



By Thomas & Charles Danziger

In our practice, we have found that Murphy's Law ("what can go wrong will go wrong") applies in more cases than any legal statute we know. This is especially true in the art world, where today's collectors are justifiably concerned about the safety of their artworks in these increasingly dangerous times.

We recently consulted with a U.S. client who feared that his company's extensive art collection could fall victim to a terrorist attack. The collection includes a number of important American paintings and is scheduled to be exhibited in museums in different countries over the next few years. Even when not traveling, the works were housed in a landmark building that he repeatedly referred to as a "juicy target".

Our client was tempted simply to cancel the exhibitions and store his works in an underground vault (he was nervous but not ill-prepared). But he realized that this was not a practical long-term solution, so he asked us whether we knew anything about insuring artworks against acts of terrorism. As it happened, we knew quite a lot.

We explained that before September 11, 2001, most fine art policies in the U.S. covered terrorism by default, because it was not listed as a specific exclusion. Such coverage was offered even though the actuaries--the people who design and establish rates for insurance products--had no reliable formula by which to price it. As a result, terrorism (like falling meteors) was covered in policies but not factored into the rates, because in the U.S., unlike in Europe, no one perceived a real risk.

This all changed following September 11, 2001. Renewals on many, if not most, commercial insurance policies contained new clauses specifically stating that terrorism was not an insured risk. Reinsurers--who insure the insurers--said that while they could, for the most part, cover the losses of the 9/11 attacks (which were estimated to exceed \$100 million in artworks alone), they were unable to insure against possibly catastrophic losses from future terrorist acts. The result was either no coverage or very limited coverage offered at astronomical premiums.

The sudden exclusion of terrorism coverage prompted much public debate about whether the U.S. government should share in the cost of an insurer's loss caused by terrorism. Proponents of the plan to use the government as an insurer of last resort argued that only the government has enough money to pay for terrorist-related losses, and that, unlike hurricanes or other acts of

nature, terrorist acts are ostensibly committed because of government policies. Critics opposed the idea of the government's writing "blank checks" for the insurance industry.

The upshot of this debate, we told our client, was The Terrorism Risk Insurance Act of 2002 (the "Act"), a temporary program to share public and private losses from terrorism. The Act, which took effect on November 26, 2002, requires insurers to offer commercial terrorism coverage, although the policyholder may opt to waive the coverage and the associated fee. As presently drafted, the Act expires December 31, 2005.

Our client asked how the new law affected his current policy, which specifically excluded terrorism coverage. We explained that such exclusions were automatically nullified for all commercial property and casualty insurance policies in force when the law went into effect. Our client could either elect to pay an additional premium for the terrorism coverage or to maintain his coverage with a terrorism exclusion (and no added premium) for the remainder of the policy period. But his insurer must offer him the option.

Looking to clarify the terms of such coverage, our client told us that one of his paintings had been damaged several years ago by a deranged visitor in a foreign museum (too much caffeine, said the local authorities). He wanted to know whether such a loss would be insured as an "act of terrorism". We told him that it would not. Under the new law, the definition of terrorism is essentially limited to violent acts resulting in damage in the U.S. (or on a U.S. aircraft or ship, wherever located) committed on behalf of a foreign interest to coerce the American people or government.

Although the rather involved definition includes other elements none would cover the act of vandalism inflicted upon our client's painting.

We explained that the Act's definition of terrorism does leave some gray areas. For instance, the legislation does not provide federal backing for an act committed in the course of a war declared by Congress. Does that mean acts by citizens or associates of a country with which the U.S. is at war would not be covered? The answer is not clear. What's more, an "Act of Terrorism" is partly defined in the law as "an act of terrorism," which is not very helpful.

Significantly, only the Secretary of the Treasury, in concurrence with the Secretary of State and the United States Attorney General, may certify that an act of terrorism has occurred, and this determination is "final, and shall not be subject to judicial review." In other words, only the U.S. government can determine whether an act of terrorism has occurred. Just as only God can make a tree, only the U.S. Government can determine whether an act of terrorism has occurred.

We further noted that under the law, because acts committed as part of a war declared by Congress are excluded from the scope of the definition of terrorism, they need not be included in the terrorism coverage insurers are required to offer. War coverage has generally not been available in the art world at any price.

The precise definition of terrorism (and the distinction between terrorism and war) has been and will probably continue to be a field day for lawyers. Take the case of a Pan American World Airways plane that was hijacked and destroyed by members of a Palestinian terrorist group. The U.S. Second

Circuit Court (applying New York law) thought that the lengthy war exclusion in Pan Am's insurance policy was ambiguous (it did not specify "hijacking" or "act for political or terrorist purposes"), and the Court found for the airline.

Our client then asked whether there was any limitation on the dollar amount of coverage under the Act. We responded that the Act provides that no payment be made for losses exceeding \$100 billion (more than our client's collection was worth), or less than \$5 million.

But how could anyone, he asked, afford to offer terrorism coverage at all -- much less up to \$100 billion. We assured him that he shouldn't lose any sleep worrying about the insurance industry or the U.S. Government's losing money. First, if an insurer pays claims resulting from acts of terrorism that exceed a certain amount in any calendar year, the federal government will reimburse the insurance company for most of the excess. As a result, the financial burden is shared by the government and insurance companies, which are therefore not at risk of bankruptcy from catastrophic claims. Second, insurers can do what they have always done: increase premiums to compensate for real or perceived risk. As for the U.S. Government, we explained that the Act specifically authorizes "risk-spreading premiums," which would permit the government to recoup terrorism losses through a surcharge on insurance policy premiums.

When our client asked what this coverage would cost to him, we said that in our experience costs are not well established, since insurers are still not sure how to set their rates. But like other forms of coverage they rely on a variety of factors, including the location of the artworks and their value.

And state regulators can (and do) challenge insurance company prices that are excessive or unfairly discriminatory.

At this point we offered some practical advice to our client: spend some time carefully reading the premium disclosure language on the policy, which by law must spell out the premiums charged for the terrorism portion of the coverage and the government's share of the compensation for any claims made under this coverage. Our client's initial reaction was that he would rather spend his time trying to teach a ham sandwich to sing, but when we explained that this review could save him money spent on premiums, he snapped to attention.

A trick of the trade, we told him, is to see whether his insurer's rates for terrorism coverage have decreased in the period following the enactment of the Act. If so, in many cases he could cancel his existing coverage and renegotiate a better rate for the same coverage.

By the end of our meeting, our client had begun to question whether terrorism insurance made sense for him after all. We suggested that, on the one hand, he could "self-insure," meaning use the money that he might otherwise have spent on this coverage to safeguard his collection better. In the past year, we have seen a change in attitude among our clients: initially, everyone wanted terrorism insurance, but today many collectors (especially those not in big cities) are opting not to take it. After all, damage caused by terrorism is still very rare—in contrast, say, to damage from storms, fire or shipping.

On the other hand, we reminded him, given the nature and location of his collection, terrorism insurance might indeed be a wise precaution. The possibility of an entire

collection being wiped out seems far less remote than it did just a few years ago. We advised him that if he did decide to buy terrorism insurance, he might also try to negotiate to lower the cost by agreeing, for instance, to a higher deductible or to a lower coverage limit.

Finally, we quoted our father's favorite aphorism: there is no use worrying because one usually worries about the wrong things anyway. Especially, perhaps, in today's uncertain art world.