

## **PART G. INSURANCE AND INDEMNIFICATION**

### **Chapter 39: Insurance and Indemnification**

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## 39. INSURANCE AND INDEMNIFICATION

### Introduction

Those on the outside tend to think of insurance as a legal form of gambling: The company bets the insured that certain events will not happen; if the events occur, the company loses; if they don't, the insured loses. The amount of the premium represents the odds of the event occurring. If the odds are high, so are the premiums. If the chances are low, so are the premiums.

All right, that is overly crude. The reality is subtler. Perhaps insurance is better described as a form of 'risk exchange' where the insured is able to divest itself of unacceptable risks at terms that are acceptable and the insurer takes on these risks at terms that are acceptable to the insurer. Provided the terms have been set equably then **both** parties should win. (Certainly this last sentence makes it clear that there is a great difference between using the 'gambling' analogy and the 'risk exchange' description.)

Insurance is a risk management tool. It does not replace the usual obligations of reducing the dangers of loss or damage in course of operating the organisation. The role that insurance should play will vary according to the individual circumstances of each collecting organisation – but what it does not do, is relieve the board and the administration of its responsibilities of care. Insurance does not protect a collection item: It protects its financial value.

Insurance is a contract. The parties to the contract are the insurance company and the named party in the policy. It does not provide protection for any third party (unless that third party is specifically named in the contract). For example, the visitors to a community museum are not *directly* protected by the insurance taken out by the museum; if injured, they have no claim against the insurance held by the museum. Insurance only protects them to the extent that if they suffer injury and sue the museum, the museum's ability to pay damages is not restricted by its own limited resources. Insurance is protection for the museum. It means that in the event of loss, theft, damage or injury, it will be better able to meet its liabilities without endangering its ability to continue operations.

This chapter does not purport to cover all issues that arise with insurance, nor all kinds of insurance. It raises the difficult question of whether to insure at all; it summarises the kinds of insurance that should be considered by collecting

organisations, and lays out some of the commonly occurring issues that arise in many forms of cover.

## **To insure or not to insure**

### ***An ownership issue***

If the organisation is the absolute owner of the work or object, there is no legal obligation to insure it: The decision is essentially one of governance. However, most collections also contain material in which ownership is less than absolute. For example, it may have been donated or bequeathed to the organisation for specific purposes<sup>1</sup> or with specific instructions<sup>2</sup>. It may be on loan or so-called 'long-term' loan; it may have been bought in partnership with another organisation and be jointly owned; it may have been bought by money specifically provided by a sponsor for the purpose (and there may be contractual obligations attaching to the sponsorship). In these cases, the organisation may well have a financial exposure that it should insure.

Accordingly, in making the decision 'to insure or not to insure', it might be useful to ask: 'Who owns the material?' 'Are we the absolute owners?' 'If not, what are our obligations to the other party?' You might crosscheck this by then asking: 'How did we acquire the material?' 'Was there anything about the acquisition that may create an obligation or that may limit or qualify our ownership?'

When the risk affects others or affects your obligations to others, prudence often requires that the risk of loss be mitigated by taking insurance.

### ***A governance issue***

Whatever the policy adopted by the board, there will be foreseeable (if uncertain) consequences for the organisation and the board's governance obligations can reasonably be expected to extend to identifying those consequences and implementing prudent plans to meet them.

For example, if the board decides that the organisation should 'self-insure' its collection, it must acknowledge that there is still a risk of loss or damage to collection material and must implement a strategy to meet that foreseeable event. So, it might decide to budget for insurance premiums and actually appropriate that sum and invest it. All too often the money not spent on premiums is merely

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<sup>1</sup> For example, 'to be used as a reference library'.

<sup>2</sup> For example, 'to be used for the benefit of the collection'.

allocated to other pressing needs rather than being applied to minimisation or mitigation of the particular risk.

If it decides not to insure its collection at all, the board is making a very serious decision affecting the future of the collection. It may be that the board should at least consider taking out 'annual aggregate cover' or 'cover in excess of an annual aggregate deductible'. For example, the institution and the insurance company may agree that if claims exceed a total of \$250,000 in a year or \$50,000 on any single loss, the company will cover the amount of the loss in excess of those amounts. Similarly, the use of 'deductibles' (discussed later) may reduce the premiums to manageable sums.

One thing is certain: the board has a heavy legal burden to protect the organisation, including its assets, workers and visitors. It is a brave board that fails to give deep thought to (i) the reasonably foreseeable risks that the organisation bears, and (ii) how the duties that attend those risks should be addressed.

## **What to insure**

Deciding which risks must or should be insured is part of the risk management strategy of any prudently managed collecting organisation. The material that follows first looks at the non-collection material insurances and then at those issues specific to collections and exhibitions.<sup>3</sup>

### ***The building***

Whether it is prudent to insure the buildings, in which the collection and administration is housed, is a common issue faced by boards. Is the organisation the owner? If not, it is likely that the lease will require that the building be insured. If it is, what would the organisation do if the building were destroyed? Can it afford not to insure?

