FirstLook

Issues and Developments in Insurance Law

LETTER FROM THE EDITOR

"Innovation is the specific instrument of entrepreneurship… the act that endows resources with a new capacity to create wealth." ~ Peter F. Drucker

Small business owners are indisputably the wellspring of innovation from which many of our country's greatest business ideas have flowed. Some of these small business owners have grown from their humble beginnings to operate giant conglomerates reaching millions of consumers across the country, while others remain content to operate their businesses within the confines of their hometowns. Small business owners are constantly innovating and creating new products and services for the expanding market, and the nature of these businesses are as varied as the individuals who operate them. But with these varied industries come new and previously unforeseen risks. For the insurers who seek to insure small business owners, changes in the products and services offered by small businesses can present pressures to cover unanticipated risks. For the small business owners, uncertain coverage can present equally compelling stressors to the businesses' bottom line.

This article seeks to explore some of the concerns applicable to both small business owners and their insurers. First, Devon J. Stewart will provide an overview of the coverage options available to small business owners and some of the potential concerns to insurers and insureds where the traditional product does not match the potential risk. His article will focus on traditional products, such as commercial general liability insurance, homeowners' policies, and commercial auto insurance. Next, Monté L. Williams will explore the potential coverage gaps that have arisen in the "sharing" industries, namely ridesharing. His article will ask the critical question: who shares the risk when an occurrence happens? Finally, Andrew P. Smith will review the conundrum for small business owners and insurers who seek to insure against risks in the legal marijuana industries, where there is a conflict between state and federal laws.

Just as small business owners continue to innovate to meet the demands of the public, so do insurance companies who seek to assist these entrepreneurs in insuring against risk. While insurers work to meet the demands of these innovative industries, questions will likely arise about the availability of coverage under traditional insuring products. If you have any concerns regarding the application of policy language to an unusual claim, don't hesitate to contact any member of our First Party Team.

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This newsletter is a periodic publication of Steptoe & Johnson PLLC's First Party Team and should not be construed as legal advice or legal opinion on any specific facts or circumstances. The contents are intended for general information purposes only, and you are urged to consult your own lawyer concerning your own situation and any specific legal questions you may have. For further information, please contact a member of the First Party Team. This is an advertisement.

Insurance Coverage Overview for Small Business Owners and the Companies that Insure Them

By: Devon J. Stewart

Renee's IT business is growing. Her secure data storage solutions service was recently featured in a prominent trade journal article, which has drawn significant attention from prospective customers and clients. Renee surveys her home office space. Her bedroom is overrun with server stacks, computer parts, and paperwork. She is running out of floor space. She signed a lease for commercial space, but the new location will not go online for another three months. Meanwhile, her home phone is ringing off the hook, and there is a steady stream of clients reserving time to consult in her living room.

One Sunday afternoon before the move, a visiting neighbor on a personal call trips over a thick bundle of cables running through the dining room. Fortunately, her neighbor is only bruised, but this is a wake-up call. Renee has never before considered the risks she is taking on by doing business from home. What if her neighbor had been a client, and what would happen if a client is hurt when she moves into her new leased space? As for her own risks, her business depends upon functioning equipment, and a single accident could destroy it all because it is housed in a single location. Furthermore, while Renee is confident in her abilities, she knows that she is only human. What happens if she makes a mistake that results in a costly data breach of client information? What other risks does she face as her business grows?

Small business owners face questions similar to Renee's. As businesses grow, so do the risks. Laws vary from state-to-state, and it can be confusing to sort through the myriad of options for insurance coverage. So what types of insurance policies should small business owners like Renee consider to manage the risks to their growing businesses? Similarly, what types of risks do insurance companies take on when they initiate coverage with a small business owner? Are there limitations to the risks assumed by an insurance coverage when they write a policy for a small business owner?

