



# INSIGHTS



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## The Precarious State of Cannabis: A Look at Available Insurance Solutions

By Yelena Dunaevsky, Emily Maier and Blaine Sherwin

The cannabis industry in the United States has experienced significant growth over the last few years. The interest around the industry has been fueled by changing societal pressures, which have resulted in gradual softening of the state and federal regulatory landscape in the United States. It has also been spurred by the formal legalization in October 2018 of the cultivation, possession, acquisition, and consumption of cannabis and its by-products in Canada.

A burst of mergers and acquisitions among Canadian and US businesses followed, spurring inquiries into the availability of banking, legal, accounting, and insurance services. Although 33 states and the District of Columbia now allow the use of medical marijuana and 11 of those have legalized recreational marijuana use, cannabis has not yet been legalized on a federal level in the United States. Still, multiple new businesses have sprung up to address consumer needs and large, existing businesses, particularly in the pharmaceutical, tobacco, medical, agricultural, and food industries, are making significant investments in cannabis.

Risk, unsurprisingly, is a major concern for the entrants into the cannabis market. Fortunately, new insurance solutions, tailored to the cannabis market, are becoming more and more available in the United States. This overview captures the current state of

play of the rapidly evolving US insurance market for cannabis-related businesses, products, and transactions.

### Regulatory Landscape

#### UNITED STATES - FEDERAL LEVEL

- Cannabis is still an illegal substance under the Controlled Substances Act (CSA). It is classified as a Schedule I drug under the CSA. <sup>1</sup> However, a provision in the 2018 Farm Bill made hemp, a subtype of cannabis, legal to grow, cultivate, process, and sell on the federal level. <sup>2</sup>
- SAFE Banking Act is up for a vote in Congress. If passed, it would ease regulations that are currently preventing banks from providing services to cannabis businesses.

#### UNITED STATES - STATE LEVEL

- 33 states and the District of Columbia allow the use of medical marijuana.
- 11 out of 33 plus DC have legalized recreational marijuana use.
- 9 states require cannabis businesses to carry commercial general liability, workers' compensation, and auto liability insurance. <sup>3</sup>

<sup>1</sup> National Association of Insurance Commissioners, *Cannabis and Insurance*, last updated on January 14, 2019 and available at: [https://www.naic.org/cjpr\\_topics/topic\\_cannabis\\_and\\_insurance.htm](https://www.naic.org/cjpr_topics/topic_cannabis_and_insurance.htm).

<sup>2</sup> Bloomberg Law Insight: *Groundbreaking 2018 Farm Bill Portends Huge Changes to U.S. Cannabis and Hemp Industries*, James Rieger, January 14, 2019, available at: <https://news.bloomberglaw.com/corporate-law/insight-groundbreaking-2018-farm-bill-portends-huge-changes-to-u-s-cannabis-and-hemp-industries>.

<sup>3</sup> See National Cannabis Industry Association, *Finance and Insurance Committee, Making Sense of State and Local Cannabis Insurance Regulations*, June 2019, available at: [https://cdn2.hubspot.net/hubfs/790303/NCIA%20Committee%20White%20Papers/FIC\\_InsuranceRequirementsFinal\\_digital.pdf](https://cdn2.hubspot.net/hubfs/790303/NCIA%20Committee%20White%20Papers/FIC_InsuranceRequirementsFinal_digital.pdf).

**CANADA**

- Medicinal use of cannabis was legalized nationwide on July 30, 2001.
- Federal Cannabis Act legalized the cultivation, possession, acquisition, and consumption of cannabis and its by-products on October 17, 2018.

It is interesting to note that in the first quarter of 2019, 84 groups lobbied to the US Congress and federal agencies on marijuana- and cannabis-related issues. Some of the largest insurance carriers (Nationwide Mutual Insurance and Chubb