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<sup>3</sup> The variety of insurance cover available is limited only by the needs, imagination, and resources of the parties. Other policies not discussed here include: boiler insurance; computer insurance; library, valuable papers and records insurance; vent insurance; all risk floaters; accounts receivable insurance; money and securities insurance; products liability insurance; contractual liabilities insurance; publishers liability insurance; and many others. It is important that the organisation and its broker discuss at length the needs of the individual collecting organisation, before settling for any particular policy or company.

The premium will vary considerably according to the location of the building, the construction materials, its age, the accessibility of fire extinguishers or the installation of sprinkler systems, even whether people are allowed to smoke on the premises.

It is wise to make sure that the cover will meet replacement costs and that there is no deduction for depreciation. Moreover, if an 'agreed amount' cover can be negotiated, this will eliminate the trap of a 'co-insurance' penalty. (For explanation of 'co-insurance', see later).

### ***Contents (excluding the collection)***

This is an issue faced by all homeowners with contents insurance: getting an inventory of all of the contents, assembling and organising the documentation and estimating the replacement value. Even collecting organisations that apparently have very little by way of furniture, fittings and equipment will be surprised when they do an audit of these items: lighting systems; display systems; shelving; furniture; security, conservation and maintenance equipment. These all add up to a considerable, if often hidden, asset.

Standard '**all risks**' insurance should be taken out. There are two types of cover:

- actual cash value (that is, replacement cost less depreciation);
- replacement cost (that is, no deduction for depreciation).

Make sure you know what you are buying. Regular checks should be made of the inventory to ensure that the amount of cover is sufficient. Coverage is usually written on the basis of 'cash value', that is, replacement cost cover (with no deduction for depreciation). Replacement cost cover (with no deduction for depreciation) will also be available but will obviously cost more. It should also be noted that many policies exclude the property of employees, volunteers and members of the public (for example, the cloakroom). This should be checked.

### ***Workers' compensation***

Employers are legally obliged to take out workers' compensation insurance for all employees.

The cost of workers' compensation insurance takes account of the dangers inherent in the employee's job. Thus, a museum administrator will cost less to insure than a salesperson, who in turn will cost less to insure than a van driver.

Premiums are calculated on the number of employees, their occupations and their gross salaries at the time of taking out the policy. During the year the

complement of staff may change considerably but this is simply noted at the end of the insurance period and the next year's cover will be accordingly adjusted.

### ***Public liability***

Public liability insurance is essential. All collecting organisations should have it, without exception. If an organisation invites the public to its premises it must protect both itself and its invitees. It is not a legal obligation, but a social obligation. It is not uncommon for Australian courts to award in excess of \$2,000,000 to seriously injured plaintiffs. Those sums are awarded not to punish the negligent but to compensate the injured. While premiums have increased dramatically in recent years, public liability cover is still relatively cheap.

It is also prudent business practice. Visitors are always likely to trip, fall and hurt themselves and just that simple incident can threaten the financial resources of the organisation and endanger the personal assets of the board and management.

### ***Goods in custody cover***

This policy is designed for organisations that hold goods on consignment or loan. This allows an organisation to insure objects that do not belong to it, thus protecting both itself and the owner.

If operating a museum, gallery or library shop, one might purchase a package which may cover say, \$30,000 stock and \$5,000 goods in custody. A declaration of actual stock and goods in custody must be made monthly and the premium will vary monthly depending on the actual variations reported each month. Similarly, where the institution is the temporary bailee of material, for example where it is considering acquisition or is undertaking identification or valuation services for the public, this kind of cover should be considered. The risks may be tempered by the use of documentation that includes clauses that contractually limit liability for loss or damage to such material but experience indicates that, because the risks attending temporary custody are high, it may be worthwhile to minimise exposure by using both insurance *and* contractual limitations of liability.

### ***Transit cover***

Common carriers do not treat culturally or historically significant objects as a separate category. They usually offer a general insurance policy costing about \$4.50 per \$600 cover. This is usually automatically added to the freight cost. It is also totally inadequate for the transport of cultural material.

Collecting organisations must use specialist carriers because they will pack and handle the collection material correctly, thus reducing the chance of a loss or

damage. All of these carriers have their own contractual terms and these should be considered with care.

### ***Plate glass insurance***

Plate glass is expensive and some property owners may elect to insure themselves against its breakage. However, where the organisation rents buildings the lease agreement usually obliges the tenant to take out plate glass insurance. If the glass has painted lettering or burglar systems attached these additional expenses can also be insured.