Commercial General Liability Insurance ("CGL")

One of the most common types of insurance for businesses is commercial general liability insurance ("CGL"). CGL policies cover an "occurrence," which is generally defined as "an accident, including continuous or repeated exposure to substantially the same general harmful conditions." *Cherrington v. Erie Ins. Prop. & Cas. Co.*, 231 W. Va. 470, 482, 745 S.E.2d 508, 520 (2013). An accident, in turn, "generally means an unusual, unexpected and unforeseen event." *State Bancorp, Inc. v. United States Fid. & Guar. Ins. Co.*, 199 W. Va. 99, 105, 483 S.E.2d 228 (1996).

While CGL coverage for "occurrences" includes "bodily injury" and "property damage" that arise out of an accident, courts have recognized that bodily injury or property damage arising out of a "breach of contract" is not an "occurrence." *State Bancorp, Inc. v. United States Fid. & Guar. Ins. Co.*, 199 W. Va. 99, 105, 483 S.E.2d 228 (1996) (citing *Reliance Ins. Co. v. Gary C. Wyatt, Inc.*, 540 So. 2d 688 (Ala. 1988)); *see also*, *Kentucky Farm Bureau Mutual Ins. Co. v. Blevins*, 268 S.W.3d 368 (Ky. 2008). In other words, where the damage arises out of the performance of a contract, there may not be CGL coverage.

CGL policies also typically exclude coverage for "intentional injuries." *Horace Mann Ins. Co. v. Leeber*, 180 W. Va. 375, 377, 376 S.E.2d 581, 583 (1988). For example, a CGL insurer does not have a duty to pay damages, or even defend, an insured in an action arising out of alleged sexual misconduct. Syl., *id.*; *see also*, *Wiley v. State Farm Fire & Casualty Co.*, 995 F.2d 457 (3d Cir. 1993). Courts have also concluded that the intentional injury exclusion applies to claims for outrage, civil conspiracy, or the violation of state banking laws. S*tate Bancorp, Inc. v. United States Fid. & Guar. Ins. Co.*, 199 W. Va. 99, 106, 483 S.E.2d 228 (1996).

A CGL policy would generally cover the type of accidental personal injuries stemming from occurrences like a slip and fall, which is of concern to business owners like Renee who invite customers to their premises. However, they do not cover most "breach of contract" or "intentional injury" claims. To the extent that major business risks fall within covered risk categories, a CGL policy can be an effective tool for managing those risks.

Home-Based Business Insurance and the "Business Pursuits" Exclusion

For small home business owners like Renee, homeowners insurance policies may cover certain types of risks, but they are subject to an important limitation. Homeowners insurance policies often exclude coverage for so-called "business pursuits." "The term 'business pursuits,' when used in a clause of an insurance policy excluding from personal liability coverage injuries 'arising out of business pursuits of any insured,' contemplates a continuous or regular activity engaged in by the insured for the purpose of earning a profit or a livelihood." Syl. pt. 1, *Camden Fire Ins. Ass'n v. Johnson*, 170 W. Va. 313, 294 S.E.2d 116 (1982) (emphasis added). *See also*, *Old Guard Mutual Ins. Co. v. Quigley*, 1990 WL 255912 (Pa.Com.Pl. 1990) (adopting majority view that the term "business pursuits" contemplates two elements – continuity and a profit motive).

A relevant example of the "business pursuits" exclusion arises out of a 1997 dispute between West Virginia Insurance Company, a homeowners policy insurer, and Linda E. Jackson, the insured. *See W. Va. Ins. Co. v. Jackson*, 200 W. Va. 588, 490 S.E.2d 675 (1997). Richard Bessette, who resided with Ms. Jackson, constructed a marine life support system in a garage on Ms. Jackson's property, which he used to experiment with extending marine life. Marine life which survived his experiments was sold or given away. In 1993, the garage was struck by lightening and destroyed by the resulting fire. Ms. Jackson claimed that the systems should be covered under her homeowners policy, and the insurer argued that coverage was precluded under the business pursuits exclusion. Although Ms. Jackson's counsel emphasized that Mr. Bessette was otherwise employed, and his experimentation with marine life was only a hobby, the Court found that his activities were actually continuous or regular for the purpose of earning a profit or a livelihood, and not simply for personal gratification.[1] The Court therefore held that coverage *was not* available under her homeowners policy. On the other hand, in syl. pt. 2, Camden Fire Ins. Ass'n v. Johnson, 170 W. Va. 313, 294 S.E.2d 116 (1982), the Court found that an individual who cares for children in his or her home as a neighborly or kindred accommodation to a friend or relative is not engaged in "business pursuits."

