



## A BUDDING MARKET: PROFESSIONAL LINES OPPORTUNITY IN THE CANNABIS SECTOR

### CONTACT

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Courtesy of AmWINS Group, Inc.

The legal cannabis industry is one of the fastest-growing sectors in the United States. Already worth over \$10 billion in annual sales, the economic impact of cannabis could reach as high as \$77 billion by 2022, according to some experts.<sup>1</sup>

As the industry grows, so have its insurance risks. Understandably, cannabis operations' first insurance priorities are property and general liability (GL)/products liability; while less apparent, financial risks commonly covered under professional lines programs need to be addressed, as well. Retail agents who work with growers, manufacturers, and dispensaries – as well as other entities along the distribution chain – need to assess four key areas of professional lines coverage to ensure that they are offering a complete portfolio of protection.

### 1. DIRECTORS AND OFFICERS LIABILITY (D&O)

From an underwriting perspective, the cannabis sector is more complicated than other business sectors due to regulatory issues and legal questions surrounding the industry. Cannabis remains illegal at the federal level; however, 33 states recognize cannabis as a legal product.

To summarize:

- 11 states have legalized cannabis products completely, permitting adults to have access to both recreational and medicinal cannabis products
- 22 states allow for medicinal marijuana use
- At least seven additional states are considering pro-cannabis legislation on their 2020 ballots
- Three states have banned all types of cannabis

Given the federal government's apparent lack of enforcement, entrepreneurs and various business leaders are beginning to suspect that cannabis issues may be delegated to the states. Nevertheless, the concern around a technically illegal product has given many insurers pause about providing D&O coverage to cannabis operations.

Cannabis operations face regulatory issues common to all businesses, including federal securities violations, false and misleading advertising under the Federal Lanham Act, or state-level violations, including unfair and deceptive trade practices violations or personal injury claims.

For instance, in the ongoing class-action case *Michael Skibbe v. Curaleaf Holdings, Inc. et al.*, Curaleaf is alleged to have violated federal law by knowingly making materially false and misleading statements to the investing public, violations of Sections 10(b) and 20(a) of the Exchange Act, and Rule 10b-5 promulgated by the SEC. This includes Curaleaf's claims about its CBD supplements treating cancer, Alzheimer's disease, opioid withdrawal, pain, and pet anxiety.

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Additionally, the regulatory market for cannabis operations is evolving rapidly. The three laws that would most significantly impact the space are the SAFE Act, the CLAIM Act, and the STATES Act.

- **SAFE Act (Secure & Fair Enforcement banking Act).** This Act would protect financial institutions that want to offer basic banking services to marijuana businesses in cannabis-legal states. Cannabis operations would change from being cash-only through the Act's establishment of guidance for credit unions and banks to service cannabis businesses. The Act, which passed the House in September 2019, is awaiting Senate action.
- **CLAIM Act (Clarifying Law Around Insurance Marijuana).** This Act would help cannabis businesses acquire insurance products by protecting insurers and insurance agents from federal prosecution when doing business with the cannabis industry. To draw an analogy, it is the insurance equivalent of the SAFE Act for banking, and as with the SAFE Act, the CLAIM Act has passed the House and is awaiting Senate action.
- **STATES Act (Strengthening the Tenth Amendment Through Entrusting States).** This bill would amend the Controlled Substances Act of 1970 to remove the classification of cannabis as a Schedule 1 drug. Although this would eliminate the current state-federal legal conflict around cannabis, the Act's passage is doubtful, at least in the short term.

Given the legal grey area in which cannabis companies operate, it is vital to attract well-qualified and experienced directors and officers. D&O is intended to cover these directors' and officers' personal liability for corporate decisions and is therefore an essential component to the suite of insurance products available. While these policies are not mandatory, the protections they afford are likely to increase engagement and retention of top-level individuals within these companies and, in turn, within the cannabis industry as a whole.

