



Emergent Insurance Issues Surrounding the Legalization of Cannabis

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I. Introduction

Canada will legalize marijuana on October 17, 2018. While the majority of licensed producers are still focused on medical marijuana production, future business growth is clearly on the recreational side. According to a 2016 report prepared by Deloitte, entitled "Recreational Marijuana: Insights and Opportunities," legal consumption (as well as ancillary markets related to testing, transportation, security, tourism, taxation, and paraphernalia) could generate \$22.6 billion in revenue per year.¹ Sales alone could reach \$8.7 billion annually, an amount similar to sales numbers generated by wine.² In light of these predictions, consumers, businesses and insurers alike would benefit from a review of the law surrounding this burgeoning industry.

In responding to legalization, the insurance industry needs to identify risk by reviewing the law, policies and language, and by developing a strategic response on how to respond to the market.

II. The Legal Framework for Canada's Recreational Marijuana Market

A. Federal Law

On June 21, 2018 the *Cannabis Act* (the "Act"), received Royal Assent. It is the regulatory framework for recreational marijuana in Canada and will come into force on October 17, 2018.³ Specifically, the Act establishes a licensing framework for the following: importation, exportation, production, testing, packaging, labelling, sending, delivery, transportation, sale, possession and disposal of cannabis. Legal forms of recreational cannabis will include dried cannabis, cannabis oils and seeds that comply with federal regulations. The sale of cannabis edible products will be authorized no later than 12 months following the coming into force of the Act.

As of October 17, 2018, the Act makes the following activities legal:

- Adults (18 and over depending on provincial legislation) can possess 30 grams or less of legal cannabis in public places;⁴
- Adults can purchase fresh or dried cannabis, cannabis oil, plants and seeds for cultivation from provincially or federally regulated retailers;
- Adults can grow up to four marijuana plants per household;⁵

¹ "Recreational Marijuana: Insights and Opportunities" report prepared by Deloitte, Touche Tohmatsu Limited (2016), at 5, online: <https://www2.deloitte.com/content/dam/Deloitte/ca/Documents/Analytics/ca-en-analytics-DELOITTE%20Recreational%20Marijuana%20POV%20-%20ENGLISH%20FINAL_AODA.pdf> [Deloitte 2016 Report].

² *Ibid.*

³ The long title of the Act is *An Act Respecting Cannabis and to Amend the Controlled Drugs and Substances Act, the Criminal Code and Other Acts*. Accessible online: <<http://www.parl.ca/DocumentViewer/en/42-1/bill/C-45/third-reading>> [the Act].

⁴ Legal age limits are set by the provinces. British Columbia will be setting the minimum age to possess, purchase and consume cannabis at 19 years old, consistent with B.C.'s minimum age for alcohol and tobacco regulations.

- Adults can share/gift up to 30 grams of legal cannabis products with other adults; and
- Adults can alter cannabis at home (e.g. make an edible) for personal use, provided that no dangerous organic solvents are utilized in the process.

In addition to decriminalizing possession, the Act also creates two new criminal offences: (1) giving or selling cannabis to youth; and (2) using a youth to commit a cannabis-related offence. Each offence comes with a maximum penalty of fourteen years imprisonment. Bill C-46, a companion bill, establishes three new drug-impaired driving offences.

B. Provincial Law

British Columbia passed the *Cannabis Control and Licensing Act*, S.B.C. 2018, c. 29 on May 31, 2018, and is in the process of drafting Bill 31 – 2018, otherwise known as the *Cannabis Distribution Act (CDA)*. These Acts will regulate the recreational sale and consumption of marijuana in the province. The stated purpose of these regulatory measures is to promote public health and safety, protecting youths and putting an end to illicit sales. It is important to note that while the *Cannabis Control and Licensing Act* has been assented to, it is not currently in force in the province.

***Cannabis Control and Licensing Act (CCLA)*⁶**

B.C. proposed a variety of cannabis regulations directed at protecting children and youth through the *CCLA*, an Act that accomplishes the following:

- Sets 19 as the provincial minimum age to purchase sell or consume cannabis;
- Allows adults to possess up to 30 grams of cannabis in a public place;
- Prohibits cannabis smoking and vaping everywhere tobacco smoking and vaping are prohibited, as well as at playgrounds, sports fields, skate parks, and other places where children commonly gather;
- Prohibits the use of cannabis on school properties and in vehicles;
- Authorizes adults to grow up to four cannabis plants per household, but the plants must not be visible from public spaces off the property, and home cultivation will be banned in homes used as day-cares;
- Establishes a cannabis retail licensing regime similar to the current licensing regime for liquor;
- Provides enforcement authority to deal with illegal sales;
- Creates a number of provincial cannabis offences which may result in a fine ranging from \$2,000 to \$100,000, imprisonment of three to 12 months, or both; and

⁵ Unlike medical cannabis patients, adults are not permitted to designate or transfer the cultivation of their 4 plant limit to another individual.

⁶ *Cannabis Control and Licensing Act*, S.B.C. 2018, c. 29, online: <<http://www.bclaws.ca/civix/document/id/complete/statreg/18029>>.