For small business owners like Renee, the question is whether the major risk categories constitute occurrences arising out of "business pursuits." Certainly Renee would be covered for her liabilities arising out of babysitting and other activities which are not continuous or regular, sometimes called the "salesperson" exception. But it is also obvious that her home IT business generally is a "business pursuit" within the meaning of her homeowners policy. One possibility for a home business owner is to request a quote for a separate homeowners policy rider to cover business property or business pursuits. This may be particularly important for home businesses, such as Renee's, that call for continuous or regular business activities at home.

Product Liability Insurance

Product liability insurance is available to manage the risk of personal injuries to consumers for small businesses that manufacture or sell products. Manufacturers may be liable for defective products, as well as any wholesaler, distributor, or retailer of the product in the stream of commerce. Product liability insurance is available for small businesses dealing with consumer products for which the risks of bodily injury to consumers cannot be adequately addressed under a CGL policy. For insurers, this specialized line of coverage may also be preferable to adequately manage exposure associated with this form of business activity, as opposed to the more general CGL policy.

Professional Liability Insurance and Errors and Omissions ("E & O") Insurance

Due to the exclusion of breach of contract claims from traditional CGL policies, professional liability insurance or "E & O" insurance can be an effective tool to manage risks arising out of malpractice, errors, omissions, or negligence in rendering services to clients. For some professionals, such as physicians, state law may require professional liability insurance. Regardless of state law requirements, where the services of a small business give rise to significant liability for errors and omissions, professional liability insurance can be an effective tool to manage the risk. Renee, for example, may determine that her customers could be significantly harmed by errors that result in data breach, in which case a specific E & O policy covering data breach liabilities may be an option to provide insurance coverage.

Commercial Property Insurance

Commercial property insurance provides coverage for damage to business property, such as equipment, materials, buildings, and other infrastructure. To the extent that a small business relies upon its infrastructure, commercial property insurance may be indispensible. For home-based businesses, homeowners insurance policies may provide coverage for business property to an extent, but business property limits may be inadequate, and a separate commercial property policy may be required to provide sufficient coverage. Renee, for example, may determine that the replacement value of her equipment is greater than the business property coverage under her homeowners policy, and she will need separate commercial property insurance.

Commercial Auto Insurance

With respect to traditional auto insurance coverage, it is important to note that there may be exclusions for personal injuries which are triggered by activities arising out of business pursuits or damage to business property. The business exclusion may be stated in a personal auto policy or in a separate exclusion in an umbrella policy. *See Cincinnati Ins. Co. v. Donzelli*, 2006-Ohio-765, ¶ 23 (Ct. App. 2006).

To the extent a small business utilizes vehicles, such as specialized service trucks, freight hauling vehicles, construction vehicles, or traditional consumer autos for business purposes, separate commercial auto insurance may be necessary to provide coverage. However, even commercial auto insurance is susceptible to certain limitations. In *LaRocco v Old Republic Insurance Co.*, 2009 WL 3169176 (S.D. W. Va.), the Court considered the availability of commercial auto coverage for injuries sustained by the plaintiff in an automobile accident which occurred during a personal trip outside of the scope of her employment. Although her employer was a named insured under the commercial auto policy, the Court concluded that the plaintiff was not entitled to coverage under the policy because she was not a named insured and could not expect her employer's commercial insurance policy to provide coverage for her while she was on a personal trip outside the scope of her employment duties.

