insured’s care, custody or control of the insured? Where the HO and Umbrella are consistent, the same issues and exposures emerge. The umbrella also excludes liability for controlled substances under federal law (including marijuana) unless prescribed by a physician. If the HO policy covers the claim, then the umbrella probably does, too.

Workers’ Compensation
The potential impact of recreational and medical marijuana legalization on the Workers’ Comp line may be significant and deserves a lot more attention than we give it here. Although employers are typically not responsible for an employee’s injuries while under the influence of alcohol or illegal drugs, determining the timing of when marijuana was consumed—whether during or off work hours—can be difficult to accurately test, just as for auto accidents.

As for the issue of medically prescribed marijuana to treat work-related injuries, many carriers are bracing for the potential surge in demand. This is one of the NCCI’s top emerging issues to watch, in view of an increase in requests to pay for prescribed marijuana. While the federal ban may preclude insurers from paying for marijuana treatments, changing attitudes and public pressure could change current practice. Ironically, we wonder if the drug could add to Workers’ Comp costs by contributing to more accidents or longer periods of disability. Right now the debate continues over whether marijuana will become an accepted treatment and if it’s a significant trend at all.

Conclusion
The continuing wave of state-level marijuana legalization creates significant business opportunities, highlights previously unforeseen insurance exposures and raises questions regarding coverage. Given the unresolved conflict between federal and state laws and the uncertainty this brings, many carriers have adopted a “wait and see” attitude for new risks.

Marijuana-related exposures are growing and add concerns about many existing insureds and coverages. These exposures would become far more significant should marijuana be reclassified in the future from its current Schedule 1 status on the federal level. This gives carriers some time to consider underwriting and policy form approaches to meeting the marijuana challenge.

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Sources


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