- Where necessary, to comply with Charter Rights and human rights law, exemptions will be provided to individuals who are federally authorized to purchase, possess and consume medical cannabis.⁷

Cannabis Distribution Act (CDA)⁸

In general, provincial rules surrounding recreational marijuana sales and store operation will be equivalent to the ones that regulate the liquor industry. In B.C., the wholesale distribution of recreational cannabis will be sold solely through the Liquor Distribution Branch ("LDB") which will be responsible for licensing and monitoring the retail sector using a mixed public/private model.

The *CDA* will establish:

- A public wholesale distribution monopoly; and
- Public (government run) retail sales (both brick and mortar and online sales).⁹

Changes to Other Legislation

The implementation of the *CCLA* and *CDA* will lead to the following changes to other B.C. legislation to ensure consistency and compliance:

- *The Liquor Control and Licensing Act*
- *The Police Act*
 - B.C. will set provincial priorities that require municipal compliance
- *Community Safety Act*
 - marijuana will no longer be listed as a controlled substance
- *Provincial Sales Tax Act*
 - cannabis will now be added to the definition of "small seller," consistent with liquor sales provisions
- *Business Practices and Consumer Protection Act*
 - *CCLA* will be recognized as a complete licensing scheme
- *The Residential Tenancy Act and Manufactured Home Park Tenancy Act*
 - cannabis smoking will be prohibited under existing leases that prohibit tobacco smoking
 - personal cultivation (other than federally licensed medical marijuana) will be prohibited under existing leases
 - the existing provisions of each Act that allow landlords and tenants to negotiate the terms of a lease will apply for new leases

⁷ < <https://www2.gov.bc.ca/gov/content/safety/public-safety/cannabis>>

⁸ Bill 31 – 2018, online: < <http://www.bclaws.ca/civix/document/id/bills/billscurrent/3rd41st:gov31-1>>

⁹ B.C.'s LDB has stated that online sales will be restricted solely to government stores.

- *Motor Vehicle Act (MVA) Amendments*
 - Any driver whom police reasonably believe operated a motor vehicle under the influence of drugs (or a combination of drugs and alcohol) will receive a 90-day Administrative Driving Prohibition (ADP), or, in the alternative, the driver refuses, without reasonable excuse, to comply with a demand to be tested by approved drug screening equipment; and
 - A zero-tolerance restriction for the presence of THC (active ingredient in cannabis) for new drivers in the Graduate Licensing Program (GLP).¹⁰

III. Implications for the Insurance Industry

Insurers must consider how much risk they are willing to assume given the new realities of the availability, prevalence and attendant increase in potential hazards associated with the legalization of cannabis. This section of the paper will outline some issues the insurance industry will likely be grappling with over the coming years.

A. Homeowners Coverage

Historically, insurers have attempted to draft policy language to exclude property damage caused by marijuana grow-operations. This issue often arises in the context of a rental property. B.C. Courts have held that damage caused to a rental property by a tenant's grow-operation falls within named peril coverage for vandalism or malicious acts¹¹. In response to these types of cases, many insurers tightened their policy exclusions and added exclusionary language specifically referencing the cultivation of marijuana. In policies with specific exclusionary language, coverage could be denied for property damage caused by grow-operations¹².

The new legislation allows the personal cultivation of four marijuana plants. Often, a homeowner's policy will exclude coverage for property damage caused by "illegal substance activity". As of this autumn, possession and cultivation of four marijuana plants will no longer constitute "illegal substance activity", although it may still materially increase the risk of property damage to a dwelling; for instance, potentially increasing the risk of water, mould, burglary and fire damage claims. If an insurer wants to decline to write a homeowner's policy if the homeowner cultivates or intends to cultivate marijuana, the relevant exclusion clause will have to be modified or amended. There is an unavoidable grey period for insurers from October 17, 2018 to whatever date their policies are rewritten. During that time, the insurer will be bound by its current policy language, potentially not excluding cannabis-related property damage, but will also be facing the increased risks associated with the presence of legal cannabis in their insureds' homes.

¹⁰ < <https://www2.gov.bc.ca/gov/content/safety/public-safety/cannabis> >

¹¹ *Hanlon v. ING Insurance Co. of Canada*, 2011 BCSC 73

¹² *Pietrangelo v. Gore Mutual Life Insurance Co.*, 2011 ONCA 162

In order for underwriters to be properly informed about what their insureds are engaged in and therefore what risk the insurer is assuming, the insured must be forthright about facts material to that risk. An insurer and an insured each owe one another a duty of utmost good faith. The insured's good faith obligations are particularly emphasized at the time of applying for an insurance policy, as the insured has a duty to disclose facts that are material to the risk. Most facts about the risk lie with the insured only. This duty is codified in the Statutory Conditions, which vary slightly from province to province. The British Columbia Statutory Condition 1 provides:

1. If any person applying for insurance falsely describes the property to the prejudice of the insurer, or misrepresents or fraudulently omits to communicate any circumstance which is material to be made known to the insurer in order to enable it to judge of the risk to be undertaken, the contract is void as to any property in relation to which the misrepresentation or omission is material.

