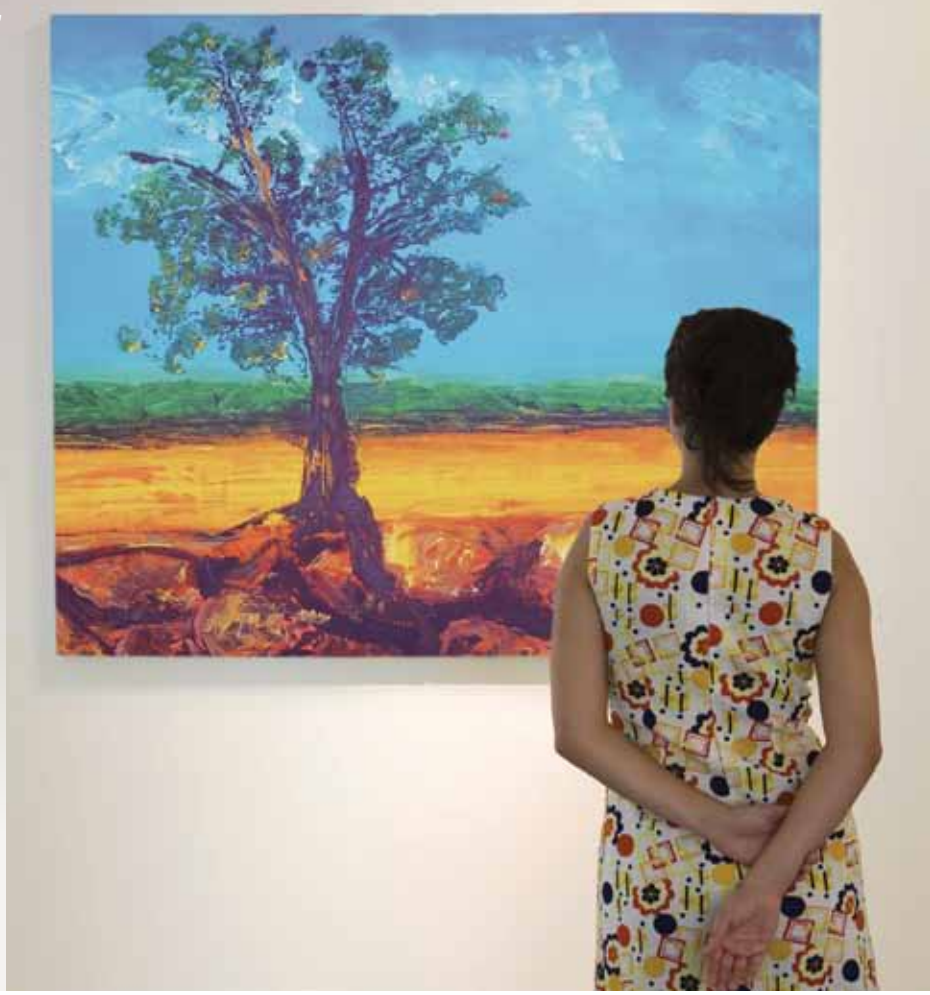
THE ART MARKET

Masterpiece Coverage for Loss Due to Art Dealer's Wrongful Conversion

By Gary L. Bender



Fast Facts:

The "all risk" masterpiece policy of insurance may not really mean "all risk."

Like Love Gallery, other unscrupulous and brazen art dealers and gallery owners have sold consigned art and kept part or all of the proceeds (see sidebar story on page 35).

Art collectors should carefully review their all-risk masterpiece policies to ensure they cover any loss due to the wrongful conversion by a gallery or dealer when the owner consigns works of art for sale.

What does an art collector do when an art dealer sells the collector's paintings on consignment for less than the agreed-upon price and converts the proceeds of sale to the dealer's own use? Does the typical so-called "all risk" masterpiece insurance policy cover the loss? Long-time art collectors Henry and Ann Marie Frigon thought so, but their insurance carrier disagreed. It was up to a federal district judge to decide in what a *Wall Street Journal* article described as a possible "landmark decision" that "seems likely to shake up the way art transactions are handled in this country."[1]

