

Irell & Manella's Art & Cultural Property Practice Group

In this edition, we provide an overview of: hidden pitfalls and risks in collector's fine art insurance policies (pg. 1); title issues of concern to collectors when handing their art to a dealer (pg. 2); concerns that collectors face when deciding whether to loan their art to a museum exhibition (pg. 3); the recently enacted U.S. restrictions on import and trade of Chinese antiquities and what they mean for collectors (pg. 6); and legal obligations of a seller of art under the California Resale Royalty Act (pg. 7).

We hope you find the articles in this newsletter helpful. As described on the back page of this newsletter, I&M's art and cultural property practice group has over thirty years of art law experience and brings a multi-disciplinary approach to advising collectors, museums, artists, and other art world participants on the always evolving legal issues of concern to the art world. In 2008, Irell & Manella – with one of the largest practices in private art and collectibles transactions in the country – counseled collectors and others on matters involving works of art and collectibles aggregating nearly \$1 billion.

Fine Art Insurance

Unexpected pitfalls for the collector

Unfortunately, unlike many other forms of insurance which have undergone extensive revisions and developments over the years, art insurance has remained relatively static, shrouded in anachronistic forms and outdated provisions. Equally problematic, some insurers have sought to cover art by simply attaching art riders to the collector's homeowners' policy. While these forms are more modern, their inclusion within the far more exclusionary homeowners' policy often results in the addition of dozens of inapplicable and potentially harmful policy provisions and exclusions.

Hidden Pitfalls

Some examples of such provisions in standard art policy forms that could potentially lead to the complete or partial loss of the collector's art insurance include those listed below:

- Some policies continue to use "named risk" coverage forms which extend coverage **only to certain enumerated perils,**

which are limited. Collectors should seek to use an "all risk" form which extends coverage to all risks of loss, subject only to limited named exclusions.

- Many policies **limit coverage to only certain named locations** and/or geographic regions expressly identified in the policy (usually only the collector's residence, and collector's often fail to include storage facilities and other locations such as works on loan to a museum or on consignment). In such instances, the unintentional failure to list where art is located (even if only a temporary location, such as a museum or an art warehouse), could result in substantially limited coverage and even a complete loss of coverage.
- Many policies contain **sublimits** for certain types of damage or loss. For example, there may be a set sublimit of coverage for art in transit that may only be a fraction of the total limits of coverage otherwise provided in the policy. Such provisions expose the collector to limited or complete loss of coverage when the value of a piece of art exceeds the sublimit. (This is a concern when shipping art, including when art is being shipped to the collector from

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Fine Art Insurance *(Continued from page 1)*

the place of purchase, to storage, or to a museum for loan.)

- Many policies contain provisions that **obligate the collector to maintain the art in certain ways** (for example, use of an alarm system, or use of only certain approved shippers to handle the art). When such provisions exist, the collector could potentially risk the loss of insurance by doing nothing more than failing to arm an alarm system or allowing a museum to use art handlers not pre-approved by the insurer.

“...the unintentional failure to list where art is located (even if only a temporary location, such as a museum or an art warehouse), could result in substantially limited coverage and even a complete loss of coverage.”

Policy Improvements

Even in those instances when the collector's policy is a more contemporary dedicated fine art policy, **collectors often are unaware that they have the opportunity to negotiate with the insurer to obtain more favorable terms** than are typically included in many art insurance policies. Such improvements include:

- Valuation provisions that provide **coverage for the “greater of market value or scheduled value at the time of potential loss,”** to cover situations when the market value of the art at the time of loss exceeds the scheduled value.
- Partial loss provisions that provide **improved measures of depreciation** for determining the loss in value of the art after partial damage.
- The **narrowing of basic art insurance exclusions**, including narrower exclusions for wear and tear, and damage during repair and restoration.
- Provisions allowing the collector to accept certain insurance and subrogation terms found in most storage, art shippers', and museum loan agreements, that would otherwise **jeopardize the collector's policy as back up or gap insurance** because of these inconsistencies.

The foregoing are just a few of the issues that affect the policies of many collectors. Collectors should seek advice on a proper review of their policies and explore the opportunity for improved protections and coverage. Another matter of concern, particularly in these troubled times for insurance companies, is **confirmation that the insurer has the capacity and reinsurance necessary to cover the risk at issue**. This is particularly important where the risk being covered could result in extensive or widespread damage (such as in the event of an earthquake or terrorism).