### ***Trustees and officers***

Given the increased personal liability imposed on trustees, board members, officers and senior management, it is common practice that the organisation take out insurance to cover them from legal liability. If this were not the case, it would be difficult to attract top quality people to these important roles. Provided that the insured has acted in good faith, this insurance gives protection against any direct loss arising from actual or alleged error, misstatement, act or omission and breach or neglect of duty.

### ***Volunteers***

Volunteers are not covered by workers' compensation insurance because they are not employees. Nor are they covered by public liability, for they are more than 'mere' members of the public. Volunteers must be covered for personal injury.

One must also make sure that the other insurance policies protecting the museum and its collection cover situations in which the loss is caused by a volunteer.

For further discussion of volunteer liability, statutory protection and insurance, see Chapter 37 Volunteers.

### ***The permanent collection***

It is a matter of considerable debate as to whether collecting institutions should take out insurance on their permanent collections. In brief, the argument against says that, as museums largely collect the irreplaceable, insurance is pointless. The argument for insurance, stresses that:

- only some kinds of collections are irreplaceable;
- only some items in the collection are irreplaceable and the insurance will enable the replacement of those which can be replaced; and
- new material will have to be found and this will also have to be paid for.

There is no legal obligation to insure the collection. Where the collection remains permanently within the collecting institution's premises, it may be arguable that the

money is better spent on security of the premises and better internal care and control of the material. But when the material leaves the immediate control of the organisation, the risks increase and, with it, the prudence of insurance.

Whether the organisation should insure or not, and if so - what to insure, for how much, and subject to what conditions - are all matters for decision by the board. These are important matters of institutional policy and governance. They are the board's responsibility.<sup>4</sup> Once the over-arching issues have been decided by the board, then it is up to the organisation's administration to do the scoping, selection, negotiation, implementation and administration required by the insurance strategy.

When considering this cover it is important to consider the subject and extent of the cover. For example, where the institution contains a permanent collection and a study collection, the decision may be made to insure only the permanent collection because it is the more valuable. Conversely, it may be decided to insure only the study collection because the risks to its damage are higher due to the use to which it is put. Such decisions are unique for each institution.

Of course, it is unwise to focus exclusively on the risk of complete loss. Where the material is damaged you will have the costs of restoration and conservation. 'If one has certain items that are unique and could not be replaced with something similar, but which form an intrinsic part of the collection and that one either does not wish to view as an asset, or cannot do so due to ownership constraints, then one might wish to insure solely against restoration costs. By speaking to recognised conservators it should be possible to establish the maximum probable expenditure per item to restore major damage. There is obviously a point beyond which it is not possible to restore but one should work to a point as near that as possible in calculating the cover required to fund restoration costs.'<sup>5</sup>

There are now policies available that relate specifically to collecting organisations. The collection is usually – and ideally should be – covered by a type of insurance known as 'all risks', that is, it covers all risks of physical loss or damage including fire, theft, storm, flood, escape of water, accidental damage etc subject to specific exclusions. (Although transit cover and goods in custody insurance are set

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<sup>4</sup> As with other governance obligations, the board's liability only extends to giving the issue its diligent consideration. It is not required to get the answer 'right'.

<sup>5</sup> Nick Brett, AXA Art Insurance Limited, *Works of Art: Their Financial Protection* (unpublished).

out below as separate categories, a good specialist "All Risks" policy should incorporate both these elements.)

Again the insurance company will assess the risks in determining the premium. Factors other than market value may include: security measures deployed, frequency, manner and expertise of handling, special characteristics of the objects (such as fragility or attractiveness to thieves), storage and environmental controls (such as humidity, light, dust, heat).

Once a claim is made, the burden is on the organisation to prove that the amount claimed is a fair market value for the loss. This may be easy if there are comprehensive registration records maintained and if expert valuers (or auction records) substantiate the claim. This is rarely a problem for major institutions, but is commonly more difficult for organisations that do not maintain adequate records or collect material that, while being socially and historically significant to the local community, does not have an established market value.

You avoid this difficulty if the basis of the insurance is 'agreed value'. This avoids any ambiguity with regard to quantum in the event of a total loss since the values are agreed between both parties at the beginning of the contract. This does however mean that an up-to-date valuation of specific items needs to be maintained, so it is best used for the more important items in the collection, the balance being insured on an indemnity or market value basis.

### ***Other collections***

Many large collecting organisations maintain collections other than the permanent collection, such as collections that are made available for research, loan, educational purposes etc. These are often of lesser value and lesser rarity than the permanent collections. These create an interesting conundrum because, although they may be of modest financial value or consist mainly of duplicates, the way that they are used (indeed their very purpose) exposes them to a greater likelihood of loss or damage.