Henry and Ann Marie Frigon were art connoisseurs who bought and sold works of art over a number of years. During that time, the Frigons developed a close business and personal relationship with Richard H. Love, proprietor of R. H. Love Galleries, Inc., of Chicago (Love Gallery), and bought 11 American Impressionist paintings from Love Gallery. In fact, R. H. Love tutored Henry Frigon in art history, appreciation, collecting, and investing. From time to time, the Frigons consigned their works back to Love Gallery for resale. Sometimes they relied on oral consignment agreements providing for minimum sale prices and other terms. At other times, they entered into written agreements. Paragraph four of the written agreements provided that the identified works of art "may be sold by Gallery at an amount equal to or greater than the amount…as set forth as the 'Consignment Price.'"[2]

Between 1997 and 2002, each of the 11 paintings the Frigons previously purchased from Love Gallery (for which they had paid a total of more than $1 million) was consigned back to Love Gallery. The minimum sale price was $1,600,000 collectively.

During the years of their close relationship with R. H. Love, the Frigons were unaware that Love Gallery was in deep financial trouble. They later learned that Love Gallery sold their consigned pieces of art for less than the minimum agreed prices and kept the proceeds of sale for its own use to stay afloat and ahead of its creditors. All of the Frigons' 11 paintings were eventually sold—contrary to the terms of the consignment agreements—through

trades or sales for less than the minimum prices set by the Frigons. For example, in August 1997, the Frigons' *Harborside Reflections* was sold for $80,000, approximately $40,000 less than the consignment price.[3] In November 2000, the painting *The Bath* was consigned to Love Gallery for a minimum sale price of $225,000 and was undersold for $125,000.[4] R. H. Love didn't tell the Frigons the paintings had been sold.

Finally, in January 2003, R. H. Love told the Frigons that the highest-priced painting, which was consigned for a minimum price of $300,000, had been sold. In a letter to the Frigons, Love stated that the painting sold for $435,000 on an installment basis and that the Frigons would be paid $36,250 monthly over 12 months. In fact, Love Gallery undersold the painting for $150,000 cash and a trade of another painting. Love Gallery deposited the money into its own bank account and paid the Frigons two installments of $36,250 but made no further payments to them.[5]

Henry Frigon demanded that all the consigned paintings be returned. Eventually, R. H. Love admitted that all the paintings had been sold and that Love Gallery spent all the money received for them.[6] He also informed the Frigons that Love Gallery could not pay them the minimum sale price for their art collection.

In addition to making claims against purchasers for their art sold under the consignment sales agreements with Love Gallery, the Frigons reported the loss to their insurance carrier.[7]

All-Risk Masterpiece Policy of Insurance

The Frigons insured their collection against loss under a masterpiece policy of insurance with Pacific Indemnity Insurance Company (insurer). The all-risk masterpiece policy covered all causes of loss of the insured property unless specifically excluded. The Frigons represented in their claim that the paintings were "lost" as of March 1, 2003.[8] As a result of the claim, the insurer registered the art with the Art Loss Register (ALR) and began an investigation concerning the circumstances of the loss.[9]

> As the insureds, the Frigons had the initial burden of showing the existence of a covered loss. Once shown, the burden shifted to the insurer to show an exception to coverage.

Upon completion of the investigation, the insurer denied coverage. The Frigons then filed suit against the insurer seeking a judicial declaration that their loss for converted works of art was in fact covered under the all-risk masterpiece policy terms. The suit was filed in the United States District Court for the Northern District of Illinois, Eastern Division, and assigned to Judge Robert W. Gettleman.[10] Both parties filed cross-motions for summary judgment.

As the insureds, the Frigons had the initial burden of showing the existence of a covered loss. Once shown, the burden shifted to the insurer to show an exception to coverage.[11]

The Frigons argued that an all-risk policy covers all causes of loss except those specifically excluded in the masterpiece policy. Citing *Couch on Insurance,* the Frigons maintained that "[a]n All-Risk policy 'creates coverage of a type not ordinarily present under other types of insurance, and recovery is allowed for fortuitous losses unless the loss is excluded by a specific policy provision; the effect of such a policy is to broaden coverage, and a fortuitous event is one which, to the knowledge of the parties, is dependent upon chance.'"[12] The Frigons contended there were no exclusions under the policy for loss due to theft, misappropriation, conversion, or fraud by persons entrusted with possession of the insured's goods and, therefore, the loss was covered.