How to Lose your Art, Without Really Trying

Title issues for collectors to protect their art while with a dealer, whether on consignment or otherwise

While title problems most often arise in connection with the purchase of art, after the purchase collectors (whether they become sellers or not) are not immune from such problems. For example, in many states, an art dealer to whom art has been consigned for sale or otherwise entrusted for any purpose (including to arrange storage, conservation, restoration or exhibition) can sell the art to a good faith purchaser, even if the

collector owner never intended to sell, or intended to sell but the sale is in violation of conditions specified by the owner (and even if the dealer does not remit the sales proceeds to the owner).

In such cases, the owner may have a claim against the dealer to whom the art was entrusted, but usually has no right

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to recover the art or payment from the good faith buyer. The indictment of well known art dealer Lawrence Salander this month in NY on multiple charges of fraud is a recent example of this concern. Numerous collectors had entrusted Salander with their art, some for potential sale and others for exhibition or other arrangements. Salander is accused of selling those artworks without consent, and keeping the proceeds. Those collectors are now without their art or the sale proceeds, and their claims against Salander may be worthless since he is bankrupt. Another recent example is Andy Warhol's "Red Elvis." The owner of the painting entrusted it to a dealer to arrange its loan to a museum for exhibition; it was not for sale.

The dealer, without the owner's knowledge, sold it to another collector. The owner sued the buyer for return of the painting, but the court barred her from recovering the painting because the court ruled the buyer had acquired good title to it even though the owner never consented to any sale. Unfortunately, too often collectors are unaware of these risks and fail to seek advice and take steps at the outset that could help them avoid ending up in this situation.

“If the dealer becomes bankrupt, the art (or sale proceeds) can become part of the dealer’s bankruptcy and be unavailable to the collector.”

A related problem for collectors is that in many states art consigned to an art dealer for sale can become subject to the claims of the dealer's creditors unless the owner properly structures and documents the consignment within the requirements of applicable laws. Whenever a collector delivers a work of art to a dealer for sale "on consignment," depending upon how the consignment is structured, the art could potentially be treated as the dealer's property. If the dealer de-

faults on loans from its creditors, the creditors may seek to foreclose on the artwork, sell it and keep the proceeds, thus leaving the collector without the artwork or the proceeds. If the dealer becomes bankrupt, the art (or sale proceeds) can also

become part of the dealer's bankruptcy and be unavailable to the collector. Recent dealer bankruptcies have left numerous collectors having to defend against such challenges. Current law can provide protections for collectors, and to avail themselves of such protections, they should properly structure and document their arrangements whenever their art leaves their possession.

To Loan or Not to Loan

What a collector should consider

Collectors often are asked to lend art to museums or galleries for exhibitions. One of the perceived benefits of loaning art is the belief that exhibition of art will increase its importance and value. Nonetheless, agreeing to loan a major work of art is an important decision that can have unexpected consequences.

Loan Considerations

Before agreeing to any loan, a collector should consider several factors, including: (i) condition of the art and its fitness to travel; (ii) number and location of exhibition venues (single or multiple) and length of exhibition; (iii) security and

environmental controls during transit, storage and display; (iv) reputation and history of the borrowing institution with regard to art on loan (there are several recent examples of damage to art on loan caused at parties and functions in museums, and art insurers often note that most damage claims arise from art on loan); and (v) reputation of the organizers of the exhibition, including whether the exhibition is sponsored by any commercial entity, and whether such sponsors cause any conflict with the collector's public or private opinions or positions.

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Foreign Loans

Loans of art to museums outside the United States raise several additional issues, including: (i) whether there are export restrictions in the foreign country that may prevent or delay the return of the art after the exhibition; (ii) whether art while on loan is subject to seizure or attachment in that country as part of a civil or criminal claim (once seized, the collector is at the mercy of a foreign legal system, and government seizures and attachments usually are expressly excluded from coverage under most insurance policies); (iii) political and financial stability of the jurisdiction; and (iv) adequacy and recoverability of insurance and government indemnity offered to cover damage to the art when outside of the United States.