Conclusion

Small businesses are diverse, and so are their risks. Similarly, the products provided by insurers to manage business owners' risks are diverse and subject to various exceptions and limitations. The key to successful risk management is quality risk assessment and selecting the most appropriate product to insure against risk. For both business owners and insurers, evaluating major risk categories is essential so that when a client trips over a cable line, lightening strikes, or hackers attack, all parties will be on the same page with respect to coverage.

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[1] Although subject to the business pursuit exception under the general coverage of her homeowners policy, the Court noted that the marine life support system was covered up to the $2,500 policy limit for business or commercial property, discussed above.

Insuring the Sharing Industries: Who Shares the Risk When an Occurrence Occurs?

By: Monté L. Williams

Ridesharing services are a relatively new innovation, brought on by advances in technology and the innovations of companies such as Lyft, Uber, and Sidecar. Ridesharing services involve an individual (such as a college student looking to make some extra cash) using their personal vehicle to transport passengers identified via an app for a fee. These services have filled a transportation need, particularly in crowded cities such as New York City and San Francisco. These industries have recently been branching out from the major cities into other areas of the country and have experienced phenomenal growth.

However, an insurance gap has arisen between the insured's activities in pursuit of ridesharing income and the risk covered by typical automobile policies. Personal auto insurance policies typically do not cover drivers transporting passengers "for hire" or "for a charge." Additionally, some ridesharing services, such as Uber, have denied coverage through their commercial policies when drivers are logged into the service's app, but not transporting passengers. The gap between these activities and available coverage has the potential to leave thousands of individual entrepreneurs exposed where their policies do not adequately cover their exposure to risks.

A few cities and states have begun enacting legislation that requires ridesharing services to cover the insurance gap, but most states have no laws on this issue. While most see the insurance gap as a problem, it does present an opportunity for insurance companies to provide coverage for sharing industries. This article will cover the issues pertinent to both small business insureds and their insurers.

Potential Ridesharing Insurance Gaps

Transportation Network Companies (TNC), also called ridesharing companies, are companies, such as Uber, Lyft and Sidecar, that use technology to match prospective drivers operating their own vehicles with passengers seeking transportation. Generally speaking, this trend is being driven by younger people who place less value on ownership, who want to decrease their footprint on the environment, and who see an opportunity to earn money by sharing their possessions.

Ridesharing companies offer their services through an application based platform. Customers download the app on their smartphones and use the app to request a ride.[1] The app works by connecting these customer requests with drivers in the surrounding area using GPS. In most instances, these drivers do not have a commercial license and are driving personal vehicles with personal automobile insurance.[2] Payment is made by the rider entering his credit card information on the app, which then saves this information and automatically charges the saved credit card at the end of the ride.

Whereas taxis require a permit, inspection, maintenance, insurance, and their drivers are screened and trained, critics ridicule ridesharing services because drivers need only, "a car, some gas, a smartphone, and a bank account." Additionally, if a taxi driver is off duty and headed home, or between fares, there is still a commercial policy in place to cover the driver. This is not always the case for ridesharing services, creating more risk.

1. *Insurance Gap*

Personal automobile insurance policies typically include livery exclusions. Livery exclusions bar coverage when an otherwise insured driver's vehicle is in commercial use, such as when drivers transport passengers "for hire" or "for a charge." Generally, the insurance industry has asserted that rideshare drivers are providing a commercial service any time they are logged into a ridesharing app and are available to transport passengers. Ridesharing services have argued that they are not responsible for insuring drivers who are logged into the app but who are not transporting passengers.

Thus, this debate created a "gap" period that leaves the driver and third-party passesngers exposed and without coverage. The issue is who should be responsible for providing insurance during the "gap" period. This insurance gap was evidenced by a tragic incident that happened in 2013 in San Francisco. On December 31, 2013, an individual that was driving for Uber struck and killed a six year old girl as she used a crosswalk with her mother and younger brother. Consequently, the girl's family filed a lawsuit against Uber and the driver alleging wrongful death, negligent hiring and supervision, negligence with a motor vehicle, and infliction of emotional distress.