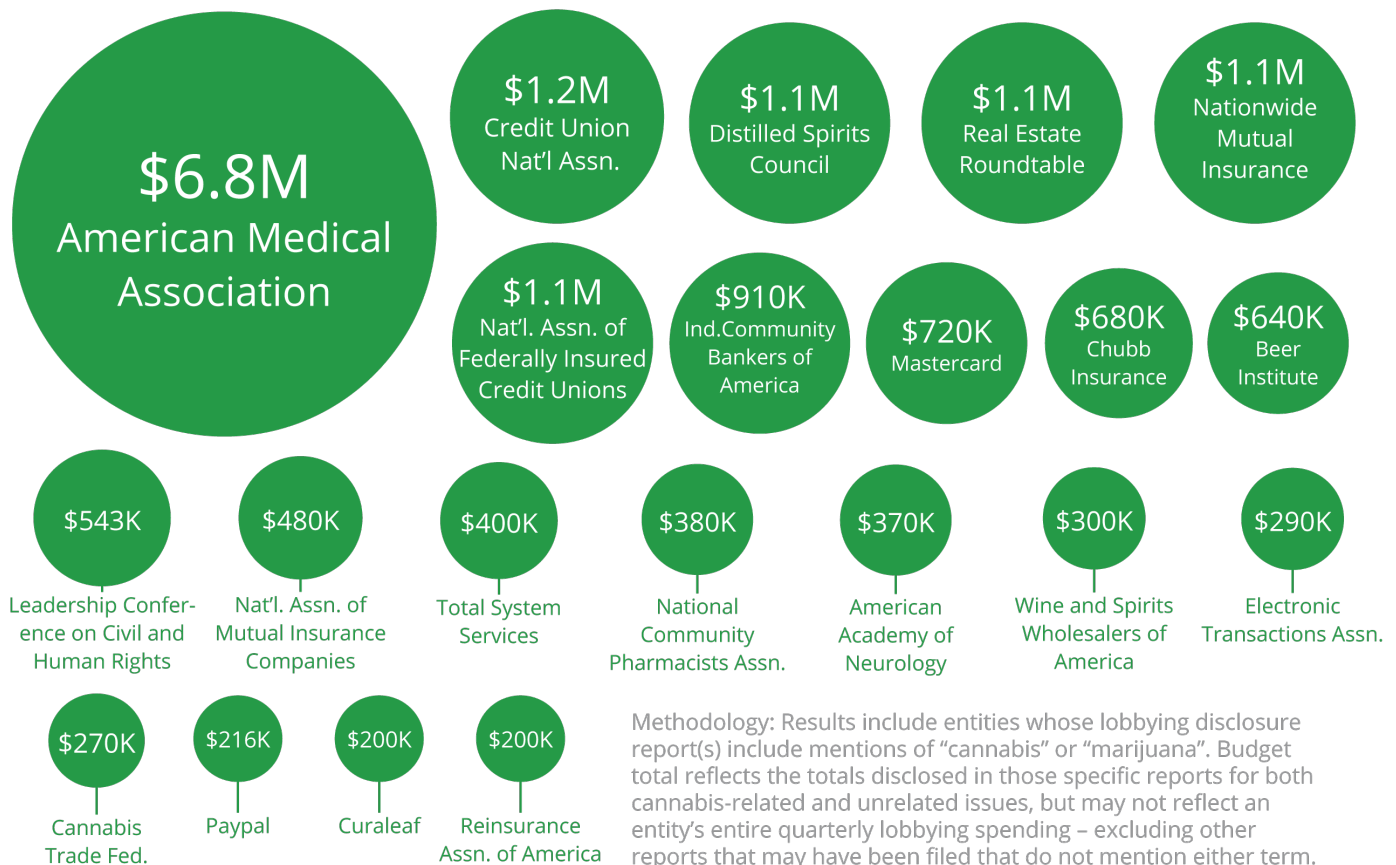
Insurance) and at least two insurance organizations (National Association of Mutual Insurance Companies and Reinsurance Association of America) were among them.<sup>4</sup>

**Financial Markets Landscape**

Spending on legal cannabis worldwide is expected to reach \$57 billion by 2027, according to ArcView and its research partner, BDS Analytics. Canadian spending on adult-use is expected to grow from around \$113 million in 2018 to \$4.8 billion in 2024.<sup>5</sup> Projections pin North Americans as the largest group of cannabis buyers, growing from \$9.2 billion in 2017 to \$47.3 billion in 2027.<sup>6</sup>

**The biggest spenders lobbying on cannabis or marijuana**

Entities whose Q1 2019 total lobbying budgets of at least \$200,000 mention cannabis or marijuana.