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Written Loan Agreement – Essential Terms

When borrowing art, most museums in the United States (and abroad) will use a standard one or two page loan form they send to the collector and expect the collector to simply sign and return it. All too frequently, lenders do sign and return the museum’s form without reviewing or fully understanding its terms. These forms are inadequate in several respects, and a detailed amendment to them or a new agreement is required to properly address the issues raised in most loan transactions. The key is to understand the desired terms and make sure, regardless of format, that they are addressed and that risks and obligations are allocated between the borrower and lender as desired.

The loan agreement should include: (i) the beginning and end dates, the number of venues, and all locations of the exhibition; (ii) how and at whose expense and risk the art will be

packed and shipped (identifying art handlers and shippers, specifying handling requirements, and providing for the collector’s right to have a lender’s representative or courier travel with the art because damage to art is often caused during transport and by improper handling and careless storage); (iii) when and where the art will be picked up and returned to the collector; (iv) whether the art will be exhibited anonymously or with credit to the collector (and, if so, the exact wording of the credit); (v) whether the art will be published in a catalog; (vi) the allocation between the collector and the museum of all taxes and other costs relating to the loan, whether incurred by the collector or borrowing institution (insurance, shipping, handling, use and personal property taxes which may apply or be imputed, duties, etc.); (vii) terms prohibiting any conservation or other work being performed on the art (no frame or casing be removed or new hanging devices attached) without consent; (viii) terms requiring the preparation of a condition report before pickup and upon return to the collector; (ix) terms specifying any required levels of climate control, special lighting, and any installation requirements (not located near heating or cooling vents, sprinklers, etc.); (x) terms specifying security and display requirements (guard, rope, glass barriers, etc.); (xi) terms prohibiting reproductions of the art for catalogs or merchandising, such as on note cards, calendars, and mugs, unless the borrowing institution obtains all required copyright licenses and the lender’s consent (the standard loan agreement exposes the collector to infringement claims from the copyright holder); and (xii) terms prohibiting flash exposures, events and parties, eating, and drinking where the art is displayed. For foreign loans, the loan agreement should also allocate responsibility for obtaining, paying for, and complying with all export and import licenses and authorizations and should address VAT liabilities.

Insurance

The loan agreement should specify whether the lender or the borrowing institution will be responsible for insuring the loaned art (wall-to-wall), and should also provide for an appropriate valuation in the event of loss or damage (utilizing agreed-upon value of the art, market value, or preferably the

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To Loan or Not to Loan *(Continued from page 4)*

greater of agreed or market value). Risk of loss and damage, including any deductibles, should be the museum's responsibility. If a government indemnity is being used instead of or in combination with insurance, the collector should be sure to learn all the conditions and exclusions relating to the indemnity.

Most museum loan agreements provide that the museum will add the collector's loaned art to the museum's insurance policy, and many collectors assume that the museum coverage is as good as their own insurance. They often also assume that even if there is a problem or gap in coverage with the museum's policy, the collector's own policy will be available as a back up. Unfortunately, these assumptions often are erroneous.

Most museums do not provide the collector with a copy of their full policy, so the collector is unable to know all the terms, exclusions, coverage limitations and requirements contained in the museum's policy. The museum policy may not have total limits that allow for full coverage for the collector's art in the event of a loss that affects other artworks at the museum, and often museum policies give priority on payment to the museum's own art over loaned art. There can also be provisions in the museum policy that allow only the museum to pursue a claim for loss, notwithstanding that the collector is named as an additional insured or loss payee on the museum's certificate of insurance.

Museum policies usually do not provide for severability of interests between the museum and the collectors and others who loan art, thus exposing the collector to the potential loss of coverage as a result of the acts or omissions of others. As to the collector's own policy as a back up, many collector policies have "other insurance" clauses that do not clearly provide to what extent the policy will serve as an excess or gap coverage policy, and may contain various provisions inconsistent with the provisions of many museum loan agreements as to coverage, valuation method, exclusions, order of payment and handling of claims. These provisions can result in a lengthy delay and added cost before any claim is paid, or

worse, result in a loss of any back up coverage.