Full-side D&O coverage for cannabis operations can be found, but at a price. Despite the risks faced, cannabis operations often perceive appropriate D&O coverage as cost-prohibitive. Exploring alternative solutions, such as a Side A-only policies, is an option to consider, as expanded coverage can be four times as expensive as basic. Regulatory exclusions in policies are also problematic and can go far beyond just a regulatory investigation. It is important to evaluate the policy and look for stock drop and bankruptcy exclusions, along with exclusions on prior acts.

## 2. ERRORS AND OMISSIONS (E&O)/MEDICAL PROFESSIONAL

As the market expands, more cannabis operations are pursuing E&O and medical professional coverage. This is due not only to more sophisticated buyers, but also to statutory requirements. With Arizona leading the charge, states are beginning to require medical professional coverage by statute. Others, such as Missouri, require the capability to purchase Professional Liability coverage as part of their licensing application process.

Within the distribution channel, testing labs are the most obvious operations with an E&O exposure. Given the Farm Bill's 0.3 percent THC limit for hemp/CBD products – with cannabis designated at greater than 0.3 percent – testing labs are essential throughout the distribution channel, as products are evaluated for strain, potency, and quality, among other criteria.

Another major segment within the distribution chain presenting a significant professional liability exposure includes dispensaries. Currently, the two primary areas for which dispensaries obtain professional liability coverage are licensed pharmacists providing advice and dispensing the cannabis products and physicians prescribing referral cards. This consulting by licensed professionals falls outside the scope of coverage afforded by a products liability policy.

Unfortunately, a common gap in medical professional liability exposure exists when these roles are limited solely to medical director or healthcare consultant services, so policy coverage needs to be carefully evaluated. Many insurance carriers do not extend coverage for the prescription or recommendation of non-FDA approved drugs, including medical marijuana; therefore, coverage must be tailored to include cannabis so that physicians are not left to handle medical malpractice claims on their own.

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For entities in which employees other than pharmacists undertake the dispensing role, the industry has stepped up to cover risks via Budtenders E&O. First endorsed on GL policies to fill potential gaps in product liability, Budtenders E&O provides protection to employed dispensary clerks who provide consumers with advice or recommendations on specific products.

As the cannabis E&O market evolves, enterprising carriers are also beginning to construct tailored programs utilizing stand-alone E&O forms. Given the relatively low limits available via GL/products endorsements (typically up to \$1M), this presents an opportunity for the insurance market to provide higher capacity in conjunction with the growth of the cannabis industry. As the demand for professional liability continues to increase along the distribution channel – including entities without a straightforward E&O exposure, such as cultivators and manufacturers – new products are in development to respond to those ancillary consulting exposures that may lead to financial loss, ultimately without a bodily injury or property damage trigger.

### 3. EMPLOYMENT PRACTICES LIABILITY INSURANCE (EPLI)

Growth in cannabis business has corresponded with increased sector employment, making it one of the fastest-growing job markets in the country. The number of job openings within the industry at the end of 2018 were up 76% over the prior year,<sup>2</sup> and cannabis is projected to hit a job creation rate of 110% in the three years from 2017-2020, eclipsing that of other high-growth sectors.<sup>3</sup>

Expanding businesses and increased staff levels typically result in more employment-related lawsuits. With a high number of wage-and-hour and part-time employees, cannabis operations face EPLI and Fair Labor Standards Act (FLSA) issues.

Whether employees in federally-illegal businesses are subject to FLSA was addressed in *Kenney vs. Helix*, heard by the 10th Circuit. Robert Kenney was a former employee of Helix TCS, Inc., which provided security services for businesses in Colorado's legal cannabis industry. Kenney's lawsuit against Helix alleged that he regularly worked over 40 hours a week, but that the employer misclassified him as exempt from the FLSA's overtime obligations. Helix argued the "illegality defense" – that cannabis industry employees are not entitled to FLSA protections because they knowingly assume the risk that their activities will subject them to federal criminal penalties and therefore are not entitled to benefits under federal law. However, the court held that FLSA does apply.<sup>4</sup>

With rapid growth in the cannabis sector, there are many new companies operating in the space. New companies are vulnerable to claims by employees for discrimination, wrongful termination and harassment. EPLI policies can help protect the entity from claims by employees, and EPLI insurers and brokers can also provide resources for employers to aid in the development of employee handbooks and establishment of employment policies and procedures to assist in creating best practices for managers and employees.

