

Insuring The Ever-Growing Cannabis Industry: Part 2

By Jodi Green and Patricia Daza-Luu (June 12, 2019, 3:08 PM EDT)

Despite the shaky and contentious political climate, state and federal support for the cannabis industry is steadily trending in a singular direction — upward. As we reported in part one of this series, a majority of states have legalized medical marijuana, while 10 states have followed our northern neighbor's lead in legalizing recreational use. These state efforts became a springboard to launch the most impactful political change to insurers weighing the risks and benefits of entering the cannabis space: the federal exemption of hemp from the Controlled Substances Act.

In December of 2018, the \$867 billion Agriculture Improvement Act, best known as the Farm Bill, sailed through Congress with strong bipartisan support. Relevant here, the Farm Bill exempted low-THC portions of the cannabis sativa L. plant, defined as “hemp,” and related products from the purview of the CSA.[1]

While the sale of hemp and hemp products will no longer be a criminal act, hemp's effective legalization cuts both ways. On the positive side, industry experts opine that hemp's legalization will propel the cannabis market to reach \$22 billion by 2022, with hemp-based CBD products driving the boom. On the other hand, hemp will now be subject to a host of other product-related laws — including rules promulgated by the Federal Drug Administration and similar state regulations. Thus, the Farm Bill has the dual effect of legitimizing a portion of the cannabis space, while simultaneously creating fertile ground for new liability exposures.

In this second installment of our series on insuring the cannabis industry, we will first dissect the complexities of the 2018 Farm Bill and analyze the potential exposures it creates. We will also offer an updated assessment of the impact on, and availability of, insurance relative to cannabis from the front lines of the insurance industry.

A Botany Lesson: Dissecting the Definition of Hemp Under the Farm Bill

Like most statutes and regulations, the Farm Bill is a complex web of corresponding parts and definitions that can create confusion for laypeople and lawyers alike. Key to our discussion is the distinction between hemp and other types of cannabis plant parts and products. Under the Farm Bill, hemp — which refers to any cannabis-derived plant or product with less than .3% THC — is no longer considered



Jodi Green



Patricia Daza-Luu

a controlled substance under federal law. To fully understand the impact of this definition, we start unraveling the Farm Bill with a botany lesson.

Cannabis sativa L. is the botanical name for the plant that produces the flowering buds commonly known as marijuana. Numerous varieties of the cannabis plant are cultivated with differing levels of cannabinoids.[2] Cannabinoids are chemical compounds derived from the cannabis plant that have differing physical and psychological effects. While over 500 cannabinoids have been scientifically identified, the two most well-known cannabinoids are THC and CBD.

THC, or Tetrahydrocannabinol, is the chemical that is responsible for the euphoric or “high”-inducing effects commonly associated by marijuana. In general, the flowering buds of the cannabis plant can contain anywhere from 5% THC to up to 30% in certain premium sources. CBD, or cannabidiol, can be extracted from the cannabis plant and used in medical drugs, high-end beauty products and consumable and vaporized oils and other edible products. Unlike THC, CBD does not produce a “high,” but is used for pain reduction, and to treat other medical conditions, including anxiety, epilepsy and multiple-sclerosis.[3]

Dazed and Confused? Resolving Misconceptions Regarding the Farm Bill

The Farm Bill is the primary agricultural and food policy tool of the federal government, which is renewed roughly every five years under the purview of the U.S. Department of Agriculture. Under the last iteration of the Farm Bill, it was illegal under federal law to purchase seeds of the cannabis plant, although states were allowed to establish hemp cultivation “pilot programs” for industrial and commercial purposes, subject to extremely stringent approval and permitting.

The 2018 Farm Bill now allows companies to purchase seeds and cultivate and sell plants and products across state lines, so long as they meet the Farm Bill’s “less than .3% THC” requirement — all without a governmental permit. The new Farm Bill also builds in protections for farmers under the Federal Crop Insurance Act, providing valuable assistance to farmers who, in the normal course of their agricultural production, experience crop losses.[4]

In short, the Farm Bill transformed hemp from an illegal drug governed by the CSA under the purview of the Drug Enforcement Agency to a crop. Notably, however, states are expressly empowered under the Farm Bill to impose more stringent standards governing hemp — including to bar its cultivation and sale altogether.[5] Many states have been slow to adapt their laws to the new federal rules, creating confusion by leaving federally legal hemp illegal under state law. For this reason, federal decriminalization does not remove all obstacles to the sale of hemp. Instead, it has created significant confusion — at least for the present time.