At a minimum, before signing a loan agreement, the collector should make sure he or she understands the insurance coverage and terms provided by the museum (including reviewing the actual terms of the policy instead of just accepting

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a certificate of insurance or a summary of coverage or exclusions), and should review his or her own policy to make sure it will operate as back up. As most museum certificates of insurance simply state they are "only for information purposes," the collector should require that such disclaimer be deleted, or instead, **should require the museum's insurer to actually provide an endorsement** that specifically (i) names the collector as a "loss payee" with proceeds paid directly to the collector, (ii) provides for severability of interest regardless of the acts or omissions of the museum, and (iii) identifies the loaned art and its agreed value. Also, if the collector does carry his or her own insurance, the loan agreement should be modified to provide that such collector's insurance does not limit or reduce the museum's risk of loss or damage or coverage (most museum agreements provide otherwise, relieving the museum of responsibility), and provide that the museum's insurance shall be primary to (as the first line of defense against loss or damage), and shall not seek contribution from the collector's own insurance.

New U.S. Import Restrictions on Chinese Antiquities

What collectors need to know about buying or loaning antiquities

History

The 1970 UNESCO Convention was created to help stem the illicit export of, and market in, cultural property of an archaeological or ethnological nature, such as antiquities and artifacts. The basis of the Convention is that such items represent and convey the cultural history, traditions and origin of a country and its people and therefore should not be taken from them. Such cultural property is often smuggled out of its country of origin against the desires and export laws of that country and imported into other nations for sale in the international art market. The Convention seeks to protect such property through the adoption of import restrictions by those other nations on property that is determined to be at risk of pillage and illegal export. The belief is that if the cultural property is banned from entry into a country, then the international market for such property will cease to exist, and there will no longer be a reason for the objects to be smuggled out of their country of origin.

The United States implemented the UNESCO Convention by adopting the Cultural Property Implementation Act (CIPA) in 1983. The President, acting through the State Department and entering into bi-lateral agreements with other signatory nations to the Convention or declaring unilateral action, has the authority to impose import restrictions in the U.S. on certain designated cultural property from those other nations. So far, the U.S. has imposed import restrictions on cultural property from fourteen countries, including Cambodia, Colombia, Mali, Italy, Peru, Cyprus, and most recently, China.

China

After much debate and a lengthy period of consideration, on January 14, 2009 the United States entered into a bilateral agreement with China whereby the U.S. will now prohibit the import into the U.S. of certain broadly defined categories of Chinese artifacts and antiquities. The designated prohibited items include “materials representing China’s cultural heritage” including ancient ceramic, bronze, gold, iron, bone, ivory, horn and shell vessels, jewelry, sculptures and architec-

tural decorations; jade and amber ornaments, jewelry, weapons, tools and insignia; coins; musical instruments; silks and textiles; lacquer and wood; glass; painted bricks, walls, banners, scrolls and fans; and monumental sculptures at least 250 years old such as stelae, temple and tomb imagery, architectural elements and reliefs (a detailed list of all designated objects can be found in the January 16, 2009 Federal register, Vol. 74, No. 11).

The effect of the new import restrictions is that (i) any designated item may not be brought into the U.S. unless there is verifiable documentation that the object left the identified country prior to the effective date of the import restriction (rarely is such documentation available), or the identified country has issued a specific export permit authorizing the export of the object (a highly unusual occurrence in these circumstances), and (ii) if you import the object in violation of the foregoing restrictions, you risk seizure and forfeiture of the property and potentially civil and criminal penalties. An extremely important point, of which many collectors are unaware, is that even if the collector had no involvement with the import of the designated object (such as when the collector purchases the object after it is in the U.S.), if the object was imported in violation of the import restrictions the government can later still seize and cause the collector to forfeit the object (without compensation).

Precautions for collectors

Collectors of Chinese antiquities and artifacts should exercise caution in their purchases by requiring the seller to provide as much information as possible about the provenance of the item, including proof of proper import if recently imported, or documentation establishing the object was located in the U.S., or exported from its country of origin prior to the effective date of the restrictions (such as prior sale or exhibition catalogs with images of the object). The designated categories are broadly defined and collectors should also seek legal counsel to gain a full understanding of the risks and ramifica-

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New US Import Restrictions *(Continued from page 6)*

tions involved in such a purchase, as well as to draft into their purchase documentation appropriate representations, remedies and recourse (such as an indemnity) against the seller in the event the object is later seized or forfeited because of improper import.

Collectors that have previously acquired and still own Chinese artifacts should seek legal advice before shipping any such object outside the U.S. (such as for loan to a foreign exhibition or to a foreign second residence or otherwise). If the object could be considered to fall within any of the designated

categories of prohibited items, the collector may not be able to reimport the object back into the U.S. at the end of the exhibition; this is the case, regardless of the fact that the object was previously in the U.S., unless the collector can establish the object was exported from China prior to the effective date of the restrictions. The foregoing precautions apply equally to cultural property from any of the other countries with whom the U.S. has imposed import restrictions.

