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Sixth Circuit Applies “Criminal Acts” Exclusion to Damage Caused by Marijuana Grow Operations

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Currently, 30 states have enacted laws decriminalizing medical and/or recreational use and possession of marijuana or marijuana plants. Yet, despite state action, the use, possession, distribution, or cultivation of marijuana, “for any purpose,” remains illegal at the federal level. This state v. federal dichotomy can create difficult questions as to how courts interpret and apply state medical or recreational marijuana laws, the Controlled Substances Act, and federal public policy to commercial contracts -- including insurance contracts. One such example of these competing priorities was considered in a recent Sixth Circuit opinion, *K.V.G. Props., Inc. v. Westfield Ins. Co.*, 2018 U.S. App. LEXIS 23296 (6th Cir. Aug. 21, 2018).

In *K.V.G.*, Westfield Insurance Company issued a standard first-party commercial insurance policy to K.V.G. Properties., Inc. (“KVG”), a landlord with a number of commercial properties in Michigan. The insurance coverage dispute began when some of KVG’s commercial tenants got caught growing marijuana in their rental units. Unfortunately for KVG, the tenants caused substantial damage to the premises. To sustain their “business” the tenants removed walls, cut holes in the roof, altered ductwork, and severely damaged the HVAC systems, resulting in around \$500,000 in damages to KVG’s property. KVG promptly evicted the tenants, citing unpermitted use of the premises and “illegal” growth of marijuana.

KVG tendered its property damage claim to Westfield. Westfield, however, denied coverage arguing that its policy excluded coverage for “[d]ishonest or criminal acts by you ... or anyone to whom you entrust the property for any purpose.” According to the insurer, the conduct of KVG’s tenants was criminal under either state or federal law and that these acts were the main cause of KVG’s loss. The core issue, according to the court, was whether the tenants committed a “criminal act” within the meaning of the policy.

In the abstract, the court acknowledged that the nature of marijuana grow operations under Michigan law raised an interesting federalism question as applied to insurance contracts. Cultivating marijuana remains a crime under federal law (i.e., the Controlled Substances Act), but it is protected by Michigan’s Medical Marijuana Act, Mich. Comp. Laws §§ 333.26421-333.26430 (the “MMMA”) under certain circumstances. In diversity cases, the court typically applies state law “act[ing] as faithful agents of the state courts and the state legislature.” Given that the MMMA was passed by ballot initiative, and exercising Michigan courts’ common-law power to interpret public initiatives, “we would hesitate before reading a Michigan insurance policy to bar coverage for a ‘criminal act’ when Michigan law confers criminal and civil immunity for the conduct at issue.” Thus, the Sixth Circuit indicated that under different circumstances, KVG might have a strong federalism argument in favor of coverage.

Ultimately, however, the Sixth Circuit avoided addressing head-on the application of conflicting state v. federal law and public policy seemingly raised by the tenants' marijuana grow operations. Instead, based on the record evidence the court concluded that no reasonable jury could find that KVG's tenants actually complied with Michigan law, including the MMMA. The court reasoned that KVG itself, in separate eviction proceedings, claimed that its tenants violated the law. KVG claimed that the tenant "illegally grew marijuana" in the unit and that the "illegal growing of marijuana" was a "continuing health hazard." Furthermore, neither party disputed that federal agents raided the premises as part of a criminal investigation, which had some tendency to show that the tenants were not "in clear and unambiguous compliance" with Michigan law. Finally, the court held that the "dishonest and criminal acts" exclusion did not require a criminal *conviction*, but only evidence of a "criminal act."

Taken together, the court found that the tenants' grow operations, supported by KVG's own binding admissions, constituted a "criminal act" within the purview of the exclusion - regardless of which law (state or federal) applied. KVG's speculation that the tenants *could have been* complying with the MMMA, without more, was insufficient to raise a triable issue of fact. In the absence of any evidence of *legality*, the court accepted Westfield's evidence of *illegality* of the tenants' operations, and affirmed summary judgment in favor of the insurer.