

Property Insurance Coverage Pitfalls for Cannabis Businesses and Landlords

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Nearly all Americans now live in a state where some form of cannabis is legal. Given that the cannabis industry is now valued in billions of dollars and has created hundreds of thousands of jobs across 39 of the 50 states, it requires the same range of insurance products that protect businesses in other sectors. This includes insurance for property owners that lease to tenants engaged in cannabis-related activities. Fortunately, common fact patterns have emerged that are instructive to cannabis businesses and property owners that wish to ensure they have effective coverage.

Where Liability Lies

It is not uncommon for a landlord to lease a property for a non-cannabis purpose, only to purportedly later learn that the tenant is using the property for an unpermitted cannabis operation. In such a case, the primary question is whether the landlord knew what the property was being used for and when. *Mosley v. Pacific Specialty Ins. Co.*, 49 Cal. App. 5th 417 (2020) is instructive on this issue.

Mosley involved an action under a homeowners' insurance policy, wherein the trial court granted summary judgment to the insurer on the basis that coverage was excluded for a fire that occurred *after a tenant rerouted the property's electrical system to steal power from a main utility line for a marijuana growing operation, causing a fuse to blow*. The Court of Appeal reversed the judgment, finding that there was a triable issue as to whether the tenant's actions were within the owners' control (for purposes of determining whether the plant-growing exclusion applied). It was undisputed that the owners did not know about the operation or the alteration, and there was no evidence as to whether they could have discovered the operation by exercising ordinary care or diligence. The court explained in relevant part that **"an insured increases a hazard 'within its control' only if the insured is aware of the hazard or reasonably could have discovered it through exercising ordinary care or diligence."**

A landlord's knowledge of the operations is therefore relevant for several reasons. It may be relevant to a provision for increasing a particular hazard, as noted above. Equally important, it may be relevant to a provision in the policy for fraud or misrepresentation in the application or claims process. Many homeowners and commercial general liability policies contain a provision that the policy may be void or rescinded for fraud or a misrepresentation perpetrated in the application or claims process. Thus, if the insured property owner knew of the intended use, but misrepresented the nature of the

property's intended use, there may be no coverage for an insured's loss.

Misrepresentation

Another common scenario involves the landlord or tenant misrepresenting the nature of the business at the insured location to obtain a better rate, to avoid mandatory inspections, or for other reasons. For example, an insured may state on the insurance application that it is a retail dispensary when in fact it manufactures cannabis using extraction machines and volatile solvents. Because the nature of the risk is substantially different for a retail dispensary than for a manufacturing operation, higher premiums and routine inspections may be required. A dispensary's primary risk is theft whereas the use of solvents during extraction poses a risk of explosion.

Security Compliance

Failure to properly comply with security safeguard warranties and exclusions that are commonly found in cannabis commercial property policies has precluded coverage for many cannabis-related property claims, particularly those that involve theft and fires. For example, a common question is whether the storage of on-site harvested cannabis or finished stock complies with the Locked Safe Warranty provision that is required in most cannabis policies. Policy language varies, but most require harvested plant material or stock to be stored in a secured cage, a safe, or a vault room.

Definitions also vary between policies and it is important for the insured to pay close attention to the policy language to ensure that their business practice aligns with what is required under the warranty. It is common to hear an insured complain that it "complied with state regulations" with respect to the storage of cannabis, only to learn that the policy requires security that is more strict than applicable regulations.

The definitions and terms used within security safeguard warranties and exclusions in cannabis commercial property policies have evolved over the past few years to better align with the insured's business operations, and to avoid ambiguity and unnecessary coverage disputes and litigation.

Examples of precise requirements for a compliant vault include:

- Being located in an enclosed area constructed of steel and concrete with a single point of entry
- A minimum steel door thickness of one inch
- Continuous monitoring by a central station alarm, motion sensors, and video surveillance
- A minimum of one-hour fire rating for all walls, floors, and ceilings
- Procedures that limit access only to authorized personnel.

Similar coverage issues frequently arise regarding whether the insured has complied with other common security safeguards required by the policy, including specific requirements for what qualifies as a central station burglar alarm and the location of motion sensors and video surveillance equipment. Again, the cannabis business owner or landlord are often tripped up by the assumption that so long as they are "compliant" with state cannabis regulations, all will be well and they will be covered by their insurance policy.

This is frequently an incorrect, and ultimately expensive, assumption that may be avoided by closely reading the requirements of the policy to ensure that they align with actual business practices.

Conclusion

Cannabis businesses and property owners currently have a good selection of insurance options across multiple lines of coverage with reputable insurance companies. To avoid unnecessary coverage problems and expensive mistakes, however, it is important that the company or landlord work with an insurance broker who is familiar with the available cannabis-specific insurance forms and the common problematic factual scenarios, some of which are identified above.

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National Law Review, Volume XV, Number 8

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