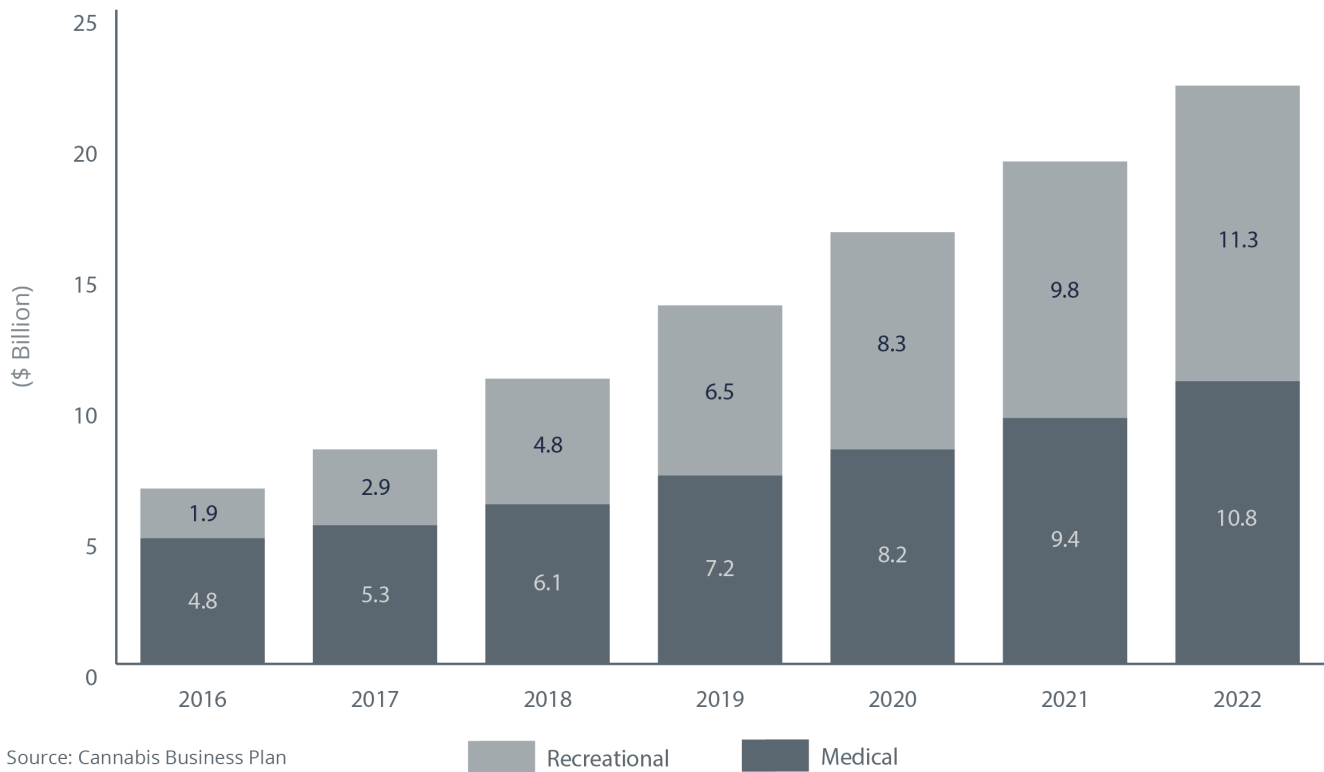
Source: Senate Lobbying Disclosure Act Database by Janie Bosch, POLITICO Pro DataPoint

<sup>4</sup> Federal Cannabis Lobbying Continues to Grow in 2019, Janie Boschma, POLITICO Pro DataPoint, April 23, 2019, available at: <https://www.politico.com/ff?id=0000016a-4c6a-ded4-affa-6eeb9d050001>.

<sup>5</sup> The State Of Legal Cannabis Markets Executive Summary, 7th Edition, The Arcview Group and BDS Analytics, available at: <https://arcviewgroup.com/research/#6th>.

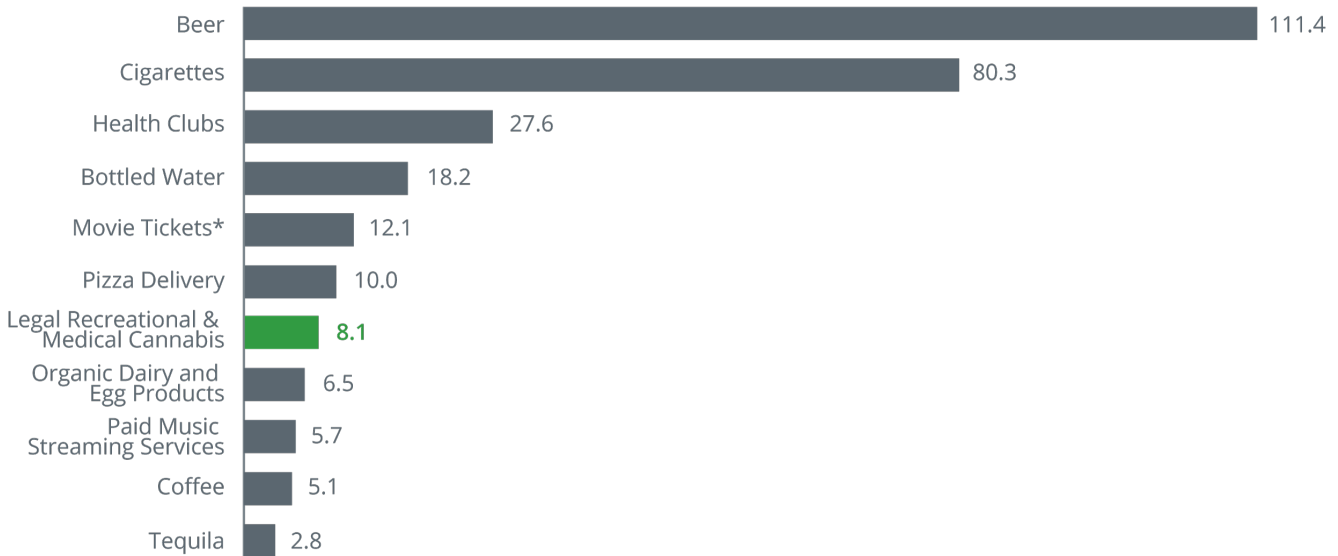
<sup>6</sup> Legal Cannabis Industry Poised for Big Growth, In North America And Around The World, Thomas Pellechia, Forbes, Mar 1, 2018, available at: <https://www.forbes.com/sites/thomaspellechia/2018/03/01/double-digit-billions-puts-north-america-in-the-worldwide-cannabis-market-lead/#6007bd5e6510>.