The Frigons cited cases that addressed whether conversion of property was covered by an all-risk insurance policy. In *Great Northern Ins Co v Dayco Corp,*[13] a manufacturer did not receive full payment for goods shipped to the buyer in Russia because the goods were lost in transit. The manufacturer claimed it was entitled to payment under its all-risk policy of insurance. The insurance company, however, argued that the policy covered only "direct *physical* loss" and the manufacturer's loss was in the nature of a credit due to theft, meaning its loss was for the money it expected to receive, not the goods themselves.[14] The court held that the insurer "totally ignore[d] the nature and plain meaning of an 'all risks' policy which creates 'a special type of coverage extending to risks not usually covered under other insurance . . . .'"[15]

In *Intermetal Mexicana, SA v Ins Co of North America,*[16] the Third Circuit held that the all-risk policy covering "all risks of direct physical loss or damage" to machinery and equipment subjected the insurance carrier to liability when the plaintiff's equipment was not returned pursuant to a valid court order.[17] The court stated that "[a]mple authority exists for the proposition that such 'all-risk' language . . . covers conversion."[18]

In *Consolidated Int'l Corp v Pakistan Nat'l Shipping Corp,*[19] the insurance "policy provided coverage 'against all risks of physical loss or damage from any external cause . . . .'"[20] The plaintiff agreed to sell printing equipment to another company in exchange for partial payment and a letter of credit drawn on a foreign bank for the balance. The plaintiff obtained an all-risk policy of insurance from Lloyd's of London and shipped the equipment to the purchaser. The equipment arrived intact and undamaged. The bank refused to honor the letter of credit, claiming it had expired. The purchaser obtained possession by posting a bond but did not replace the letter of credit and, thus, the plaintiff was never paid for the balance owed for the equipment. The plaintiff made a claim for conversion of property with Lloyd's. The court held that "[r]ecovery under an all risk policy extends to any fortuitous loss that is not specifically excluded under the terms of the policy."[21]

The Frigons argued that, as in *Great Northern* and *Consolidated,* they no longer had control over their paintings and did not receive payment for them. There was no applicable exclusion

under the all-risk policy and, therefore, their loss for Love Gallery's conversion of the paintings was covered.

The insurer claimed that the masterpiece policy was never intended to be a "performance bond" for the Frigons' business dealings with Love Gallery.[22] The gallery's failure to meet its obligations under the consignment agreements did not change the fact that the paintings were sold pursuant to those agreements for money or other valuable art and Love Gallery simply owed the Frigons a business debt for the unpaid balance. Indeed, R. H. Love testified that he intended to repay the entire debt to the Frigons. Thus, the insurer argued, there could be no "loss."[23] The insurer maintained that since the paintings were, in fact, sold at the Frigons' request, they no longer owned the art, and therefore, the art was no longer covered under the masterpiece policy.

The insurer also argued that even assuming the Frigons met their burden of proof by showing a loss under the masterpiece policy, an exception to coverage exists when the insured or a person at the insured's direction intentionally caused the loss.[24] Here, the insurer claimed that Love Gallery, as agent for the Frigons, executed the sale of the paintings pursuant to the consignment agreements. According to the insurer, the Frigons put in motion the loss by entering into the agreements with Love Gallery and the subsequent sales by Love Gallery as the Frigons' agent.

On January 16, 2007, Judge Gettleman issued a memorandum opinion and order granting the Frigons' motion for summary judgment in part and denying the insurer's motion for summary judgment.[25]

The court characterized as "rather simplistic" the insurer's argument that the Frigons can only establish a business debt for the sale of paintings under the consignment agreements, which is not covered under the policy.[26] The court stated it was undisputed that "each and every painting was sold in violation of the terms of the applicable Consignment Agreement."[27] It was also undisputed that the Frigons saw little, if any, of the proceeds of sale. "According to the undisputed facts, the Gallery simply took the paintings, sold them or traded them for whatever it could get and kept the proceeds, not revealing to [the Frigons] that the paintings were gone."[28]

As authority, Judge Gettleman cited *Metalexport Co v Gen-O-Ral Processing Corp,*[29] in which the court held that when the consignee sold the consigned item and failed to turn over the proceeds, his rightful possession became a wrongful conversion.[30] As in *Metalexport,* Gettleman held that "the Gallery sold the paintings without authority and then failed to remit the proceeds, thereby converting both the paintings and the money received."[31] The court noted, and as the insurer admitted, "in Illinois a conversion is 'any unauthorized act, which deprives a man of his property permanently or for an indefinite time.'"[32]

