

Contraband defense deemed improper for insurance denial

Court says cannabis can be covered by insurance policies

By Marshall Gilinsky and John Leonard



A recent decision by a federal judge in Colorado has reignited discussions about whether insurance companies can dodge their coverage obligations when a policyholder suffers an insurance loss involving cannabis products that are legal under state law.

Whereas the U.S. District Court in Hawaii previously allowed an insurance company to deny a homeowner's claim for stolen cannabis plants (*Tracy v. USAA*), the District Court in Colorado rejected a similar defense last month in *Green Earth Wellness Center LLC v. Atain Specialty Insurance Company*.

The Colorado court's reasoning in this case is sound both in terms of legal analysis and common sense. The court chastised Atain Insurance for its bait-and-switch ploy of promising to insure the "stock" at a legal cannabis facility, only to turn around and deny coverage for a loss of harvested product on the grounds that it was "contraband," and therefore uninsurable as a matter of public policy.

Green Earth Wellness consists of a retail medical marijuana business and adjacent grow facility in Colorado Springs. Green Earth purchased a commercial property insurance policy from Atain Specialty Insurance Company to protect against damage to property at its facility. The insurance policy expressly covered Green Earth's "stock" — defined as "merchandise held in storage or for sale, raw materials and in-process or finished goods." When a nearby wildfire caused soot and ash to enter the ventilation system of Green Earth's cultivation facility, the grower suffered significant property damage and presented a claim for more

than \$200,000 in damage to potted mother plants and clones, and approximately \$40,000 in damage to buds that had been harvested and were being prepared for sale.

Atain denied the claim.

Among numerous reasons for denying coverage, Atain asserted that the damaged plants constituted "contraband," which was excluded under the policy. Atain also argued that it would violate public policy to force the insurance company to cover the damaged plants, since the production and sale of cannabis remains illegal under federal law.

Litigation ensued.

The court ruled in favor of the insurance company that potted plants being cultivated were subject to a "growing crops" exclusion. However, the court rejected the contraband defense, allowing Green Earth's claim for coverage of damage to its harvested cannabis to proceed to trial. The court also allowed Green Earth's statutory claims for bad faith breach and unreasonable delay in payment for this part of its claim to proceed to trial.

Bad faith standards vary from state to state, but generally an insurance company acts in bad faith when its conduct, prompted by a conscious and deliberate act, "unfairly frustrates the agreed common purposes and disappoints the reasonable expectations of the other party thereby depriving that party of the benefits of the

agreement." (*New Appleman Insurance Bad Faith Litigation*.)


Atain was clearly aware that Green Earth grew and sold medical marijuana when it underwrote and sold the policy — Green Earth filled out a "Medical Marijuana Dispensary Supplemental Application" form as part of the insurance application process. It was only after the claim arose that Atain asserted that the property was "contraband" and that public policy precluded coverage.

On its face, Atain's position was duplicitous, if not fraudulent — how could an insurance company sell a policy to a legal cannabis facility, accept premiums, and then lawfully claim that the coverage it knowingly sold is void as a matter of public policy? The court correctly and soundly rejected Atain's "contraband" and public policy defenses, noting in a particularly biting footnote that Atain appeared to be making illusory promises that theoretically could warrant claims for unjust enrichment and consequential damages.

ATAIN ALSO ARGUED THAT IT WOULD VIOLATE PUBLIC POLICY TO FORCE THE INSURANCE COMPANY TO COVER THE DAMAGED PLANTS

The court also correctly chose not to follow the 2012 decision in *Tracy v. USAA*. In that case, Barbara Tracy filed a claim under her homeowner's policy with USAA Casualty Insurance Company for cannabis plants stolen from her home. USAA argued that it would violate federal law and public policy to require the insurer to pay for the replacement of plants that are illegal under federal law. The Hawaii court agreed (albeit somewhat reluctantly) and granted summary judgment

in favor of the insurance company. In light of important clarifications of federal public policy regarding cannabis since Tracy's insurance claim in 2010, the court in *Green Earth v. Atain* was correct not



CANNABIS BUSINESSES MIGHT CONSIDER ALTERNATIVES TO TRADITIONAL INSURANCE, SUCH AS CAPTIVE INSURANCE

to follow the decision in *Tracy v. USAA*.

Although the cases reached different conclusions, logic dictates that in such cases, coverage should apply. An insurance company is free to investigate the risks presented by a particular customer before selling the insurance policy. Should the insurance company determine that cannabis or cannabis operations are an unwelcome risk, it can either refuse to sell the policy or expressly exclude cannabis-related losses. Forward-thinking insurance regulators are openly stating that losses to cannabis-related property should be covered under standard property insurance policies, unless there is a specific exclusion to the contrary. (See Susan L. Donegan, *Marijuana Legalization in Vermont: Implications for Financial Services*.)

Hopefully, insurance companies will abandon unseemly practices like those on display in the *Green Earth* case. Indeed, insurance companies would be wise to embrace — and not alienate — the large and rapidly growing market for insurance products that the cannabis industry represents. Because reliable commercial insurance partners can be hard to find, cannabis businesses might consider alter-

natives to traditional insurance, such as captive insurance, to meet their risk management objectives.

Until marijuana is descheduled or becomes legal under federal law, issues stemming from the divergence between state and federal laws will persist. As coverage disputes play out in the courts, cannabis businesses must be diligent in procuring insurance from companies that understand the risks and stand by their promises. And to the extent that businesses are faced with baseless coverage defenses, they should fight for the coverage they purchased.

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