Adding to the confusion, the sale of hemp (with or without CBD) may be subject to a host of other conflicting rules and regulations depending on how it is used and marketed. Food products are subject to differing regulations than cosmetics. Legal hemp products containing CBD that are considered food products now fall under the Food Drug & Cosmetic Act and state and local regulations governing testing and labeling.[6] While hemp products that do not contain CBD, such as hemp seed, hemp seed oil or protein powders, have received the U.S. Food and Drug Administration’s green light to sell, the current FDA guidance provides that CBD cannot be added to foods and sold without FDA approval.

Following this guidance, many states that previously allowed the sale of CBD-infused food products and beverages have now banned it, including California and New York.[7] For example, the California

Department of Public Health has opined that “[u]ntil the FDA rules that industrial hemp-derived CBD oil and CBD products can be used as a food or California makes a determination that they are safe to use for human and animal consumption, CBD products are not an approved food, food ingredient, food additive, or dietary supplement.”

To date, the only CBD product that has received FDA approval is Epidiolex, a CBD drug used to treat epilepsy. Conversely, the FDA has opined that cosmetics can contain CBD as long as the CBD does not cause the product to be “adulterated or misbranded.”[8] Further, federal, state and city regulations governing hemp may all differ, creating a patchwork of conflicting regulations that companies can mistakenly breach.

Notably, as of April 2019, the FDA and Federal Trade Commission have already targeted cannabis companies by sending warning letters regarding fraudulent marketing concerning the health benefits of cannabis-related products, including those containing CBD.[9] As discussed below, lawsuits have also been brought on similar grounds, and an influx of FDA warning letters will only incentivize further litigation.

Liabilities and Insurance Coverage Issues Presented by the Farm Bill

Even in cannabis-friendly states like California, cannabis companies and insurers must be wary of the liability risks associated with the cannabis industry. Though the slippery slope has yet to erode, cannabis could be the next cottage industry for the class action plaintiffs’ bar.

By analogy, lawsuits can be instituted over improper labeling of hemp products in the same manner as lawsuits against other food and beverage companies. For example, multiple class action lawsuits in Canada, where cannabis is federally legal, have already developed, charging cannabis companies for failing to disclose the use of pesticides after product recalls of medical cannabis arose.[10]

Similarly, sales of hemp-derived products that allegedly fail — whether intentionally or not — to comply with the strict regulations governing the THC content in products will give rise to potential liability and product recalls, even though hemp grown and sold in compliance with the Farm Bill (and applicable state regulations) is no longer technically illegal.

Recent litigation foreshadows potential insurance coverage issues that may arise in this context. California’s Proposition 65 provides a compelling case study. Proposition 65 requires companies to disclose the presence of certain harmful chemicals in goods and provides limited remedies (including civil penalties) to the public. Because penalties can be awarded for violations of Proposition 65 even without any bodily injury or harm, liability insurance coverage will likely be unavailable for these lawsuits where actual bodily injury is not alleged.[11] In a Proposition 65 case seeking civil penalties against sellers of nail products for failure to warn of certain allegedly toxic ingredients, a California appellate court found that no coverage was afforded where the plaintiffs alleged exposure to the allegedly toxic nail products but did not claim any actual bodily injury due to the exposure.[12]

The same reasoning applies with equal force here, where lawsuits under Proposition 65 and other state regulations have already been filed against cannabis companies, with more expected to follow after the FDA and state agencies institute express requirements concerning the labeling, testing and sale of hemp and cannabis.[13]

In *Brandon Flores et al. v. LivWell Inc.*, for example, a class-action lawsuit was brought against a cannabis

company for use of a controversial pesticide in its marijuana. The court reasoned that the case did not allege damages, but sought only to recover for mere overpayment for the product (marijuana).[14] Because the plaintiffs suffered no cognizable physical or emotional injury from their inhalation of marijuana, the case would also likely be deemed to lack the requisite bodily injury to potentially trigger insurance.

Given these trends in analogous products-related cases, cannabis companies and insurance underwriters should be careful to strictly scrutinize and comply with developing regulation of cannabis and hemp products, and be especially mindful of any representations made in connection with those products to reduce potential legal exposure.