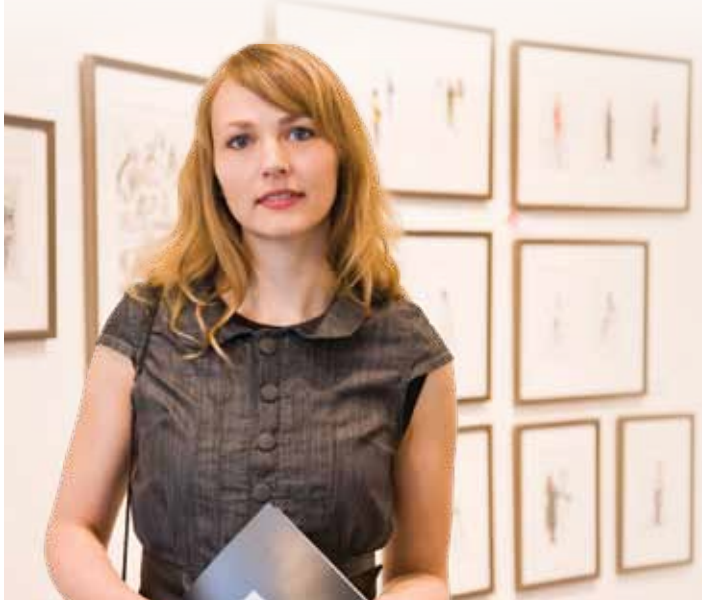
As to the insurer's contention that the Frigons did not suffer a loss of their property, the court found that Love Gallery's unauthorized sales to bona fide purchasers deprived the Frigons of their property. "As far as plaintiffs are concerned at this point in time, the conduct of the Gallery toward their paintings is no different than had the Gallery taken the paintings on consignment and destroyed them."[33] The court continued: "The fact that the Gallery may owe plaintiffs the value of the lost paintings is no more significant than the fact that a thief would owe the victim of his theft the value of the stolen property."[34] The court found that the Frigons met their burden of showing a covered loss and the insurer failed to meet its burden of showing an exception to coverage. Accordingly, the court found that the loss of the paintings was, in fact, covered by the masterpiece policy.

Finally, the court addressed the insurer's argument that the Frigons put in motion an intentional act that would fall under the masterpiece policy's exclusions. The policy stated:

> We do not cover any loss caused intentionally by you or a family member, or by a person directed by you or a family member to cause a loss. An intentional act is one whose consequences could have been foreseen by a reasonable person.[35]

In rejecting the insurer's argument, the court held that "the Gallery's actions were not taken pursuant to the consignment agreement but in contravention of it. Therefore, the exclusion does not apply."[36] Because the extent of the loss was still disputed between the Frigons and the insurer, the court could not determine damages without proofs.

The insurer subsequently filed a motion for reconsideration, claiming that the court's opinion "misunderstood certain facts and misapplied the law of conversion."[37] The insurer argued that the court held the gallery had converted the paintings at the time



The *Frigon* case could change how insurance companies write coverage or amend current policies by requiring the insured to notify the company of a consignment of the insured's pieces of art.

Recent Conviction of Florida Gallery Owner for Art Theft

Can't happen to your art collector client? On December 30, 2011, in Sarasota, Florida, a rock star of the art world was sentenced to two years for first-degree grand theft over $100,000. The once high-flying gallery owner, Robert Preiss, was convicted of selling art consigned to his gallery for less than the amounts authorized and led his clients to believe their masterpieces didn't sell at all while he pocketed the money. Collectors worldwide had consigned art worth millions of dollars to Preiss's gallery. Preiss is being investigated for other art theft allegedly committed while he was out on bond. (Todd Ruger, "Art dealer accused of brazen scheme," *Herald-Tribune Sarasota,* December 31, 2011). Art collectors need to make sure their all-risk masterpiece policies of insurance cover theft and conversion of their art while on consignment.

of their improper sale by the end of 2002, which predated the date of the masterpiece policy. The court disagreed and held that the conversion occurred in March 2003, which was within the policy period, when the Frigons demanded the return of the paintings and Love Gallery refused. "It was the Gallery's failure to return the property on demand that was the final element of the conversion."[38]

Accordingly, in its March 4, 2007, memorandum opinion and order, the court denied the insurer's motion. The insurer did not appeal and the parties subsequently settled all claims against one another.