The driver was in the gap period during the incident; he was logged into the Uber app, but had neither received nor accepted a ride request. Uber denied responsibility, maintaining that it had no responsibility to insure the driver until he had actually accepted a ride request and was either driving to pick up a passenger or was carrying a passenger at the time of the injury. The company further maintained that the driver was an independent contractor and not an employee. The case is currently ongoing and whether Uber's argument will succeed has yet to be determined. However, this exposes the potential impact of the insurance gap.

Uber has responded to insurance concerns since the above incident. Uber became the first company to cover the gap period, when it announced its new insurance policy in March 2014. The new policy provides "contingent coverage for a driver's liability at the highest requirement of any state in the US: $50,000/individual/incident for bodily injury, $100,000 total/incident for bodily injury and $25,000/incident for property damage." The policy is activated "when a driver's personal policy is no longer in effect, after a driver has turned on the Uber app, and before Uber's $1,000,000 commercial policy is in place, which covers drivers en route to make a pick up and when drivers have passengers."[3] Thus, Uber's contingent coverage will only kick in if the driver's personal insurance provider "completely declines or pays zero."[4] It is unclear, yet, whether other ridesharing industries will follow Uber's lead.

2. *Options for Insurance Companies*

Insurance companies that are concerned about covering personal vehicles used for ridesharing services have begun underwriting against vehicles engaged in such service. For example, a Lyft driver who had an accident while driving a passenger was notified that she would not be renewed unless she demonstrated that she is no longer driving for Lyft.[5] Another option for insurance companies is to clarify the exclusion of accidents related to ridesharing. In 2013, the Insurance Services Office (ISO) released PP 23 16 10 13, "Personal Vehicle Sharing Program Exclusion Endorsement," which excludes all personal auto coverage while the covered auto is enrolled in a ridesharing program.[6]

On the other hand, ridesharing does present a new market for insurance companies. This opens the door for auto insurance companies to introduce new products or rating plans. Typically, a rating plan varies rates by pleasure, work, and business usage, and mileage is difficult to capture accurately. To address concerns that the ridesharing vehicle personal usage risk might be higher than expected under current rating plans, insurance companies could introduce a new variation of business usage for ridesharing vehicles. Carriers could also require ridesharing vehicles to enroll in usage based rating programs in order to ensure the most accurate data about vehicle usage to get appropriate rates for the personal use of vehicles.

Perhaps the biggest opportunity, and risk, for insurance companies is providing coverage for the insurance gap that ridesharing causes. The insurance would cover the period before the $1,000,000 ridesharing policies kick in, e.g. while the app is on but before the drivers are on their way to pick up passengers. These will probably be in the form of an endorsement to the personal auto policy.

Conclusion

While the main issue with ridesharing is the conflict between personal and commercial insurance policies, more issues will surely rise as these services gain popularity. In the case of ridesharing, the insurance gap is slowly closing as states begin to regulate ridesharing services. The determination of whether coverage will result from a particular incident is highly fact specific and depends upon a thorough examination of the target policy language, in conjunction with the jurisdiction-specific statutes and case law. As these issues continue to arise across the various jurisdictions of the country, consultation with a knowledgeable expert in this field will be critical to determining the outcome of any coverage dispute.

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1 Administrative Law: Transportation Network Companies: How Should South Carolina Adjust Its Regulatory Framework?, 66 S.C. L. Rev. 701.

2 Id.

3 Id.

4 66 S.C. L. Rev. 701

5 Wolf, J. (August 6, 2013). Driven to take risks. San Francisco Bay Guardian Online. http://www.sfbg.com/2013/08/06/driven-take-risks.