### Projected Growth of Marijuana Revenue 2016–2022



### Annual US Marijuana Sales vs. Other Industries (2017)

(\$ Billion)



\*Includes US & Canada.

Source: Brewers Association, Alcohol & Tobacco Tax & Trade Bureau, Mordor Intelligence, Statista, Eli Lilly and Company, US Distilled

In the US alone, cannabis revenues from both medical and recreational use are projected to exceed \$20 billion by 2022.

Over the last two years, annual cannabis sales in the United States have exceeded sales numbers for coffee and organic dairy products and are on track to surpass pizza delivery revenues.

Several Canadian and UK companies, some with capitalizations exceeding \$6 billion, are making huge strides in the global markets. Companies like GW Pharmaceuticals plc., Aurora Cannabis Inc., and Canopy Growth Corporation are already trading on NYSE and Nasdaq. Privateer Holdings-backed Tilray, a Canadian pharmaceutical and cannabis company, completed its initial public offering and listed on Nasdaq in July 2018.

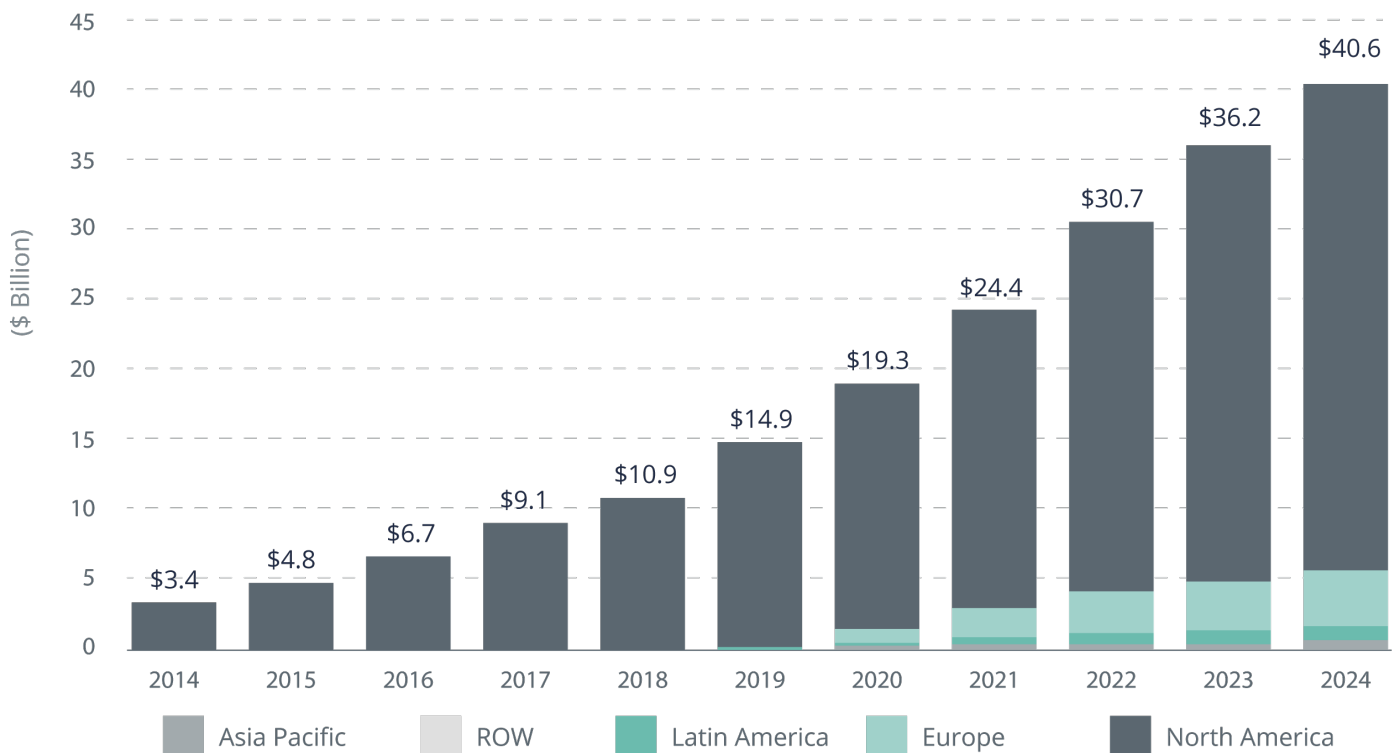
In the private sector, according to PitchBook data, cannabis startups went from drawing 11 venture investments worth a combined \$16 million in 2013 to funding 146 venture capital ("VC") deals worth \$982 million in 2018. And in just the first four months of 2019, the value of VC deals in this space increased to \$1.2 billion.<sup>7</sup>

