



CLM 2022 Focus November: Cannabis, Environmental, Insurance Fraud,  
Property, Subrogation, Claims & Litigation  
November 2-3  
Washington D.C

### **The Hurdles of Cannabis Related Claims and Subrogation**

#### **Learning Objectives**

When a loss occurs involving Cannabis there are the possibility of additional questions and complexities that may be involved not only due to the product but as well to the location, policy, hazards with clean-up, and subrogation. As with any loss that occurs due to fire, flood, or other peril; it is imperative the claims process is proper as well as subrogation rights are preserved in an efficient and economical manner. The claims professional as well as outside vendors must understand which claims need to have the scene preserved for investigation, proper evidence collection, and what problems or questions may arise due to the involvement of cannabis. We must also understand the legal pitfalls as a result of an inadequate scene investigation as well as the state and federal related laws related to the jurisdiction of each loss.

#### **The Evolution of Cannabis in the United States**

The first attempt at federal regulation of marijuana came in 1906, with the passage of the Pure Food and Drug Act. Since that time, numerous laws have been passed both on the federal and state level which in some respects were on level regarding the fact it was illegal.

In the last several years, we have seen a dramatic shift in cannabis related legislation on the state level and the conflicts with jurisdiction and direction of the federal government.

The acceptance and use of medical and recreational marijuana continues to grow across the country, policyholders in the cannabis related industry continue to face the potential to be caught between conflicting state and federal regulatory directives.

At the state level, all but 6 states have legalized the cannabis to varying degrees. But, while certain usage has been legalized at the state level, supporters of legalization have yet to make substantive inroads when it comes to federal-level policy beyond the deprioritization of enforcement.

As federal policy around the enforcement of the Controlled Substances Act concerning marijuana remains unsettled, cannabis companies continue to face challenges when accessing coverage under basic insurance policies purchased to manage risk and facilitate ordinary business operations.

### **What are the Legal Changes?**

Obtaining insurance for businesses engaged in the cannabis industry can be challenging. While cannabis businesses are legal under the laws of most states, cannabis remains a Schedule 1 substance under the Controlled Substances Act of 1970, which means that, under federal law, it is illegal to manufacture, sell or distribute cannabis. It also is illegal at the federal level, under some circumstances, to engage in monetary transactions involving cannabis products. To address this problem, a bipartisan group of U.S. senators recently introduced the Clarifying Law Around Insurance of Marijuana Act (CLAIM Act), which is meant to prevent legitimate businesses from being cut off from the insurance market. Specifically, the legislation is designed to provide a legal safe harbor for insurance companies by easing the federal restrictions around selling insurance to businesses engaged in all stages of the cannabis industry, from the growers to the retailers. As mentioned, this has only been introduced but not passed to become law at this point.

In 2012, the U.S. District Court for the District of Hawaii in *Tracy v. USAA Casualty Insurance Co.* upheld an insurer's denial of coverage with respect to a claim in which a policyholder medical patient sought coverage under her homeowner's insurance policy for stolen marijuana plants. The insurance policy at issue explicitly covered loss to "trees, shrubs, and other plants," but did not expressly exempt marijuana plants.

Notwithstanding the plain language of the terms in the insurance policy, the court effectively agreed with the insurer's coverage denial reasoning that requiring the insurer to pay insurance proceeds for marijuana plants "would be contrary to federal law and public policy, as reflected in the controlled substance act."

Whether the outcome of this case would have been different in 2021 given that the possession and use of marijuana is now permitted in Hawaii in connection with certain medical conditions and a valid prescription — but still illegal under federal law is unknown.

### **The Products and dangers related to these operations**

Many of us only think of the marijuana plant itself when the word cannabis is mentioned. There are many derivatives, from legal to expressly illegal. Legal operations include anything from cannabis components which are used in medications, cannabidiol (CBD), raw recreational smoking product, or hash oil. Cannabidiol (CBD), for example, has become increasingly popular due to its anti-inflammatory effect on the body.

The illegal side is generally when cannabis is combined or infused with a narcotic or manufactured in an unlicensed or clandestine operation.

The most common causes of fires or other claims related to cannabis operations are:

- Electrical Circuit Failure/Powered Equipment/Lighting
- Pressure Vessel failures
- Criminal Revenge
- Theft
- Water/Mold related

Due to the necessity for lighting, fans, dehumidifiers, and other electrical devices, indoor operations normally consume a lot of electricity. To get around the high utility bills and possible red flags to local agencies, many of these operations will bypass the electrical service meter or use power from adjacent structures. Even if the service meter has been removed, it is likely that there is still power connected to the structure, and it is important to take precautions until it is proven otherwise. Many times, distribution devices, such as power strips and extension cords, are of poor quality and have a higher possibility of being overloaded, which poses a serious fire and safety risk.

Legal operations require inspections and permits from the onset and normally throughout the duration of the business. Many business owners will try and do what is possible to save money, which can include using unlicensed individuals for repair or installation work. Having the clear honest answers from the business owner or insured can be difficult and cause undue additional expenses related to the investigation and claim.