6 Kinney, T.A. (May 29, 2014). Ridesharing, Transportation Services and Insurance. Professional Independent Agents Association of Ohio, Inc. http://www.ohiopia.com/Uploads/Documents/eNews%202014/Ridesharing_and_Insurance_5_29_2014_Kinney.pdf.

Insuring Marijuana:
Complications with Insuring an Industry Growing Like a Weed

By: Andrew P. Smith

The landscape across the United States regarding marijuana – both its sale and use – has changed substantially in the last several years. Medical marijuana is now legal in 23 states and the District of Columbia.[1] Recreational use of the plant is legal in four states – Alaska, Colorado, Washington, and Oregon (effective July 1, 2015) – and the District of Columbia. In 2014, the legal marijuana industry expanded 74 percent to reach $2.7 billion in combined retail and wholesales.[2] Conservative estimates predict $10.8 billion in sales in legal cannabis states in 2019. [3]

Despite the growth and increasing legality of marijuana, it is still classified as a "Schedule 1" substance by the Food and Drug Administration, making it its use or possession illegal under the Controlled Substance Act ("CSA").[4] This dichotomy of a burgeoning market in the face of a federal prohibition proposes significant challenges for insurers facing claims from small business owners associated with growing and using marijuana. Given the variabilities across state lines, uncertainty is unfortunately the name of the game for insurers. Similarly, small business owners seeking to insure their legitimate businesses are seeking coverage options in an industry traditionally designed to exclude "illegal" activities.

Besides the more obvious complications of insuring marijuana-related activities attendant to this unique industry (e.g., difficulty quantifying losses, in understanding the industry, and an absence of statistics to draw upon), there is also the more pressing issue that marijuana remains a Schedule 1 substance with no universally accepted medical use and no universal criminal guideline applicable to all 50 states. In December 2014, Congress passed a federal spending bill that contained protections for medical marijuana in states where it is legal. The bill contained an amendment that prohibits the Department of Justice from interfering with the implementation of states' laws that allow the sale of medical marijuana, which was subsequently signed into law.[5] In addition, the Department of Justice issued a memorandum to all U.S. attorneys in August 2013 stating its intent not to challenge state laws legalizing marijuana.[6] Yet, in April 2015, a Department of Justice official said in a statement to the Los Angeles Times that he did not believe the federal spending amendment applies to cases against individuals or organizations. As a result, the Department of Justice has continued forfeiture proceedings against medical marijuana dispensaries it considers to be in violation of federal law. These developments illustrate not only the conflict between federal and state laws, but also between the branches of the federal government itself. To make matters worse, there is precious little case law on the federal preemption question when it comes to the CSA and state laws allowing for certain types of marijuana uses. What case law does exist only demonstrates that the law in this area is far from settled.

A. *Tracy v. USAA*

As a general matter, insurers will arguably not have to provide coverage for something that is explicitly illegal under federal law – unless they affirmatively elect to do so. Until marijuana is no longer a Schedule 1 substance, an insurer's primary argument against coverage will be that marijuana is an illegal substance excluded from coverage, regardless of what state law provides. This principle played out in federal court in *Tracy v. USAA Cas. Ins. Co.*[7] In Tracy, a Hawaii homeowner had 12 marijuana plants stolen from her property.[8] She filed a claim for $45,000 for the stolen plants, which her homeowner's insurer, USAA Casualty, initially paid. When the homeowner claimed the amount paid was insufficient to cover her losses, USAA refused to pay additional monies on the claim. She filed suit in state court, which USAA removed to federal court based on diversity jurisdiction. Ultimately, USAA moved for summary judgment, claiming the homeowner did not have an insurable interest in her marijuana plants under state and federal law. The court held that, while the homeowner did have an insurable interest in the plants, because marijuana was still designated as a Schedule 1 drug under federal law, USAA did not have to pay the claim as doing so would be contrary to federal law and public policy. Thus, the court concluded that while one can have an insurable interest in marijuana plants, such an interest was preempted by federal law.

