

## Art Law Gallery

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### Art Insurance: Clean as a Rockwell

“*Defective art*” is buzzing up the art scene, but not in that postmodern kind of way. This time, it’s not so cool. For instance, director Steven Spielberg recently dealt with defective title when he discovered that his Norman Rockwell painting, the *Russian Schoolroom*, had been stolen from a Missouri gallery 16 years earlier. Spielberg has since returned the painting to the FBI, where it sits in custody battle between two other alleged owners. Casino magnate Steve Wynn, on the other hand, accidentally poked the tip of his elbow into his 75-year old Picasso painting, *La Reve*, leaving the work in defective condition. Wynn had originally struck a deal to sell the painting for a record sum, but is now in court disputing issues concerning loss of value.

In these examples, “defective art” would have been more “cool” and less burdensome had it been backed by sound insurance. For instance, had Spielberg obtained title insurance, he would have been reimbursed for the full cost of the painting, as well as any legal fees expended on defending ownership. Moreover, he may have avoided purchasing the work of art had the insurance company conducted a thorough title check. And while Wynn originally possessed insurance, there is debate as to the extent of coverage. To avoid situations like these, an art collector or investor should seriously consider insurance, and if so, ensure the policy effectively transfers various types of risks to the insurance company. Insurance companies whose names are frequently associated with art insurance include Axa Art, Aris, Willis Fine Art Jewelry & Specie, McGowan & Company, and Travelers Inland.

#### Title Insurance

Art title insurance, which acts like real estate title insurance, may be a worthwhile hedge for art collectors and investors alike. Given the long-standing industry practice of maintaining the confidentiality of buyers and sellers, a veil of secrecy shrouds many art transactions and by extension, the provenance of many pieces of art. To further complicate matters, the involvement of intermediate dealers in many art transactions keeps the primary seller and buyer at arms length. Finally, there is no central registry for art transactions to facilitate chain of title and provenance research. Because the art market lacks transparency, the illegal and illicit sale of art contributes to a “black market” worth an estimated \$6 billion a year, and is ranked third most profitable illegal industry (preceded only by weapons and drugs).

This lack of transparency in a largely unregulated industry poses numerous problems for art

collectors, namely defective title. This issue is particularly troublesome in the U.S. market, where an owner who is wrongfully dispossessed of a piece of art retains good title to artwork even if it is subsequently acquired by a good faith purchaser for value. As a result, the good faith purchaser for value will not only be forced to return the piece of art to its rightful owner, but also lose the purchase price he or she paid for the artwork.

Art collectors and investors who seek to mitigate such risk are increasingly turning to title insurance, which reimburses policy holders for the value of works that may be lost to title claims. Whether such an insurance policy covers the actual purchase of a work or the appreciated value of the work will depend on the policy. At the very least, the insured should verify that the policy adequately covers chain of title and lien risks. Additional considerations may include (i) the effect of a policy on the owner's ability to pledge pieces of art as collateral for secured transactions and (ii) the extent to which a policy covers beneficiaries other than the owner of the artwork and litigation costs arising out of a provenance or ownership dispute. It is unlikely for a title insurance policy to insure the authenticity of a piece of art.

While there are clear benefits to title insurance, one frequent complaint is its cost. Premiums range anywhere from 1% to 7% of an artwork's purchase price, making the average art title insurance premium more expensive than its real estate counterpart, which are typically less than 1% of the cost of the real estate. Insurance companies justify the high premium for art title insurance by highlighting the unregulated, non-transparent nature of the art market, where it is uncommon for a work of art to have a clean chain of title and indisputable provenance. Indeed, the title research process for art is significantly more complex than that of real estate, and may involve the research of historical records, archives and private collections written in multiple languages spread across several countries. Additionally, the cost of a policy may depend upon risk characteristics that are specific to a piece of art. For example, a piece of art from Europe that was looted by the Nazis during World War II is likely to have significant ownership gaps and therefore a higher premium.

### Property Insurance

Besides defective title, an art collector or investor may seek to insure artwork against possible theft, loss, damage, or destruction. Such insurance is similar to a homeowner's insurance policy, but applies to works of art and is often extremely specific with respect to types of risks covered under the policy. Accordingly, it is critical that the insured review the policy in detail to verify that it covers all the risks that he or she intends to cover. The extent of desired coverage will often depend upon the nature of the insured. A gallery, for instance may seek additional protection against employee theft, while a collector such as Wynn may seek coverage for unintentional damage for artwork. Geography too is an important consideration, with Florida collectors insuring their works against hurricane and flood damage and California collectors insuring them for earthquake damage. Regardless of the variation among policies, it is critical that a collector seek periodic appraisals of his or her artwork and adjust insurance coverage as necessary to account for appreciation in the value of the artwork.

To adequately insure artwork against theft or loss, special attention must be paid to the valuation clause of the policy. For instance, will the reimbursement involve an agreed-upon value, a

scheduled value, or the current market value of the artwork at time of loss? To what extent, if any, will the insurance company make efforts to recover the stolen or lost art? Furthermore, if the artwork is recovered after the insurance company has paid out on the policy, then the insurance company may become the new owner of the work by subrogation. Since the fair market value of fine art tends to increase over the long term, the insured should therefore consider requesting a right of first refusal to repurchase the recovered artwork from the insurance company at a pre-negotiated price (i.e. the original value of the claim).

In cases involving damage or destruction, the insured should confirm that he or she is entitled not only to the reimbursement for restoration costs, but also for any loss in value to the artwork attributable to the restoration. He may also request for coverage over gradual deterioration or quality maintenance fees. The valuation clause of the policy is of particular importance when artwork is damaged or destroyed. For example, if the insurance company were to provide valuation services, then the policy might include an arbitration clause to adjudicate any disagreement that the insured might have with the appraised value of the artwork. Alternatively, the parties may agree to select a neutral third party to value the artwork. Finally, if the insured is a frequent seller of art, he or she may wish to mitigate risk for damage to a piece of art while it is in transit to its purchaser. Under such circumstances, it is important that the insured seek coverage for the artwork until delivery to the purchaser has been effected.

Like title insurance, the cost of insuring artwork against theft or loss is dependent upon the risk characteristics of the work in question. These may include the value of the artwork, the security and construction of the building where the artwork is stored, and whether or not the artwork is frequently moved and/or relocated. It is also possible for the insured to take out a policy for individual works of art in his or her collection, or a blanket policy covering the entire collection.

Although it comes at a cost, art insurance may be a sound investment. But like the studious pupils in Rockwell's *Russian Schoolroom*, the insured must do his or her homework, and carefully examine the policy with the assistance of an attorney to ensure full and complete coverage.