The question of materiality is a question of fact. The insurer bears the onus of establishing that a fact is material. The test for determining if a fact is material is twofold:

1. whether a prudent insurer would be influenced by the information in either deciding whether to accept the risk or in setting the premium; and
2. whether the particular insurer would have been influenced by the information.

When attempting to prove materiality in court therefore, an insurer generally produces evidence from its own underwriting department respecting what decision it would have made had all the facts been known as well as evidence of the industry standard in general. Whether or not a fact is material is to be assessed objectively from the point of view of a reasonable or prudent insurer. At this point in time, surely not all insurers will chose to write homeowner's policies where the dwelling contains legal marijuana plants. Therefore, perhaps now it can be said that a "reasonable and prudent insurer" would consider the presence of legal marijuana to be material. However, as time passes and perhaps as personal cultivation of marijuana becomes more common place, what a *reasonable and prudent* insurer considers material may evolve such that a "reasonable and prudent insurer" would no longer consider the presence of legal marijuana in the home to be a material fact. Over time, the market will determine how much risk it is willing to assume respecting the personal cultivation of marijuana.

If an insurer does not want to cover a dwelling where there will be legal marijuana plants, it should include a specific question about the presence of marijuana plants in the home on the application for insurance. The insurer is in a better position to know what is material to the risk and should ask an insured specifically about what it considers material. If an insurer fails to make the appropriate inquiry, the court may conclude that the insurer cannot void the policy pursuant to the Statutory Conditions¹³.

¹³ *Aviva Insurance Company of Canada v. Thomas*, 2011 NBCA 96

It is important to note that the Statutory Conditions refer to the knowledge of the person applying for the insurance (Statutory Condition 1) and to risks within the control and knowledge of the insured (Statutory Condition 4). When an insured rents property to a tenant, the insured may not always know what is happening at the insured premises. If a tenant grows marijuana legally, the insured landlord may not be aware of that fact. An insurer will not likely be able to void the policy pursuant to the Statutory Conditions in that circumstance, if the insured had no knowledge of the presence of the marijuana¹⁴.

It will of course remain open to insurers to continue to exclude coverage for property damage caused by "illegal substance activities". Arguably, if the dwelling contained five plants instead of the four provided for by the legislation, that could qualify as "illegal substance activity" and trigger the exclusion.

If an insurer chooses to enter the market and insure dwellings containing marijuana plants, presumably with premiums reflective of the increased risk, it will be important to maintain knowledge respecting the value of marijuana plants, as they may be considered insured property for the purposes of a homeowner's policy¹⁵. On the other hand, the marijuana plants may be subject to "tree, shrub and plant" special limits within the policy.

B. Commercial Cultivation and Sales

The legalization of recreational cannabis will bring into the light an entire industry which has seemingly been existing in the shadows. The countless dispensaries in B.C. cities are not currently operating legally and the new legislation will no doubt bring about big changes to the cannabis market. Those illegal dispensaries will be permitted to apply for licenses to sell legally, which licenses will no doubt come along with insurance requirements. Canada has over 100 cannabis producers who likewise will be able to apply for permits and licenses to produce cannabis.

Various insurers in North America are responding to the requirements of cannabis producers and retailers and offering specific products catering to the cannabis industry. Historically, the industry has been underinsured or uninsured, likely as a result of the business not being above board. The legalization of recreational cannabis presents an opportunity for commercial insurers to be at the forefront of a new industry.

There have been various risks associated with insuring this industry. The first is a cash-on-hand issue. Dispensaries tend to have a lot of cash on their premises and as a result are targets for theft. Employee theft is another issue. Insurers could respond to this increased risk by limiting coverage to thefts under a certain dollar value or by insisting on adequate security measures being in place on the insured premises.

¹⁴ *Babniwal v. The Mutual Fire Insurance Company of British Columbia*, 2016 BCSC 422

¹⁵ *Stewart v. TD General Insurance Company*, 2014 ONSC 854

Product liability is a particular risk. The entire cannabis supply chain, from the grower to the retailer will require product liability insurance, including product recall and liability coverage. It may be difficult to find insurers willing to write those risks when agencies such as the Canadian Medical Association still consider there to be significant risks associate with cannabis use. The issue of product liability is arguably more complicated for cannabis infused and derived products, or edibles, which are set to be legal within one year. As industry standards for labelling and standards develop, the risk should decrease, which may make the provision of such insurance more appealing to insurers.

A comprehensive look at commercial insurance issues and the legalization of recreational cannabis is beyond the scope of this paper, but suffice it to say, the effects will likely be far reaching and the industry will be responding for years to come.

IV. Conclusion

At this stage, there are a lot of questions and few definitive answers. The insurance industry will need to be responsive to the demand for new types and scopes of insurance, while balancing the risk it is willing to assume.

It remains to be seen how much personal cannabis use will increase with legalization, what the actual increase in risk will be and how our industry chooses to respond.