B. *Ter Beek v. City of Wyoming*

The Michigan Supreme Court, however, reached a different conclusion when assessing whether state law legalizing certain types of marijuana use is preempted by federal law that prohibits it. In *Ter Beek v. City of Wyoming*,[9] a Michigan resident challenged a city zoning ordinance that prohibited the use of land in a way that was contrary to federal law. Ter Beek was a medical marijuana user under the Michigan Medical Marijuana Act ("MMMA") , which specifically allowed for medical marijuana use in Michigan. He challenged the zoning ordinance on the grounds that it was preempted by the MMMA. The Michigan Supreme Court was faced with the question of whether the ordinance was preempted by the MMMA, but more importantly, whether the MMMA was preempted by the CSA, which makes possession of a Schedule 1 substance a federal crime.

On this question of preemption, the Michigan Supreme Court, unlike the court in Tracy, held that the MMMA "does not stand as an obstacle to the accomplishment and execution of the full purposes and objectives of the CSA." *Ter Beek,* 846 N.W.2d at 538 (citations omitted). The court concluded that a state law will present such an obstacle to a federal law "[i]f the purpose of the [federal law] cannot otherwise be accomplished—if its operation within its chosen field else must be frustrated and its provisions be refused their natural effect." *Id.* Here, the Michigan law allowing certain types of medical marijuana does not "frustrate the CSA's operation nor refuse its provisions their natural effect, such that its purpose cannot otherwise be accomplished." *Id.* at 539. The court relied partly on the following language from the CSA regarding preemption:

> No provision of this subchapter shall be construed as indicating an intent on the part of the Congress to occupy the field in which that provision operates, including criminal penalties, to the exclusion of any State law on the same subject matter which would otherwise be within the authority of the State, unless there is a positive conflict between that provision of this subchapter and that State law so that the two cannot consistently stand together. [21 USC 903.]

Id. at 537, citing 21 U.S.C. § 903. Applying this language to the MMMA, the court held that the state law does not "purport to alter the CSA's federal criminalization of marijuana, or to interfere with or undermine federal enforcement of that prohibition." *Id.* at 539.

The *Tracy* and *Ter Beek* courts reached different conclusions on the question of federal preemption, highlighting one of the complications associated with insuring marijuana-related activities across various states – namely, whether insurance policy provisions regarding marijuana are enforceable in the face of conflicting state and federal law. Consequently, for an insurer venturing into this newly burgeoning industry, consciousness of the application of these principles is critical in determining whether coverage will lie for marijuana-related activities under traditional or innovative insuring products.

C. *Barnett v. State Farm*

A third case to consider marijuana loss under personal lines insurance policies is *Barnett v. State Farm*.[12] In *Barnett*, police in California seized a homeowner's medical marijuana plants grown in the home. Following the seizure, police eventually destroyed the plants, and the homeowner filed a claim under his State Farm homeowner's policy in which he sought $98,000 in recoverable assets. State Farm denied the claim citing an exclusion for losses incurred during a "theft." The homeowner then brought a bad faith claim against State Farm for denial of the claim. State Farm was granted summary judgment, which was upheld on appeal. According to the court, "the required criminal conduct to constitute a 'theft' under Barnett's homeowner's policy resulting in a covered loss for 'stolen' property is missing under the circumstances here."[13] The court did not address the insurability of marijuana ownership and left open the question of whether the marijuana could have been covered had a true theft actually occurred. Aside from the issue of preemption and its effect on policy interpretation, if an insurer does face a marijuana-related loss, there are exclusions and limitations in traditional property policies that may serve to limit the insurer's liability. One such limitation is found in the Insurance Services Office, Inc. ("ISO") standard homeowner policy:

> We cover trees, shrubs, plants or lawns, on the "residence premises," for loss caused by the following Perils Insured Against:
> a. Fire or Lightning;
> b. Explosion;
> c. Riot or Civil Commotion;
> d. Aircraft;
> e. Vehicles not owned or operated by a resident of the "residence premises";
> f. Vandalism or Malicious Mischief; or
> g. Theft.