Global spending on cannabis-related products is projected to exceed \$40 billion by 2024.

### Insurance Needs

Businesses entering cannabis-related markets, like businesses in all other industries, need various service providers, including attorneys, accountants, bankers, and, of course, insurers. Availability of insurance products and coverages has been growing over the last few years with the rest of this industry. Quite a few gaps remain, but although insurers are still concerned about the availability of reinsurance coverage, more of them are becoming comfortable with covering various kinds of risks. For example, California now has six admitted insurance carriers.<sup>8</sup> Knowledgeable insurance brokers can help tremendously with hammering together the right kind of coverage.

### Global Legal Spending in Key Markets by Continent (In Billions)



Source: Arcview Market Research/BDS Analytics

<sup>7</sup> See *The Wild West of the budding cannabis industry*, Kevin Dowd, June 21, 2019, available at: <https://pitchbook.com/news/articles/the-wild-west-of-the-budding-cannabis-industry>.

<sup>8</sup> California Department of Insurance now has a Cannabis Insurance List, listing agents and brokers operating in the cannabis market, available at: <http://www.insurance.ca.gov/01-consumers/160-cannabis/upload/Cannabis-Insurance-List-Updated-02-19-19.pdf>.

## Marijuana-Related Market Segments in Need of Market Solutions

Segment	Description
<b>Cultivation</b>	Businesses that handle marijuana along the supply chain, including indoor, outdoor, and mixed businesses that cultivate, process, harvest, test, package, and transport cannabis for sale and consumption.
<b>Dispensaries &amp; Retailers</b>	Retail outlets or stores where most consumers can purchase medical or recreational marijuana products. Like cultivation facilities, dispensaries go through an application process to obtain state licensure. Cash management is often vitally important to these businesses.
<b>Infused products</b>	An extremely lucrative segment of the industry that offers a wealth of growth opportunities through a wide variety of products, including cannabis beverages, beauty & skin care products that contain cannabidiol (CBD) oil, edibles such as chocolate gummies, and cannabis capsules.
<b>Landlords</b>	A wide range of businesses offering business-to-business services to other companies in the industry, such as testing laboratories, packaging firms, marketing firms, and consumption device manufacturers, in addition to real estate owners of commercial properties leased to cannabis-related operations.

Source: AM Best data and research

The types of insurance the cannabis industry currently needs include:

- Automobile/Distribution (auto and cargo)
- Commercial General Liability
- Crop (Indoor/Outdoor)
- Crime
- Disaster Coverage
- Director and Officer Liability
- Employment Practices Liability
- Equipment Breakdown
- Errors and Omissions
- Excess/Umbrella
- General Liability
- Product Liability
- Premises Liability
- Property
- Surety Bonds
- Workers' Compensation

### FACTORS AFFECTING INSURANCE COVERAGE AND PREMIUMS

The cannabis business sector is growing not only by dollar value, but also by number and types of businesses. These new types of businesses may be dealing directly with the plant (e.g., growing, processing, or storing it); they may be focused only on transportation of plant-derived products or on the creation of new products derived from already-processed materials; or they may be designing irrigation, lighting, or software related to business operations of another business. The range of possible businesses is extremely wide, and the risks are diverse. Insurers tend to look at the following few factors to determine availability and cost of coverage.

- Whether the cannabis that the business uses is derived from hemp or from Tetrahydrocannabinol (THC).
  - Cannabis plants containing more than 0.3 % THC would be considered non-hemp cannabis (i.e., marijuana) under federal law and would have no legal protection under the 2018 Farm Bill.<sup>9</sup>

<sup>9</sup>The Farm Bill, hemp legalization and the status of CBD: An explainer, John Hudak, The Brookings Institution, December 14, 2018, available at: <https://www.brookings.edu/blog/fixgov/2018/12/14/the-farm-bill-hemp-and-cbd-explainer/>.