There is no one answer. The organisation must consider each collection, the use that it is put to; the rarity of the material; its financial value; the ease of replacement; and even the way that its uses are administered,<sup>6</sup> to determine

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<sup>6</sup> For example, if a natural history collection lends a collection of hundreds of rock samples or butterflies to an academic researcher, is there a system by which the loaned material is condition reported and counted before the loan and upon return? If not, there is little point in insuring the material for loss or damage when on loan because the claim would not be able to be substantiated.

whether insurance is prudent. But if you want to replace the collection in the event of its destruction, you will need money - and that suggests that insurance may be prudent.

### ***Temporary loans and travelling exhibitions***

The usual practice is to insist that the 'borrower' will meet all insurance needs. The issue of who should arrange and pay for insurance should always be set out in the loan agreement.

The standard requirement is that the material will be covered for 'all risks' both at the museum and while in transit. In these instances it is usually advisable to take an 'agreed value' policy rather than a 'market value' policy.<sup>7</sup> It is also desirable to consider whether 'deductibles' are desirable, for although they keep the cost down, it means that the borrowing museum will be liable to make up the difference and it may not have the resources to do so. If that were to occur both parties would be in a difficult position.

The conditions of the loan agreement must always be consistent with the requirements of the insurance policy.<sup>8</sup> This is a fundamentally important consideration in the drafting of the loan agreement. Indeed, it is advisable for the borrowing institution to check its insurance policy and include in its standard loan agreement any restrictions or requirements imposed by its insurance policy.

Where both the lender and the borrower have their own insurance policies, the parties are best advised to compare the terms of the policies to see which is the more favourable. For the borrower, because there are likely to be many loans, it is administratively easier if its own policy is used. However, if the lender insists that the loan be covered by its own insurance, the prudent borrower institution will insist that:

- a premium quote is given;

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<sup>7</sup> See 'Insured value' below.

<sup>8</sup> The prudent borrower will not agree to any demand that it will be liable 'to the full extent of insurance coverage'. It is none of the lender's business what that full extent may be. To disclose that can, in some cases, even be in breach of the insurance policy. It does have a right to be contractually insured that the borrower's insurance is sufficient to cover the value of the loaned item.

- it is named in the policy as an additionally insured party or the insurance company's right of subrogation against the borrower is waived;<sup>9</sup>
- either a certificate of insurance is delivered to the borrower or that the loan contract specifically excludes the borrower from any obligation to insure or liability for not insuring;
- the borrower will not be liable for any error or deficiency in information provided by the lender to its insurer or for any lapse by the lender in coverage.<sup>10</sup>

## Insurance issues affecting collections and loans

### ***Exclusions***

Common exclusions include 'wear and tear, gradual deterioration, inherent vice, damage resulting from any repairing or restoration process, war on site, terrorism on site and nuclear reaction'.

International lenders sometimes insist that the insurance policy covers war and terrorism. Both of these are difficult to obtain.<sup>11</sup> Sometimes these demands may be waived if the lender is satisfied that the security measures taken by the borrower are sufficient.

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<sup>9</sup> 'Subrogation', is the right of the insurance company that has paid out on a policy to 'stand in the shoes' of the indemnified party (the insured) and to then seek redress against the party responsible for the loss. For example if an employee of the borrowing institution is negligent and causes damage to the insured material, the lender's insure will pay out the owner but would have the right to then chase the employer of the negligent employee (the borrowing institution) to recover the amount of the payout. In this way, it is clear that the lender's insurance provides no protection to the borrower unless it is either a named additional insured or the rights or subrogation are explicitly waived.

<sup>10</sup> M. Malero, *Managing Museum Collections* (2nd ed), Smithsonian, at 242.

<sup>11</sup> Indeed terrorism insurance was so problematic in the USA that the bush administration introduced the *Terrorism Risk Insurance Extension Act* which was a temporary mechanism intended to provide certain cover until the private insurers could develop their own responses to the terrorist threat in the USA. Unless extended, the Act expires on December 31, 2007. See <http://www.treas.gov/offices/domestic-finance/financial-institution/terrorism-insurance/>

Sometimes, during the course of the loan the insurance company may advise the insured that the exclusions have been varied. If this occurs, the insured must advise the other party immediately and provide a revised certificate of insurance.

### ***Sole recovery***

The agreement should state that in the event of loss, theft or damage of the loaned material, recourse to the insurance cover will be the lender's sole remedy.<sup>12</sup> This puts the focus clearly upon the need to get a proper agreed valuation for the loan.

Further, in a related but distinct point, the loan agreement should explicitly state that the borrower will not be liable for any sum over and above the insured amount (that is, that the insured value is the deemed 'total loss' value. Malaro helpfully suggests adding a clause to the following effect: 'Any recovery for depreciation or loss of value shall be calculated on a percentage of the insured value specified by the lender in the agreement.'

