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RECENT LEGISLATION MAY AID LANDLORDS IN PREVENTING LOSS CAUSED BY MEDICAL MARIHUANA GROWING OPERATIONS

By: Amanda B. Fopma **June 19, 2015**

SECREST WARDLE NOTES

If passed, residential landlords should undertake a comprehensive review of their lease agreements and revise them accordingly. By the plain language of Senate Bill 72, a private property owner may only prohibit the smoking or cultivation of the marihuana if said provision is set forth in the written lease.

Beyond that, given the strong precedential bias against landlords and their insurers' ability to recover in tort for negligently caused fire damage, landlords would be well served by evaluating the insurance provisions of their leases with counsel to strengthen their right to recovery. Something as simple as changing the insurance provision in the residential lease to require the tenant to pay for all fire insurance premiums and to keep the premises fully insured against fire damage, could make a world of difference if the property is damaged by a negligently caused fire. Note, however, it is incumbent upon the landlord to ensure that the amount of insurance is sufficient to fully protect their property.

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On January 29, 2015, Senate Bill 72, a bill to amend the scope of Michigan Medical Marihuana Act, MCL 333.26427, more specifically where possession or otherwise engaging in the medical use of marihuana is prohibited, was introduced to the Michigan Senate for consideration.[1] The new legislation was prompted by the continued complaints of landlords whose rental properties–homes and apartments–were damaged by mold, water and fire as a result of growing operations. A substitute version of Senate Bill 72 with minor revisions was overwhelmingly passed by the Senate on March 10, 2015, in a 34 to 3 vote.[2] At the heart of Senate Bill 72 is the new prohibition on possession or otherwise engaging in the medical use of marihuana on private property in violation of a prohibition established by the property owner. The proposed revisions

[1] Senate Bill 72 introduced on January 29, 2015: http://www.legislature.mi.gov/documents/2015-2016/billintroduced/Senate/pdf/2015-SIB-0072.pdf

[2] Substitute for Senate Bill 72 as passed on March 10, 2015: http://www.legislature.mi.gov/documents/2015-2016/billengrossed/Senate/pdf/2015-SEBS-0072.pdf

to the scope of the Michigan Medical Marihuana Act would make it legal for private property owners to decline leasing residential property "to any person who smokes or cultivates marihuana on the premises, if the prohibition against smoking or cultivating marihuana is in the written lease." [3]

If enacted, this revised scope will be seen as a victory for landlords all over the state, not simply because it may provide more latitude to landlords when screening prospective tenants, but because it can be used as a way to prevent potential losses to the landlords and their insurance carriers. While most of us are familiar with the provisions of a residential lease that obligates a tenant to pay for damages to the property, when it comes to fire damages caused by a tenant's negligence, the law is not in the landlords' favor and often leaves their insurer on the hook for the loss without the ability to subrogate against the negligent tenant. And, though it may not seem readily apparent, landlords and their insurers are seeing an increase in the number of fire claims resulting from marihuana growing operations and its processing through methods like butane extraction. In *New Hampshire Ins Group v. Labombard*, 155 Mich. App. 369, 377; 399 N.W.2d 527 (1986) the Michigan Court of Appeals held "…absent an expressed and unequivocal agreement by a tenant to be liable to the lessor or the lessor's fire insurer in tort for negligently caused fire damage to the premises, the tenant has no duty to the lessor or insurer which would support a negligence claim for such damages." The philosophy underpinning this holding is that in a lease situation the tenant is permitted to reasonably expect that their rental payments will be used to cover the landlord's ordinary and necessary expenses including, without limitation, fire insurance premiums.

Since the Court of Appeals issued this far-reaching decision, whether a tenant can ultimately be held responsible for negligently caused fire damage turns on the expressed language of the residential lease. Where the lease agreement is silent on the issue of a tenant's responsibility for negligently caused fire damage, Michigan courts have overwhelming found in favor of the tenant, leaving the landlord, or more often the landlord's insurer, on the hook for damages they did not cause.

Contrast the Court's holding in *Labombard* with *Stefani v Capital Tire Inc.,* 169 Mich App 32 (1988) where the Court of Appeals permitted the landlord to proceed on its negligence claim against its tenant for the difference between the insurance proceeds received and the value of the building that was destroyed. Here, the lease obligated the tenant to pay the fire insurance premiums and subsequent addendum further obligated the tenant "to keep the premises fully insured against fire damage." *Id*. at 37. Although the case was factually distinguishable, the presence of an affirmative obligation on the tenant to pay for and maintain fire insurance, negating the presumption a portion of the rental payments would be used by the landlord for insurance premiums, was sufficient to allow the case to proceed.

The holdings of *Labombard* and *Stefani* taken together, however, should not be interpreted as permitting a landlord to recover for *all* losses resulting from a tenant's negligently caused fire. In *Reliance Ins. Co. v East-Lind Heat Treat, Inc.,* 175 Mich App 452 (1989), the Court of Appeals considered a landlord's claim and the insurer's subrogation claim in light of a lease wherein the tenant expressly agreed to "pay a fixed monthly rental fee plus real estate taxes and insurance, fire and extended coverage on said premises." *Id*. at 457. The landlord sought to recover its uninsured losses and the carrier sought to subrogate for amounts it had paid out under the Policy. The Court of Appeals, in finding in favor of the tenant, held both *Labombard* and *Stefani* were distinguishable. While the Court acknowledged the lease in *Reliance* was not silent on the issue of the tenant's obligation to pay fire insurance premiums, it also distinguished *Stefani* on the basis the tenant's obligation was not so extensive as to keep the property "fully insured." Under the

[3] *Id.*

lease the landlord was entitled to select the limit of liability and bill the tenant for the whole amount. Because the obligation to ensure the property is insured in an amount adequate to cover all of its losses rests with the landlord, the Court concluded it was the parties' intent that the landlord would bear the risk as to whether the limits of liability would be sufficient to cover the damage preventing recovery from the tenant for uninsured losses.

This proposed legislation does not just offer landlords the ability to rule out potential tenants who may have a higher likelihood to cause damage to the rental property, but it may also reduce the number of potential claims that are denied based on an Increased Hazard provision in the landlord's policy. Nearly all residential policies provide an exclusion for losses resulting from an "Increased Hazard," defined as any loss occurring while hazard is increased by a means within the control and knowledge of an insured. Where a landlord is unaware that a tenant's growing operations and productions result in a loss, including a fire, absent other exclusions there will likely be coverage for the loss. However, if the landlord, as the insured, is aware of a growing operation or the use of a process that increases the hazard and it is within their control, the insurer may have a basis to deny the claim. That certain methods of marihuana production can constitute an increased hazard is not a novel idea. Rather, this issue was recently addressed in *Nationwide Mutual Fire Ins. Co. v McDermott*, _____F3d__ (6th Cir 2015), (released February 24, 2015, not recommended for publication), where the Court concluded an insured's use of butane extraction resulting in a fire was a loss that occurred while the hazard was increased by means within the knowledge and control of the insured. The increased screening that may be afforded if this proposed legislation is enacted has the potential to lessen the likelihood an insurer could deny coverage on the basis of Increased Hazard, as an argument could be made that the damage resulting from the increased hazard occasioned the tenant's negligence was not within the control and knowledge of the insured landlord.

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