### 4. CYBER/MEDIA AND CRIME

Because most cannabis operations are cash businesses, they lend themselves to a high crime exposure. While most commercial insurance defends against lawsuits brought against a company, the crime policy reimburses the company for losses of money, securities, and other tangible property that is stolen or embezzled by employees and third parties. A crime insurance policy can provide coverage for theft of money by an employee, premises coverage for loss of money by third parties, in transit coverage, forgery coverage, counterfeit currency fraud coverage, client coverage and expense coverage.

Cyber liability is also important to this business sector, which faces elevated risks associated with network breaches. Protecting both patient and consumer data from hackers is a top priority to cannabis companies, as the failure to protect this information can lead to hefty fines and reputational harm. Operations store license, patent, and other business information. and often deal with NDA requirements around growing, extracting, and other proprietary processes. They also have access to customers' personal and medical information that is subject to HIPAA and needs to be protected from breach. Further, regulation requires the tracking of cannabis from seed-to-sale, so tracking software is potentially subject to hacking, along with systems for mobile device ordering.

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With the increased use of technology and more efficient processes, businesses throughout the distribution channel will need to address the potential for business interruption and loss of income due to a breach – especially as the demand for cannabis products continues to increase. The Controlled Substances Act of 1970 designates the advertisement of Schedule 1 drugs (e.g. cannabis) as a felony. Compounding this issue, cannabis advertising laws vary from state to state. Similar to restrictions faced by the alcohol and tobacco industries, cannabis operations may not market their products to minors. Further, allowable content is typically restricted to educational purposes. Finally, advertising policies on popular platforms such as Facebook and Google further constrain marketing ability. Therefore, many cannabis companies turn to alternative social media outlets and personal websites for product promotion.

Despite these elevated risks, contractual requirements are the primary driver for operations to purchase cyber products. Demonstrating the need for cyber to businesses that do not already face contractual mandates creates a massive sales opportunity for retailers within a new industry. A caution for retailers is that cyber insurance coverage is not standardized across the insurance industry, and each company's form needs to be reviewed carefully in light of various exclusions and limitations.

## CONCLUSION

The cannabis industry continues to evolve and expand within the U.S., driven by the increased legalization of cannabis – whether medicinal or recreational – within states. Given this rapid growth and the normalization of cannabis as its own industry, various operations throughout the cannabis distribution chain continue to face unforeseen financial exposures for which they will need proper coverage. E&O, D&O, EPLI, and cyber coverage in the cannabis space remain almost exclusively in the E&S marketplace, making it essential for retailers to partner with a wholesaler providing the market access, expertise, and guidance to properly tailor programs for this unique niche.

AmWINS understands the insurance market, as well as the various operations within the cannabis industry. This specialized knowledge is essential to identifying and capitalizing on opportunities in the market and creating complete, compelling underwriting submissions. AmWINS utilizes specialist brokers across the United States and London who are well-versed in the current issues within the cannabis and hemp/CBD space. This expertise allows us to guide our retail clients through the placement process and help them understand all lines of coverage needed to build a comprehensive risk management and insurance program for their insureds.

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## ABOUT THE AUTHORS

The following AmWINS specialists contributed to this article.

- Aileen Spiker Berry – Vice President, Professional Lines, AmWINS Brokerage in Palm Beach Gardens, FL
- Charlie Grodecki – Vice President, Professional Lines, AmWINS Brokerage in Charlotte, NC

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## SOURCES

- <sup>1</sup> MarketsInsider, “8 incredible facts about the booming U.S. marijuana industry,” May 7, 2019
- <sup>2</sup> Glassdoor Economic Research
- <sup>3</sup> Forbes, “Cannabis is becoming a huge job creator,” May 20, 2019
- <sup>4</sup> No. 18-1105, 2019 WL 4557433 (10th Cir. Sept. 20, 2019)