The Resale Royalty

A seller's obligation to pay the artist

The resale right or resale royalty, which originated in France as "*droit de suite*," is the right of an artist to receive a percentage of a seller's proceeds when the seller resells art created by such artist. Each time a work of art is resold, the artist is entitled to payment of the resale royalty from the respective seller.

The basis for the royalty is often stated to be that artists early in their careers are unable to command much for their art. Later in their careers, having presumably worked hard to gain recognition and appreciation, their early art may command substantially increased prices on resale, and it is argued that this appreciation is attributable to the artists' hard work, so the artists should be compensated. Some collectors, however, view the royalty as an unnecessary additional tax on the sale of the art.

Payment to the Artist

The resale royalty now exists in the European Union, though with many qualifications and a graduated scale of payments to the artist. Within the United States, only California has adopted a resale royalty right. The California Resale Royalties Act provides that **whenever a "work of fine art"** (defined to include an original painting, sculpture or drawing) **is sold** or exchanged, whether by private sale or at auction, **and the seller resides in California or the sale takes place in California, the seller must pay to the artist 5% of the selling price of**

such art. At the time of the sale, the artist must have been either a citizen of the United States or a resident of California for at least two years. No royalty is payable unless the selling price is at least equal to the purchase price originally paid for the art by the seller. The artist's right to this payment extends for a period of 20 years following the artist's death (in the case of an artist who dies after January 1, 1983, and in all other cases, the artist's royalty rights ceased upon the artist's death). If the artist cannot be located, the seller must pay the royalty to the California Arts Council. The artist's right to a resale royalty cannot be waived by the artist.

Enforcement

While historically most artists have not enforced their right to a resale royalty under the California law, more artists are becoming aware of their rights and are making dedicated efforts to track sales and collect the royalty (including through recent lawsuits). An artist is entitled to sue for recovery of the royalty for a period of three years after the sale, or one year after discovery of the sale, whichever is later. Prior to selling their art, the collector should seek counsel on the potential application of the resale royalty.

Irell & Manella LLP's substantial expertise in the field of art and cultural property law, as well as in memorabilia and collectibles, extends over three decades. Our practice is both national and international, and includes purchase and sale transactions; auction and dealer consignments; loans to domestic and foreign museums and galleries; art insurance review and policy negotiation; charitable gifting of art; sales, use and personal property tax planning for purchases, sales and loans of art; tax deferred exchanges of art; art appraisal agreements; art consulting and advisor agreements; resale royalties; cultural heritage and patrimony matters; estate and foundation planning for art assets; private and public commissions of art; state, federal and foreign moral rights; import/export; and copyright and other intellectual property rights.

Our clients include some of the world's foremost private collectors, including many museum trustees, as well as private foundations, artists, museums, motion picture studios, and galleries. The attorneys in our art group also have extensive practical knowledge and experience dealing with transactions and events within the unique environs of the art world. Our attorneys have authored many art law related articles and are frequent lecturers on art and cultural property law issues at a variety of venues, including professional conferences (including ALI-ABA, PLI, USC Tax Institute, Heckerling Institute, IFAR and other associations), museums and art related gatherings including art fairs, and they are often quoted, and their transactions covered, in numerous regional, national and international publications. For information on our art law practice, or to learn more about the lawyers in our group, please visit our website: www.irell.com

Steven Thomas, a partner in the firm's Los Angeles office, is the head of the art law practice group. Mr. Thomas specializes in the many varied aspects of the purchase, auction, sale, loan, collection and gifting of fine art, cultural property and memorabilia, including national and international transactions among private owners, dealers, museums, galleries, and auction houses. He has also advised on several record-setting private purchases, sales and consignments of fine art, including negotiating the sale of what was reported as the most expensive painting ever sold, the Gustav Klimt "gold" portrait of *Adele Bloch-Bauer I*. Mr. Thomas annually teaches a course in Art and Cultural Property Law at the UCLA School of Law, and has authored "An Overview of Issues of Interest to the Art Collector." Mr. Thomas is available at (310) 203-7694 or sthomas@irell.com.

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