### **What are the complexities involved in claims management**

Gathering all information regarding the scope of the loss and correctly identifying additional liabilities are important to starting off the claims work in the right direction. Legal operations will also involve business interruption and loss of product which can require assessments outside of the typical day to day property losses.

Environmental related hazards such as mold or air quality is a factor that is a common occurrence, especially when the operation is shut down for a period of time. Fertilizer tanks, depending on the size of the facility, can add to the cost and mitigation of hazardous materials. The disposal of the plants or related products themselves can be costly or a problem depending on the location of the loss. The restoration mitigation can require special teams or permitting which can add the down time of a business.

### **Holding a Scene**

Holding a scene means that our Insured cannot begin repairs so it is important that this decision is carefully evaluated to preserve our Insured's rights to an efficiently handled claim. The holding of a scene may begin with an opportunity for a different expert to come and determine whether there is subrogation potential, or it may be more complex. It is possible that we may want to provide notice to potential tortfeasors to come and inspect the scene. Even in the event of a housefire this process may take a month to complete. Considerations when holding a scene should include the size of the loss, the nature of the damage, the ability to remediate in the interim, the ability to document the scene and the ability to preserve evidence versus the need to view evidence in place.

There are ramifications if the decision is made to collect evidence versus leaving the evidence in place. For instance, if wiring is a suspected cause of the loss, it is beneficial to have an expert on side to view the wiring in place to look for beading or arcing of the wires. If something is found

and there are potential deficiencies of a known entity – that entity should also be provided an opportunity to view the wiring while in place.

In other losses, the area of the loss may not ultimately be under the control of our control as an insurance company. We may need to provide notice to view a neighboring property in the event of a spread case. That involves notice letters that specifically request that evidence and the scene is held and point out the consequences if that does not happen. Consequences if a scene or evidence is not preserved differ from state to state in their severity.

There are also cost considerations as sometimes components of a loss may only be collected by way of a great expense. For example, if a small component breaks on a very large piece of machinery that would be expensive to collect and also require a good deal of expense to replace a piece of otherwise good working machinery – a joint notice of the larger machinery would be beneficial so that all parties can agree to limit the scope of evidence collection.

Whether a scene is held or not, appropriate documentation is needed for further evaluation by various experts. The consultant who actually visits a scene or examines a product may not be the ultimate expert for trial so documentation for further analysis is critical for litigation.

### **Public Agency Investigations**

A public agency investigation is often a good starting point for a subrogation investigation but should not be exclusively relied on. The public agency, being the first responder, will normally have the first interviews with employees or witnesses. Obtaining this information or contacts can expedite the insurance investigation and cut the time spent on chasing down misinformation. Even in criminal cases, some agencies have the understanding that there is some information they can share without compromising the case and ensuring they are not missing any facts when speaking with the insurance investigator.

When a public agency moves forward without a carrier in a loss there are options including court intervention to ensure that the carrier has access to conduct our own investigation. Remember that in some jurisdictions, Cannabis is illegal, and the potential evidence will be collected and destroyed.

### **Identifying Culpable Parties**

Various members of the subrogation “team” can be used to identify and put adverse parties and parties who may also have affirmative claims on notice. The origin and cause investigator or consulting engineer can assist in this process from their initial inspection by identifying items in the area of origin as well as through interviews with the insured or property contacts to obtain details of work completed in the area or the specifications of equipment. Proper identification

of potential culpable parties is integral to the efficient scheduling of additional inspections as well as ensuring no parties are left out.

Interested parties may include more than just potential adverse parties. For example, neighboring properties who were affected, landlords or the owner of public property involved. Ideally notice is provided to a live scene. However, all parties whether adverse or not adverse, may not be known right away. A good faith effort must be made, and all relevant evidence documented in place and collected for further evaluation.

#### **Handling the Defense and Defense Experts**

Each loss is different, and it is not always practicable to hold a scene for a long amount of time. We have a duty to our insured to release a scene as quickly as possible while also allowing all adverse parties a reasonable inspection opportunity.

A common tactic of defense attorneys is to claim that they are prejudiced because they did not have an opportunity to independently inspect a scene. In this instance it is important to informally provide all photographs. It is possible that at trial the original subrogation expert who viewed the scene may not be allowed to testify so we will have to hire a new expert to opine based on the same photographs as defense counsel. This is a method undertaken by the courts to ensure that the evidence presented to both sides is even.

Other parties may try and unreasonably delay a scene inspection, so carriers are within their rights to point to the duties to our insured to justify a shorter time period of access by adverse parties. In addition, damaged property must be remediated to prevent things like mold, vandalism, and exposure to elements. It is possible that the parties can agree to hold only a certain area of a property so repairs and remediation can be started in other areas. These conversations should be documented in letters or emails in the event there are issues in the court down the road about access provided to adverse parties.