### ***Insured value***

Loans should be insured for their agreed value: neither too high nor too low. Where the lender sets a value for insurance purposes it is essential that this figure be examined by the curator for the borrower and its appropriateness will be determined by its likely market value.<sup>13</sup> Where the value put on the item by the lender is not considered defensible by the lender, the borrower must attempt to negotiate the figure down to an objective value that is verifiable by reference to the market. If the parties are unable to agree on the value, the loan should not proceed as the borrower is exposing itself to liability for the gap between the contracted value of the item and the amount that the insurance company will pay in the event of its loss, theft or damage.<sup>14</sup>

The issue with insuring permanent collections is slightly different. 'On large collections it is obviously not practical to list each and every item and to assign it a value, but one may wish to list everything with an individual value in excess of, say,

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<sup>12</sup> See M. Malaro, *Managing Museum Collections* (2nd ed), Smithsonian, at 241-242.

<sup>13</sup> Note that the agreed value is just that. Reference to likely market value is only one consideration that can be helpful in working out what that agreed value should be.

<sup>14</sup> There is also an ethical issue for the borrower institution. In agreeing to an over-valuation it is permitting its reputation to be used to ramp the value of the item. Subsequent potential purchasers of the item may/are likely to be shown the value that was agreed by the borrower institution and rely on the supposed care, attention and expertise implicit when it signed off on the 'agreed value'.

£2,000 and insure for a block figure representing the value of all the remaining items in that category, that is, 'all remaining Chinese porcelain £65,000'.

With regard to what value one places on an object, this depends entirely on the context, but for insurance purposes the main options tend to be: retail replacement cost, replacement cost at auction or net asset value. It is perfectly possible to insure for a lower agreed value, but in order not to negate the point of insuring the item, there should be a reason for doing this, such as the example of an item being used as collateral where one only wants to insure for the amount of the loan.<sup>15</sup>

Even though an exact replacement may not be possible (for example, in fine art or other one-off material), cover can be arranged so that you receive an adequate sum to cover the cost of purchasing a similar object. You should be careful to take into account dealer's mark-up or auctioneer's commission and other potential acquisition expenses when setting the amount insured. Because of these expenses, the replacement value will usually be more than net asset value.<sup>16</sup>

### ***Absence of insured value***

Where the lender fails to provide a value for insurance purposes it is important that the borrower either (i) make a reasonable estimate of value and submit that to the lender for inclusion in the agreement, or (ii) obtain a complete waiver of all liability arising from the loan, or (iii) include a term by which the value of the item shall be deemed to be that reasonably determined by the insurance company.

If the borrower puts forward an estimate of the insurance value it is important that the agreement explicitly states that the estimate is not an appraisal of market value and is not to be used by the lender for any other purpose. While it is unlikely that the borrower will want to obtain independent third party valuations for this purpose, such estimates are often fairly easily obtainable through discussion with the curator of the exhibition or relevant department and from sales records.

### ***Replacement versus restoration***

Where the item is made of material that is made of materials that may be replaced or exchanged, the borrower will usually insist that it be insured for its replacement

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<sup>15</sup> Nick Brett, AXA Art Services Limited, *Works of Art: Their Financial Protection* (unpublished).

<sup>16</sup> See Fn 15.

value. For example, assume that a gallery borrows a Janet Laurence work made of grasses, wood, soils and sand. If the grass component dies or is damaged, the insurance cover is likely to deem that the damage amounts only to partial loss and that it can be repaired. In such case the policy would meet the cost of restoration of the fungible material plus any loss of value - or the insurance company could consider the grass component that died as 'inherent vice' and therefore an exclusion under the policy.

The Replacement v. Restoration dilemma often arises in loans of new media and digital objects. For example, with new media works, the borrower would be prudent to borrow a 'display copy' and not the 'master copy/original artwork'. In the event of damage to the 'display copy', the insurer would meet only the cost of replacing the copy. Because of this, it is important to establish the value of the 'display copy' early on in the loan negotiations as this is always much less than the value of the 'master copy/original artwork'. Another example arises when borrowing digital photographs. If the general public get close to the work during the display period it may end up damaged by fingerprints. While the artist/lender considers the work to have been damaged, an insurer is likely to treat the value of the claim as the cost of reprinting the photograph.

Sometimes, because of the unique nature of the piece, or because of its particular family, religious or cultural significance, its value lies in that significance rather than its monetary value. In such cases the cost of restoration may exceed the value of the item but the lender insists on a term in the policy that obliges restoration. There is no easy answer to this. An open chequebook is never a good idea and will be antithetical to your insurer. Usually the answer lies in negotiating with the insurer and the lender to arrive at an agreed cap.<sup>17</sup>

### ***Waiver of obligation to insure***

Sometimes the lender agrees to waive the borrower's obligation to insure. Sometimes this may be because the overall value of the material is so small or because the material is already covered under the lender's own blanket policy. There is no easy answer for the borrower – it depends on the circumstances. For example, if the borrower agrees that the value of the material is miniscule (and that value is reflected in the agreement), it may decide to take the risk and remain uninsured. Where the value is high, it may be prudent for the borrower institution to take out

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<sup>17</sup> In such a situation it is prudent also to include a term whereby any liability for claim over and above the agreed cap is expressly excluded.

its own insurance or, at least, obtain in the loan agreement a complete waiver of all liability arising from the loan.<sup>18</sup>

### ***Cost***

Nick Brett, of the London-based insurer AXA Art Insurance Ltd, has the following advice as to costs:

The rate charged by an underwriter is made up of various different components. They need to charge for the likelihood of loss from various perils, i.e. fire, water, accidental damage, theft, malicious damage etc as well as allow a margin for the expense of underwriting the risk, carrying out surveys and a modest margin for profit.