Whether the business is "touching the plant" or "not touching the plant."

- Some insurers are not writing policies for businesses that are dealing directly with the plant.
- Whether the business is in compliance with testing processes.
  - California has established the Bureau of Cannabis Control, which requires that all harvested cannabis and all manufactured cannabis products be tested in accordance with Section 5715 of Title 16 of the California Code of Regulations along [three separate categories](#):
    - Inhalable cannabis
    - Inhalable cannabis products
    - Other cannabis and cannabis products
- Whether the products of the business are crossing state lines.
  - Although some states have legalized cannabis-related products, others have not. Cannabis is not yet legal on a federal level, which makes its transportation through interstate commerce illegal, and may subject the business to criminal liability. Interstate distribution poses additional risks, which insurers are typically not willing to cover.
- The types of equipment the business is using for manufacturing and extraction.
  - For example, lighting for grow facilities, THC extraction process (commonly butane), and other equipment must comply with state laws and regulations.
- Whether the business is Occupational Safety and Health Administration ("OSHA") compliant.
  - Like all other companies, cannabis-related businesses are subject to OSHA compliance requirements. Considering the industry's fast rate of development and the spotlight that it attracts, it is very likely that OSHA will be taking a hard look at cannabis businesses individually and cannabis industry as a whole. The four major parts of OSHA compliance are: (1) a written safety plan; (2) employee training; (3) accountability; and (4) safety auditing.

- Location of the business.
  - Insurers will carefully consider the location of the business. Proximity to schools, daycare, residential areas or parks, as well as whether the business is in high-crime, industrial versus retail, and high versus low traffic areas, will all be taken into account.
- Whether the business meets the carrier's requirement for safe rooms, vaults, and alarms.
  - The continuing reluctance of the banking industry to accept deposits forces most cannabis businesses to rely on cash transactions. This well-known fact creates a significant risk for virtually all cannabis businesses. As such, the importance of security measures including safe rooms, vaults, alarms, and, in most cases, armed security is paramount to the safety of the business and its employees.
- International, federal, state, and local regulatory requirements.
  - International, federal, state, and local regulatory requirements vary significantly. Policies typically contain exclusions for regulatory issues, so it is important to understand and establish the exact scope of coverage for each portion of the business and each facility in each jurisdiction.

#### LATEST DEVELOPMENTS PER INSURANCE TYPE

The US insurance market serving cannabis-related businesses has been expanding. Around 25 carriers (mostly non-admitted) are now offering coverage in the United States and Canada.<sup>10</sup> Many large, national, and multinational carriers are now offering policies across various lines. Coverage can now be obtained for a number of different entities and businesses and for several types of risk.

<sup>10</sup> *Cannabis: New Opportunities for Insurers, But with Burgeoning Risks, Best's Special Report, March 12, 2019, available at: <http://www3.ambest.com/bestweekpdfs/sr497749919749full.pdf>.*

**TYPE OF BUSINESS OR ENTITY COVERED**

- Building Owners (LRO)
- Consultants
- Dispensaries
- Medical
- Recreational
- Extractors
- Growers / Cultivators – Indoor and/or Outdoor
- Manufacturers
- Processors
- Testing Laboratories
- Trimmers and Harvesters
- Wholesalers

**TYPE OF RISK COVERED**

- Building
- Business Income
- Business Auto
- Business Personal Property
- Completed Stock
- Crime
- Crop
- Cyber
- General Liability
- Goods in Process
- M&A Representations and Warranties
- Management Liability (Directors & Officers, Employment Practices Liability, Fiduciary)
- Product Liability
- Property (including cannabis inventory) and Equipment

- Breakdown
- Surety bonds
- Tenants Improvements
- Umbrella Excess Liability
- Workers' Compensation

However, each area of insurance is developing at its own pace. The current insurance market is highly fractured, mostly because carriers have divergent risk appetites. Therefore, creating and maintaining coverage programs that achieve cohesion and economies of scale is still a challenge. This section outlines a few interesting updates for each specified area of coverage.

**M&A REPRESENTATIONS AND WARRANTIES INSURANCE**

The number of companies merging or acquiring assets in the cannabis market skyrocketed in 2018. The Canadian M&A market has been booming since the legalization of cannabis in Canada in October 2018, and a portion of that M&A activity is spilling into the United States.