> We will pay up to 5% of the limit of liability that applies to the dwelling for all trees, shrubs, plants or lawns. *No more than $500 of this limit will be paid for any one tree, shrub or plant.* We do not cover property grown for "business" purposes. [14]

For this "additional coverage" to apply, the plants must be on "residence premises," which the policy defines as:

> "Residence premises" means:
> a. The one family dwelling where you reside;
> b. The two, three or four family dwelling where you reside in at least one of the family units; or
> c. That part of any other building where you reside; and which is shown as the "residence premises" in the Declarations.
>
> "Residence premises" also includes other structures and grounds at that location.

Further, the standard homeowner policy explicitly excludes "Controlled Substances":

> 8. Controlled Substance
>
> "Bodily injury" or "property damage" arising out of the use, sale, manufacture, delivery, transfer or possession by any person of a Controlled Substance as defined by the Federal Food and Drug Law at 21 U.S.C.A. Sections 811 and 812. Controlled substances include but are not limited to cocaine, LSD, *marijuana* and all narcotic drugs. However, this exclusion does not apply to the legitimate use of prescription drugs by a person following the lawful orders of a licensed health care professional.[15]

Under this language, insurers may argue limitations on the total recovery for marijuana plants destroyed by fire, theft, or any of the other circumstances enumerated above, even though the policy does not contemplate marijuana coverage on its face.

Ultimately, the continued growth of the legal marijuana industry portends a corresponding growth in this area of the insurance market. However, until marijuana is no longer a Schedule 1 substance, insurers will face uncertainty regarding coverage questions as state and federal laws continue to conflict. Analysis of the case law governing the coverage question, in conjunction with accurate analysis of the policy language, will be critical in navigating this rapidly growing industry.

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1 Alaska, Arizona, California, Colorado, Connecticut, Delaware, Hawaii, Illinois, Maine, Maryland, Mas sachusetts, Michigan, Minnesota, Montana, Nevada, New Hampshire, New Jersey, New Mexico, New York, Oregon, Rhode Island, Vermont, Washington.

2 The State of Legal Marijuana Markets, 3d. Ed., Arcview Market Research, Executive Summary.

3 Id.

4 See Title 21 – Food and Drugs, Chapter II, Drug Enforcement Administration, Part 1308.

5 Amendment to H.R. 4660 ("None of the funds made available in this Act to the Department of Justice may be used, with respect to the States of Alabama, Alaska, Arizona, California, Colorado, Connecticut, Delaware, District of Columbia, Florida, Hawaii, Illinois, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Montana, Nevada, New Hampshire, New Jersey, New Mexico, Oregon, Rhode Island, South Carolina, Tennessee, Utah, Vermont, Washington, and Wisconsin, to prevent such States from implementing their own State laws that authorize the use, distribution, possession, or cultivation of medical marijuana.").

6 Memorandum for All United States Attorneys, "Guidance Regarding Marijuana Enforcement," August 29, 2013, available at http://www.justice.gov/iso/opa/resources/3052013829132756857467.pdf.

7 Tracy v. USAA Cas. Ins. Co., No. CIV. 11-00487 LEK, 2012 WL 928186 (D. Haw. Mar. 16, 2012).

8 Hawaii state law allowed her to grow and use medical marijuana.

9 846 N.W.2d 531 (2014).

10 Mich. Comp. Laws § 333.26421, et seq.

11 21 U.S.C. § 841(a).

12 Barnett v. State Farm Gen. Ins. Co., 200 Cal. App. 4th 536, 545, 132 Cal. Rptr. 3d 742, 749 (2011).

13 Id.

14 ISO HO 00 02 05 11, § I, Subs. E, "Additional Coverages – Trees, Shrubs and Other Plants" (emphasis added).

15 Id. (emphasis added).

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More than 40 areas of practice

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