One should always start on the basis of insuring against 'All Risks'. The difference between the rate for All Risks cover and the rate for limited perils cover is likely to be relatively slim, particularly from a specialist insurer who will want to provide a decent scope of cover to their client.

It is also the case that those perils which are most remote will only account for a tiny fraction of the rate, and those perils which represent major risks (i.e. fire, water and theft) will account for the bulk of the rate.<sup>19</sup>

### ***What should the policy include?***

Brett goes on to advise that a policy covering collection material differs in several ways to a general property insurance policy: It should 'include provision for specific risk management, valuation and conservation advice; it should include cover for depreciation; it should operate on an agreed value basis where possible; it should not contain inappropriate single article limits; it should provide for an appropriate claims service including referrals to specialist loss adjusters and restorers'. Gold dust advice.

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<sup>18</sup> Make sure that the waiver includes liability for 'gross negligence' as it is well established that where one party attempts to exclude liability for its own negligence, the courts are inclined to disallow reliance on an exclusion clause where the negligence has been 'gross'. If your sense of pride forbids excluding your own gross negligence, get insurance.

<sup>19</sup> See Fn 15.

## General insurance issues

### *'Co-insurance' and 'average'*

'Average' and 'co-insurance' are often used as though they were synonyms. Actually, they are slightly different. 'Co-insurance' is where more than one party takes a share of the risk and that party could be the insured themselves, either because they wish to or because the insurer insists upon it.

'Average' is where the sum insured is found to be an inadequate representation of the value at risk and so the insured is obliged to bear a share of the loss commensurate with the amount of under-insurance deemed to have taken place. It is a contractual means whereby the insurer penalises an insured who under-insures property. The insured is considered to be a self-insurer for the amount under-insured, and will also have to bear a rateable share of partial losses (in proportion to the extent of under-insurance). In other words, through the 'average' principle, you would be treated as a co-insurer.

A simple example will make this clearer:

<b>Full (Replacement) Value</b>	\$1,000,000
<b>Sum Insured</b>	\$500,000
<b>Amount of Claim, say</b>	\$100,000
<b>Amount payable by Insurers as a result of the application of Average/Co-Insurance</b>	\$50,000

Because you have only insured the item for 50 per cent of its actual value, in effect, you would be self insured for 50 per cent of the full value and thus 50 per cent of any claim.

Administrators must be aware of the dangers of the 'co-insurance' clause. This clause takes effect if the collection is under-insured. For example, if the collection is worth two million dollars it may be insured for only one million (on the basis that it is unlikely that more than half of it would be wiped out in any disaster). In such a case the payment made by the insurance company will be reduced by the same percentage as the under-insurance. So, in the above example the payout would be reduced by 50 per cent.

Although the company will allow a ten per cent margin, collecting organisations are usually better off having the co-insurance clause deleted altogether. A 'deductible clause' will help keep the costs down.

A 'deductible' is the agreed amount that will be subtracted from the payout in the event of a loss. For example, the institution may agree to meet the first ten thousand dollars of any loss. This cover will be cheaper than one in which the insured organisation meets only the first five hundred dollars.

Deductibles may be structured in a number of ways. For example, they may relate to individual items, to all losses resulting from a single occurrence, or even all losses within a specified period. It is crucial to examine the exact terms used in the contract.

### ***Exclusions***

All policies, even 'all risks' policies, include exclusions. These must be carefully considered as they often require negotiation so that the cover obtained matches the real risks. There are some exclusions that are usually non-negotiable such as 'fair wear and tear', nuclear explosion, terrorist attack, war, insurrection, revolution, attacks by vermin, natural deterioration caused by the nature of the material and so on. Some policies even exclude flood. It is important to read these carefully. What is precisely meant by such words? For example, if there is a flood exclusion will it treat claims for damage caused by a plumbing disaster in the same way as damage caused by a flooding river?

Exclusions are included by insurers to limit their liability. They are a crucial component of the insurance company's risk management strategy. They are a reflection of the extent to which the insurer's interests conflict with those of the insured. You should only accept exclusions where such exclusions are compatible with your own assessment of the identified risks. After all, you take insurance as part of your risk minimisation strategy so it is essential that the real risks are covered and not excluded.