Conclusion

Did the *Frigon* case really shake up how art transactions are handled in this country as suggested by *Wall Street Journal* writer Steven Yahn? According to William F. Zieske of Bryan Cave, LLP, one of the Frigons' attorneys, it could change how insurance companies write coverage or amend current policies by requiring the insured to notify the company of a consignment of the insured's pieces of art. In the future, insurance companies may require some sort of pre-approval or registry of the art dealer/consignees so insurers (not the insureds) can assess risk to contemplated dealer transactions to avoid another consignment gone bad.

Or, more simply, insurance companies will tailor the all-risk policy to exclude coverage of consignment agreements altogether, thereby relieving liability when a consignee walks off with a collector's works of art or the proceeds from the sale. Obviously, collectors should always perform due diligence when dealing with galleries, art brokers, or dealers. But even the Frigons thought their longstanding relationship with Love Gallery was trustworthy. As a consequence, collectors should carefully review their all-risk masterpiece policies and make sure they can consign their works of art when they are ready to sell and any loss due to the wrongful conversion by the gallery or dealer will be covered by the insurer. ■

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FOOTNOTES

1. Yahn, *This insurance case could shake up the art market,* Wall St J, February 7, 2007, p D10, available at <http://online.wsj.com/article/SB117080103220400059.html>. All websites cited in this article were accessed August 6, 2012.
2. *Frigon v Pacific Indemnity Co,* unpublished opinion and order of the US District Court for the Northern District of Illinois, issued January 16, 2007 (No. 05C6214) (from Pls' Memorandum in Supp of Their Mot for Partial Summ Judgment, p 7).
3. Pls' Memorandum, 4.
4. *Id.*
5. *Id.* at 5.
6. Some of the paintings were sold for money while others were traded away for a combination of cash and other art work. *Id.* at 5–6.
7. *Id.* at 6. The Frigons located four of the paintings at Madron Gallery, which was run by Bruce Bachman, Love's former assistant at the Love Gallery. The Frigons successfully recovered one painting in a partial settlement with Madron.
8. *Id.* at 6.
9. The Art Loss Register is a central location to report stolen or lost art and to help with its recovery. See <http://www.artloss.com>.
10. *Frigon,* n 2 *supra.*
11. *Id.* at *3 (citing *Harbor House Condos Ass'n v Massachusetts Bay Ins Co,* 915 F2d 316 (CA 7, 1990)).
12. Pls' Memorandum, n 2 *supra* at 7 (quoting Couch on Insurance 3d, § 148:50).
13. *Great Northern Ins Co v Dayco Corp,* 620 F Supp 346 (SD NY, 1985).
14. *Id.* at 351.
15. *Id.* at 352.
16. *Intermetal Mexicana, SA v Ins Co of North America,* 866 F2d 71, 74 (CA 3, 1988).
17. *Id.* at 74–78.
18. *Id.* at 78.
19. *Consolidated Int'l Corp v Pakistan Nat'l Shipping Corp,* unpublished opinion and order of the US District Court for the Northern District of Illinois, issued July 25, 1989 (No. 87C7327).
20. *Id.* at *1.
21. *Id.* at *2.
22. *Frigon,* n 2 *supra* (from Def's Response Br in Opp to Pls' Mot for Partial Summ Judgment, ¶ 1).
23. *Id.* at ¶ 11.
24. *Id.* at ¶ 17.
25. See *Frigon,* n 2 *supra.*
26. *Id.* at *3.
27. *Id.*
28. *Id.*
29. *Metalexport Co v Gen-O-Ral Processing Corp,* 365 F2d 178 (CA 7, 1966).
30. *Id.* at 180.
31. *Frigon,* at *4.
32. *Id.* (quoting *Union Stock Yard & Transit Co v Malloy, Son & Zimmerman Co,* 157 Ill 554, 563; 41 NE 888 (1895)).
33. *Id.* at *4.
34. *Id.*
35. *Id.*
36. *Id.*
37. *Frigon v Pacific Indemnity Co,* unpublished opinion and order on Motion for Reconsideration of the US District Court for the Northern District of Illinois, issued March 14, 2007 (No. 05C6214), at *1.
38. *Id.*