For example, in April 2019, Canopy Growth Corp., the world's most valuable marijuana company, announced its intention to buy New York-based Acreage Holdings Inc. for \$3.4 billion with the cash it received from alcohol giant Constellation Brands Inc. in 2018. This cross-border deal may start a wave of consolidation in the US cannabis industry.<sup>11</sup>

US-based companies are also aiming for large deals. In May, Bloomberg reported that Curaleaf Holdings Inc., the most valuable US marijuana company, was set to buy the regulated cannabis business of Cura Partners Inc., a maker of oil for vape pens, in a stock deal valued at about \$950 million.<sup>12</sup> Analysts predict an increase in M&A transactions in the cannabis market as companies seek to reduce competition, extend presence over new markets, and establish their brand.

Insurance carriers are beginning to respond to the billions of dollars on the table. At least two carriers are now offering M&A

<sup>11</sup> See *Canadian pot company buys New York rival in \$3.4-billion bet on U.S. market*, Kristine Owrn and Craig Giammona, Bloomberg, April 18, 2019, available at: <https://www.latimes.com/business/la-fi-canopy-acreage-pot-marijuana-constellation-20190418-story.html>.

<sup>12</sup> See *Curaleaf Bets Nearly \$1 Billion on Weed Oil in U.S.*, Craig Giammona, Bloomberg, May 1, 2019, available at: <https://www.bloomberg.com/news/articles/2019-05-01/curaleaf-bets-nearly-1-billion-on-weed-oil-in-largest-u-s-deal>.



representations and warranties insurance in the United States. It is worth noting that different rules apply when US and Canadian entities are involved in the same transaction.

- A US cannabis company buying another US cannabis company will be able to obtain coverage for nearly all representations and warranties (subject to diligence), but will be subject to a general exclusion for problems arising from the contrast between state and federal laws.
- A US company buying a Canadian company will be treated in a similar way.
- A US company using a Canadian subsidiary, however, may not be subject to such an exclusion.

As this market continues to develop we believe the first availability of wider insurance coverage options will be for "non-leaf touching" companies (e.g. makers of peripherals or components). The coverage will then broaden to other, more direct businesses.

### MANAGEMENT LIABILITY INSURANCE

The US market for management liability insurance, which includes directors and officers, fiduciary liability, and employment practices liability insurance, has seen marked improvement in the number of insurers, including large, multinational outfits, entering the space. About 10 insurance carriers now offer coverage for management liability. However, risk appetite varies by carrier with regards to grow facilities, retail footprint, THC versus CBD, and other factors. It is also worth noting that pricing for IPOs in general is going through rapid hardening, with heftier deductibles and higher premiums becoming a norm. This recent trend in the general IPO market would apply to cannabis-related IPOs as well.

### PROPERTY, CASUALTY, AND AUTO INSURANCE

Close to 10 insurers, including larger national and multinational carriers are now offering coverage for properties of cannabis-related businesses. Property insurance includes cannabis specific assets, such as crop, goods in process, completed stock and extraction equipment. Underwriters are particularly critical of operations that use extraction equipment because such equipment usually involves a highly pressured system, which has an increased explosion potential. Indoor crop coverage is

now available, but outdoor crop coverage is not.

Property insurance also includes traditional assets, such as business personal property and real property. Some insurers are covering crime, but this kind of coverage is difficult to obtain on a separate policy. It is typically a sub-limit within the property policy. Goods in transit can now be covered and business-owners policies are available for dispensaries. Businesses should confirm that any goods in transit or in storage are kept in a locked vault that is compliant with any local or state ordinances. Insurance carriers will rely on these types of security controls, as well as warranties statements made on insurance applications, when they determine coverage for a loss.

Casualty insurance coverage is now available from about eight insurers for cannabis cultivators, processors, wholesalers, and dispensaries in states where cannabis has been legalized for medicinal or recreational use. These include subsidiaries or national and multinational insurance carriers. Coverage limits go up to \$5 million and the premiums start at \$5,000. Most of the hurdles in policy placement come from robust exclusions on newly-formed or newly-acquired entities, host liquor liability and newly-acquired locations.

### INSURANCE IS AVAILABLE FOR:

- Cannabis paraphernalia
- Cultivators
- Distributors
- Manufacturers
- Medicinal use
- Recreational use
- Retailers
- Processors
- Wholesalers



### INSURANCE IS NOT AVAILABLE FOR:

- Events
- Testing labs
- Social clubs

At least three national carriers, including subsidiaries of large national insurers, are offering auto insurance for cannabis-related businesses. Although possible, placement of Hired & Non-Owned Auto continues to be challenging. This is particularly true with regards to the delivery of cannabis. With more and more companies looking to offer home delivery service, this is certainly an issue that will need to be addressed.