### ***Read the policy***

The insured should always insist upon being given a draft of the policy and an opportunity to examine discuss consider and negotiate it. It is essential to have a complete understanding of all its terms. If in doubt, ask.

Always insist on receiving a copy of the final insurance contract. It is the only way that one can be sure that the policy has actually been issued and is the only way to be sure of the exact terms of the protection that has been bought.

### ***Further information***

The Museums Australia website has an excellent resource for collecting organisations that wish to obtain further information.<sup>20</sup> That site also contains information on likely costs of various kinds of cover that small collecting organisations are likely to face. The large institutions negotiate individually shaped and costed insurances.

## **Government indemnity schemes**

The Commonwealth and State governments all have insurance or indemnity schemes. They vary in ease of use and practicability and this is not the place to analyse them all. This isn't a handbook for the collection or exhibition manager who needs to be expert on government indemnity schemes. The starting point of enquiry might be the summary of indemnity schemes set out in Appendix C of the 2001 Commonwealth inquiry entitled, '*Covering Your Arts: Art Indemnity in Australia*'.<sup>21</sup>

So that the reader can get a flavour of these schemes (rather than purporting to be a handbook on them), the following sections provide a brief summary of just two: The Victorian and the new Commonwealth schemes.

### ***The Cultural Exhibitions and Fine Arts Indemnification Scheme (Victoria)***<sup>22</sup>

This Indemnification Scheme provides indemnity cover for the temporary display of objects of material culture for the benefit of Victorian audiences and is managed by Arts Victoria. The scheme provides Government-backed, fully insured indemnification to approved exhibitions organised by Victorian cultural institutions.

Insurance arrangements for the Indemnification Scheme are made by the Victorian Managed Insurance Authority (the VMIA). The VMIA arranges all Victorian

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<sup>20</sup> *Risk Management and insurance for museums and Galleries*: <<http://www.museumsaustralia.org.au/site/page233.php>>. This provides a directory of related websites and a very useful article *Insurance Issues at the opening of the 21st Century*, J. Edwards & B. Robertson, *History Matters*, Vol 14, Number 3, Nov 2004.

<sup>21</sup> <[http://www.aph.gov.au/House/committee/cita/arts\\_indemnity\\_australia/artreport.html](http://www.aph.gov.au/House/committee/cita/arts_indemnity_australia/artreport.html)>.

<sup>22</sup> The following information has been obtained from the Guidelines and Application Forms available on the Arts Victoria website: <<http://www.arts.vic.gov.au>>.

Government insurance, and due to its whole-of-Government buying power is able to provide insurance premiums at extremely competitive prices.

The Indemnification Scheme aims to facilitate the presentation of significant temporary exhibitions throughout Victoria by removing the potentially prohibitive cost of insurance. It also aims to promote best practice in exhibition management across the gallery and museum sectors.

The Indemnification Scheme accepts applications from organisations within Victoria that have undergone a risk management and site accreditation assessment. Indemnified exhibitions may be:

- drawn from local, interstate or international sources;
- presented at one accredited venue only;
- toured to several accredited venues within Victoria;
- toured both within Victoria and interstate, in which case indemnification covers only the Victorian component of the tour and the transits to and/or from the interstate venues.

Applications are assessed by a Ministerially-appointed Indemnification Committee. The Committee includes representatives from regional and metropolitan galleries and museums, conservator and representatives of the major State agencies. The Committee meets four times per year, or as required, to assess and prioritise applications against the Scheme's objectives and assessment criteria described in the application guidelines. Applications must be submitted at least eight weeks prior to the requested Indemnification start date. There are four application rounds each year.

Priority is given to exhibitions which:

- are from organisations that have undergone a satisfactory risk management and site accreditation assessment through VMIA;
- will make a significant impact on the applicant organisations;
- show evidence that all security, transport, packing and handling will be carried out according to the Security Checklist found in the application guidelines;
- have a confirmed itinerary;
- have a budget and marketing strategy commensurate with the scale of the exhibition.

Other matters for consideration during the assessment process include:

- legal status of the management organisation;
- proposed itinerary, including specific accredited venues;

- exhibition budget;
- identification of the objects for display.

Security, packing, transport and courier arrangements (in all instances professional standards must be met, specific requirements must be decided for each exhibition)

All organisations applying for indemnification or presenting indemnified exhibitions must undergo a risk management and site assessment. Galleries and museums are rated against a range of industry benchmarks and given a rating of gold, silver or bronze. This rating corresponds with the level of excess payable in the event of any loss or damage to an indemnified exhibition at the gallery/museum.

What will not be indemnified include:

- touring exhibitions while at venues that have not undergone a risk management and site assessment and/or are outside Victoria;
- the transit or display of works that are being purchased by an institution;
- exhibitions with a value of more than \$55 million;
- commercial endeavours that include works for sale;
- incomplete applications may not be considered;
- wear and tear. A basic exclusion of the insurance policy that underpins the Indemnification Scheme is 'ordinary wear and tear'. Exhibitions with components that are interactive can be covered for the total loss of those objects, but not for their repair if they break down or are otherwise damaged through use.

