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Client Briefing

Insurance Recovery

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How Does Marijuana's Legalization in Pennsylvania Impact Insurance Coverage?

Entrants into Pennsylvania's medical marijuana industry will want—and, in many cases, need—to obtain various types of insurance coverage. What happens, though, when one of those businesses is sued or suffers a loss and turns to its insurer for coverage? Will the insurer provide coverage? Or, will the insurer disclaim coverage because it remains illegal under federal law to manufacture, distribute or dispense marijuana? If the insurer attempts to avoid coverage on the basis of public policy or an illegal-acts exclusion, will courts in Pennsylvania allow the insurer to do so, or will they protect the policyholder's right to coverage?

Not surprisingly—given the infancy of Pennsylvania's medical marijuana laws, regulations and industry—no federal or state court in Pennsylvania has considered these questions. When—not, if—a Pennsylvania court does confront these issues, it should—on the strength of the better-reasoned federal-court precedent, Pennsylvania's temporary medical marijuana regulations, and principles of insurance policy construction—reject any attempt by an insurer to avoid coverage on the grounds of federal law.

Federal law

Under the federal Controlled Substances Act, marijuana is listed as a Schedule I "controlled substance." Therefore, pursuant to 21 U.S.C. Section 841(a), it is "unlawful for any person knowingly or intentionally…to manufacture, distribute, or dispense, or possess with intent to manufacture, distribute, or dispense" marijuana.

However, in 2013, Deputy Attorney General James M. Cole authored a memorandum—the "Cole Memorandum"—de-emphasizing federal prosecution of marijuana-related offenses. The Cole Memorandum identifies "certain enforcement

priorities that are particularly important to the federal government," including, for example, "preventing the distribution of marijuana to minors" and "preventing the diversion of marijuana from states whether it is legal under state law in some form to other states."

"In jurisdictions that have enacted laws legalizing marijuana in some form and that have also implemented strong and effective regulatory and enforcement systems to control the cultivation, distribution, sale, and possession of marijuana, conduct in compliance with those laws and regulations," the memorandum explains, "is less likely to threaten the federal priorities…" Thus, the memorandum advises: "In those circumstances, consistent with the traditional allocation of federal-state efforts in this area, enforcement of state law by state and local law enforcement should remain the primary means of addressing marijuana-related activity."

Congress has gone further, at least with respect to medical marijuana. It has refused to appropriate funds to the Department of Justice that may be used with respect to certain enumerated states—including, Pennsylvania—"to prevent any of them from implementing their own laws that authorize the use, distribution, possession, or cultivation of medical marijuana."

Prior Insurance-Coverage Decisions

In *Tracy v. USAA Casualty Insurance*, No. 11-00487 LEK-KSC (March 16, 2012), a policyholder sued her insurer for breach of her homeowners policy for refusing to cover the theft of marijuana plants. Although Hawaii had enacted medical-use-of-marijuana laws, the U.S. District Court for the District of Hawaii refused to enforce the relevant policy provision and to find coverage "because the plaintiff's possession and cultivation of marijuana, even for state-authorized medical use, clearly violates federal law."

That court explained: "The rule under Hawaii law that courts may decline to enforce a contract that is illegal or contrary to public policy applies where the enforcement of the contract would violate federal law." That court then determined that requiring the insurer "to pay insurance proceeds for the replacement of medical marijuana plants would be contrary to federal law and public policy…."

In *The Green Earth Wellness Center v. Atain Specialty Insurance*, 163 F. Supp. 3d 821 (D. Colo. 2016), however, the U.S. District Court for the District of Colorado—citing "several additional years evidencing a continued erosion of any clear and consistent federal policy" with respect to marijuana—"declined to follow *Tracy*." It found that the insurer could not refuse coverage under a commercial property and general liability insurance policy for a loss suffered by a medical-marijuana business when certain of its marijuana plants were damaged by smoke and ash from a fire and others were stolen.

That court rejected the insurer's reliance on a policy exclusion for "'contraband, or property in the course of illegal transportation or trade'" and on public policy. After observing that "the nominal federal prohibition against possession of marijuana conceals a far more nuanced (and perhaps even erratic) expression of federal Policy," it concluded that "the policy's 'contraband' exclusion is rendered ambiguous by the difference between the federal government's de jure and de facto public policies regarding state-regulated medical marijuana."