### CYBER INSURANCE

Cannabis-related businesses are exposed to data breaches and cyber-attacks much like other businesses but may be even more vulnerable depending on the exact nature of the business. For example, many dispensaries have informational cyber risk, which can be exacerbated by the volume of credit card and other personally identifiable information these businesses typically collect during each transaction. Other cannabis businesses may be exposed to operational cyber risk from supply chain-related cyber breaches and from the industry-wide increase in the reliance on third-party technologies.<sup>13</sup>

Cyber insurance coverage can help these businesses offset post-breach and operational meltdown recovery costs. Cyber liability policies now cover everything from first-party costs suffered due to a data breach (e.g., consumer notification, IT forensics services, and credit monitoring) to business interruption and extortion payments arising from a ransomware attack. Should any third-party liability arise out of a cyber incident, including class action lawsuits or privacy regulatory inquiries, cyber liability policies can provide defense costs and damages or penalties for those as well.

### Is Cannabis the Wave of the Future?

Despite a certain degree of discombobulation in the current cannabis insurance market, larger, more established insurers are expanding operations into various lines and establishing precedent for meaningful coverage. Increase in business volume and recent regulatory changes across several US states, combined with continued enthusiasm from non-cannabis businesses, consumers, and investors, are signaling a probable rapid expansion of this market in the near future. Difficulties persist in obtaining sufficient coverage, but they are not insurmountable. They create opportunities for innovative risk solutions, which we trust will ultimately result in the availability of correct levels of coverage for this exciting new business sector.

Several transactional insurance specialists at Woodruff Sawyer have worked on cannabis business policy placements and continuously monitor the developments in the cannabis insurance marketplace. Please feel free to reach out to us with questions about your cannabis-related insurance needs.

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*As one of the largest insurance brokerage and consulting firms in the US, Woodruff Sawyer protects the people and assets of more than 4,000 companies. We provide expert counsel and fierce advocacy to protect clients against their most critical risks in property & casualty, management liability, cyber liability, employee benefits, and personal wealth management. An active partner of Assurex Global and International Benefits Network, we provide expertise and customized solutions where clients need it, with headquarters in San Francisco, offices throughout the US, and global reach on six continents. For more information, call 844.972.6326, or visit [woodruff Sawyer.com](http://woodruff Sawyer.com).*

<sup>13</sup> For additional information on cyber liability insurance solutions, see *Guide to Cyber Liability Insurance*, Dan Burke, Woodruff Sawyer, available at: [https://woodruff Sawyer.com/wp-content/uploads/2019/06/40842\\_Woodruff-Sawyer-Cyber-Buying-Guide\\_Final.pdf](https://woodruff Sawyer.com/wp-content/uploads/2019/06/40842_Woodruff-Sawyer-Cyber-Buying-Guide_Final.pdf).

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A transactional attorney by training, Yelena provides consultation and support to clients working on M&A transactions and IPOs. She uses her corporate transactional and securities law background to explore new opportunities in transactional insurance solutions. She also focuses on legal data analysis and closely follows developments in emerging legal markets. She is a frequent author of articles covering various aspects of corporate transactions.

Prior to joining Woodruff Sawyer, Yelena oversaw Bloomberg Law's practical guidance and reference content that covers debt and equity capital markets, M&A transactions, developments in securities and corporate law, and other topics. Prior to Bloomberg Law, Yelena practiced law as a senior capital markets associate at Clifford Chance and as a corporate associate at LeBoeuf, Lamb, Greene & MacRae (later as Dewey & LeBoeuf).

Yelena received her B.S. in Economics from Cornell University and her J.D. from Fordham University School of Law.

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Leading Woodruff Sawyers M&A practice, Emily provides consultation and support to clients seeking to minimize their risks associated with merger and acquisition activity. This includes Representations and Warranties, Tax Opinion Liability, and Litigation Buy-Out coverages. Emily's deal experience covers both American and European deals. Her clients are as diverse as their locations. She has worked with both strategic and private equity buyers and sellers over a wide range of transaction sizes and industries.

In 2019, Emily was named in Insurance Business America's "Hot 100," which lists top professionals whose contributions have helped shape the insurance industry. She is a frequent speaker on M&A transaction solutions, is a [regular blogger on the topic of M&A](#), and has been a featured author in publications such as Bloomberg Law.

Prior to joining Woodruff Sawyer in the United States, Emily specialized in M&A insurance transactions at leading brokerage firms in London.



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Blaine is focused on new business development and client relationship management. His primary area of expertise is Property and Casualty, where he maintains an emphasis on Manufacturing and Distribution. Blaine works closely with his clientele to provide guidance on risk mitigation and risk management solutions.

Prior to beginning his insurance career in 2015, Blaine spent nine years involved with corporate growth and supply chain management in the consumer products industry managing national accounts for top Fortune 500 companies. Blaine earned his bachelor's degree in psychology from California State University, Chico.