The Indemnification Scheme will not cover damage to didactic or promotional panels, nor can it be used to insure crates for exhibitions.

### ***The Commonwealth scheme***

In the 2009 Federal Budget the Commonwealth Government announced that as from 1 July 2010 it would replace the present Art Indemnity Australia program with a new scheme – the Australian Government International Exhibitions Insurance Program (AGIEI). It heralds a completely new approach whereby the Government will provide funding for eligible organisations to purchase their own commercial insurance.<sup>23</sup>

When the still current scheme, Art Indemnity Australia (AIA), was introduced, it was hailed as removing from galleries the financial burden of seeking commercial insurance. The new scheme recognises that when dealing with exhibitions valued at

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<sup>23</sup> See <<http://www.arts.gov.au/collections/agiei-program>>.

more than \$50 million, insurance is best treated as a commercial and budgeted cost of mounting major exhibitions. The \$50 million threshold is increased from the \$20 million threshold under the current scheme.

This is a major shift of philosophy: When the AIA first started in 1979 the Commonwealth self-insured against the risk of loss or damage to indemnified works of art. In 2001, this policy changed and the Commonwealth took commercial insurance to reinsure its risk. Now, with the new scheme, the Commonwealth has removed itself from potential legal liability and from the administrative burden (except where collecting institutions choose to use Comcover as their insurer). In its new, simplified role it will merely provide funds to enable exhibition promoters to obtain their own cover to cover their own risks. The original approach was sensible. The new approach is sensible. The current one never was.

Applicants to the AGIEI are limited to:

- Commonwealth, State or Territory Government collecting institutions;
- incorporated not-for-profit Australian collecting organisations; and
- incorporated not-for-profit organisations that have experience in developing and touring international art and cultural exhibitions<sup>24</sup>.

This is a huge expansion of access. Previous governments attempted to manage their exposure by limiting access to the scheme to just two organisations: the National Gallery of Australia and Art Exhibitions Australia Ltd. This made sense in the days in which those organisations were probably the major promoters of blockbuster shows but over the past thirty years other organisations, in particular some of the State Galleries, have become experienced presenters of mega shows. Notwithstanding this, when the AIA was reviewed in 2001, the Commonwealth continued to exclude the State institutions from direct participation in the AIA<sup>25</sup> saying that the State institutions should either partner with one of the managing organisations or rely on their own State government indemnity schemes. Thankfully, that thin-lipped state/federal tension is not reflected in the new scheme.

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<sup>24</sup> For example, Art Exhibitions Australia Ltd.

<sup>25</sup> The AIA was last reviewed in 2001, '*Covering Your Arts: Art Indemnity in Australia*'; see

<[http://www.aph.gov.au/House/committee/cita/arts\\_indemnity\\_australia/artreport.html](http://www.aph.gov.au/House/committee/cita/arts_indemnity_australia/artreport.html)>.

However, it should be noted that there will be some caveats on the ability of state-based organisations to access the program. Single-venue exhibitions in the home state/territory of the applicant, where that state/territory has its own indemnity or insurance scheme will not be eligible. This places an emphasis on touring exhibitions to more than one venue and ensures that the Commonwealth scheme is seen as an addition to, not a replacement for, state government funding.

While the above is a step forward, the description of eligible applicants might have some interesting consequences. For example, most regional collecting institutions will not be eligible to apply because most of them are not, themselves, incorporated. They are owned by local councils. A few, however, are incorporated<sup>26</sup> and would clearly be eligible provided they have exhibitions valued at \$50 million or more. Still, the details of the new scheme are yet to be released and small anomalies such as this can easily be dealt with as the program evolves.

In general, the AGIEI is a completely new policy direction and is an initiative that will be widely welcomed by the sector.

The Department of Environment, Water, Heritage and the Arts will administer the program. At time of writing, all we know is that applications for funding under the AGIEI Program will involve two stages: an initial application for in-principle approval and a final application at least 60 business days before the exhibition is to commence. Initial applications for in-principle approval for funding under the AGIEI Program will be due on 1 March each year for exhibitions commencing on or after 1 January of the following year.<sup>27</sup>

However, there will also be an interim arrangement for exhibitions commencing between 1 July and 31 December 2010 with applications closing on 31 October 2009.

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<sup>26</sup> Such as the Wollongong City Gallery which is a company limited by guarantee.

<sup>27</sup> <[http://www.arts.gov.au/data/assets/pdf\\_file/0006/88665/agiei-factsheet.pdf](http://www.arts.gov.au/data/assets/pdf_file/0006/88665/agiei-factsheet.pdf)>.