That court then considered the parties' intent: "It is undisputed," it explained, "that, before entering into the contract of insurance, the insurer knew that the policyholder was operating a medical marijuana business. It is also undisputed that the insurer knew—or very well should have known—that federal law nominally prohibited such a business." Nevertheless, the insurer never disclaimed coverage for the policyholder's inventory. Thus, the court concluded that the insurer and the policyholder "shared a mutual intention that the policy would insure the policyholder's marijuana inventory and that the 'contraband' exclusion would not apply to it."

Predicting Pennsylvania Law. Many insurance policies contain exclusions for illegal or criminal acts or activities. Moreover, Pennsylvania law may preclude enforcement of an insurance policy if the agreement contravenes public policy. Indeed, in *Minnesota Fire and Casualty v. Greenfield*, 855 A.2d 854, 869 (Pa. 2004), the Pennsylvania Supreme Court held that "in situations when an insured commits a criminal act, with respect to a Schedule I controlled substance, and unintended or unexpected injuries or losses occur as a result, whether by accident or negligence, public policy will not allow coverage under the contract of insurance."

That case, however, involved heroin, which Pennsylvania had made clear "'…has a high potential for abuse, has no accepted medical use within the United States, and…is unsafe for use even under medical supervision.'" Obviously, Pennsylvania has come to a different conclusion about marijuana.

Furthermore, although marijuana is still classified as a Schedule I controlled substance under federal law, "federal authorities," as the District of Colorado explained, have "made public statements that reflect an ambivalence toward enforcement of the Controlled Substances Act in circumstances where a person or entity's possession of distribution of marijuana was consistent with well-regulated state law." As such, in states, such as Pennsylvania, where medical marijuana is legal and highly regulated, an insurer should not be able to avoid its contractual obligations by pointing to federal law.

In fact, Pennsylvania expressly requires "medical marijuana organizations" to obtain insurance. For example, 28 Pa. Code Section 1141.44(a) provides, in relevant part: "A medical marijuana organization shall obtain and maintain an

appropriate amount of insurance coverage that insures the site and facility and equipment used in the operation of the facility." A medical marijuana organization is also required to have "an adequate amount of comprehensive liability insurance covering the medical marijuana organization's activities authorized by…permit…."

In contrast, the *Tracy* court observed that Hawaii's "Legislature expressly disclaimed any requirement that insurers provide coverage for the medical use of marijuana." While Pennsylvania does not require that insurers provide coverage for the medical-marijuana industry, it does require that medical marijuana organizations obtain insurance. It would be paradoxical for the commonwealth to require that such organizations obtain insurance but for courts to refuse to enforce their insurance policies.

Finally, allowing an insurer to avoid its contractual obligations, especially where the insurer knew at the time of contracting that the policyholder was in the medical-marijuana business, would run afoul of Pennsylvania's well-established rules for interpreting insurance policies. As the Supreme Court observed in *American and Foreign Insurance Company v. Jerry's Sport Center*, 2 A.3d 526, 540 (Pa. 2010), "insurance policies are contracts, and the rules of contract interpretation provide that the mutual intention of the parties at the time they formed the contract governs its interpretation." Thus, an insurer who agreed to provide coverage for a medical-marijuana business should not later be able to avoid its contractual obligations by arguing that federal law makes it illegal to manufacture, distribute, or dispense marijuana.

Considering the enforceability of a lease entered into by a medical-marijuana dispensary, the Court of Appeals of Arizona, in *Green Cross Medical v. Gally*, 395 P.3d 302 (Ariz. Ct. App. 2017), explained that "voiding leases relating to property used for medical marijuana dispensaries could lead to unjust enrichment or an unconscionable windfall for the person who breaches the lease." That same danger exists when an insurer tries to deny coverage it sold to a medical-marijuana business on the grounds that marijuana is illegal.

Future Considerations

The Trump administration has provided mixed signals as to whether it will continue to abide by the Cole Memorandum. A change in federal policy could cause a shift in the legal analysis. At the same time, there are on-going efforts in Congress to legalize marijuana. A change in federal law also could cause a shift in the legal analysis, albeit in the opposite direction.