The Impact of the Farm Bill on the Evolving State of the Market

All of this change leaves significant opportunity for insurers and companies in the hemp and cannabis space. Canada's legalization offers some insight into future developments in the United States. Although Lloyds of London exited the U.S. cannabis market in 2015, citing concerns about illegality, it re-emerged in Canada in 2018 shortly after recreational cannabis became legal there. The passage of the Farm Bill and its corresponding exemption of hemp from the CSA may attract insurers like Lloyds of London to enter the market once again — at least in terms of writing coverage for companies dealing in federally sanctioned hemp.

In sum, the Farm Bill's effective legalization of hemp will help the cannabis industry step out of the shadows and into the mainstream. Similar to autonomous-driving technology, as a product matures and becomes familiar, the more likely the market is to develop insurance for that product, and correspondingly, lead to that product's ubiquity.[15] While insurance for cannabis, just like driverless cars, remains on the fringe, the insurance market will benefit as data on claims and potential risks continues to develop.

Jodi S. Green is a partner and Patricia A. Daza-Luu is an associate at Nicolaides Fink Thorpe Michaelides Sullivan LLP.

The opinions expressed are those of the author(s) and do not necessarily reflect the views of the firm, its clients, or Portfolio Media Inc., or any of its or their respective affiliates. This article is for general information purposes and is not intended to be and should not be taken as legal advice.

[1] Agriculture Improvement Act of 2018, Pub. L. No. 115-334 § 10113, 132 Stat. 4490 (2018).

[2] Shelly B. DeAdder, The Legal Status of Cannabidiol Oil and the Need for Congressional Action, 9 BIOPLR 68, 72 (2015) (explaining that while “the marijuana plant and industrial hemp plant come from the same botanical species,” the “hemp plant has been crossbred to have low concentrations of THC”). CBD can be extracted from both varieties of the plant. See id. at 72 & n.34.

[3] National Academies of Sciences, Engineering, and Medicine: Health and Medicine Division, Committee on the Health Effects of Marijuana, “The Health Effects of Cannabis and Cannabinoids: The Current State of Evidence and Recommendations for Research” (Jan. 12, 2017), <https://www.ncbi.nlm.nih.gov/books/NBK425767/>.

[4] United States Department of Agriculture – Economic Research Service, Farm & Commodity Policy –

Overview, <https://www.ers.usda.gov/topics/farm-economy/farm-commodity-policy/>.

[5] Farm Bill, § 10113. See also *Big Sky Sci. LLC v. Idaho State Police*, 1:19-CV-00040-REB, 2019 U.S. Dist. LEXIS 18758, at *2 (D. Idaho Feb. 2, 2019) (discussing preemption arguments under the Farm Bill).

[6] FDA Regulation of Cannabis and Cannabis-Derived Products: Questions and Answers, <https://www.fda.gov/newsevents/publichealthfocus/ucm421168.htm>.

[7] California Department of Public Health, FAQ – Industrial Hemp and Cannabidiol (CBD) in Food Products, <https://www.cdph.ca.gov/Programs/CEH/DFDCS/CDPH%20Document%20Library/FDB/FoodSafetyProgram/HEMP/Web%20template%20for%20FSS%20Rounded%20-%20Final.pdf>. California’s position on the issue may change depending on new legislation, which seeks to pave the way to add CBD to food products.

[8] FDA Regulation of Cannabis and Cannabis-Derived Products: Questions and Answers, <https://www.fda.gov/newsevents/publichealthfocus/ucm421168.htm>.

[9] FTC Press Release, <https://www.ftc.gov/news-events/press-releases/2019/04/ftc-joins-fda-sending-warning-letters-companies-advertising>.

[10] Class-action Lawsuit against OrganiGram Gets Green Light (Jan. 21, 2019), <https://www.cbc.ca/news/canada/new-brunswick/class-action-lawsuit-medical-cannabis-organigram-1.4986632>.

[11] See *Ultra Salon v. Travelers Property Casualty*, 197 Cal.App.4th 424, 434 (2011) (allegations of mere exposure to toxic chemicals that may cause cancer or birth defects is not the same as allegations of actual bodily injury as the result of exposure, thus not triggering the insuring agreement).

[12] *Id.*

[13] Eric Sandy, What Should California Cannabis Dispensaries Know about Prop. 65 (June 21, 2018), <https://www.cannabisbusinesstimes.com/article/california-cannabis-dispensaries-prop-65-cancer-warnings/>.

[14] *Id.*

[15] Paul Tullis, “Self-Driving Cars Might Kill Auto Insurance As We Know It” (Feb. 19, 2019), <https://www.bloomberg.com/news/articles/2019-02-19/autonomous-vehicles-may-one-day-kill-car-insurance-as-we-know-it>