

ART & ADVOCACY



The Art Law Newsletter of *Herrick, Feinstein LLP*

FALL 2012 :: Volume 13

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Art Lenders Undertake New Precautions in Light of Amendment to NYACAL's Consignment Provisions

by *Leslie W. Chervokas and Stephen D. Brodie*

Introduction

Governor Cuomo recently signed into law an amendment to the New York Arts and Cultural Affairs Law ("NYACAL") and parallel provisions of the New York Estates, Powers and Trusts Law ("EPTL") that was introduced by the New York State legislature late last year. The new law (collectively referred to in this article as the "Amendment") became effective on or about November 6, 2012.¹

The Amendment is intended to protect artists² and their "successors in interest" (heirs, trust beneficiaries, testamentary beneficiaries, and personal representatives) who consign works of fine art to galleries and other art merchants³ by improving the existing trust property and trust fund provisions of NYACAL. Notwithstanding its apparently laudable purpose, however, the Amendment may have adverse consequences for lenders to art dealers. This article highlights those consequences and proposes certain safeguards.

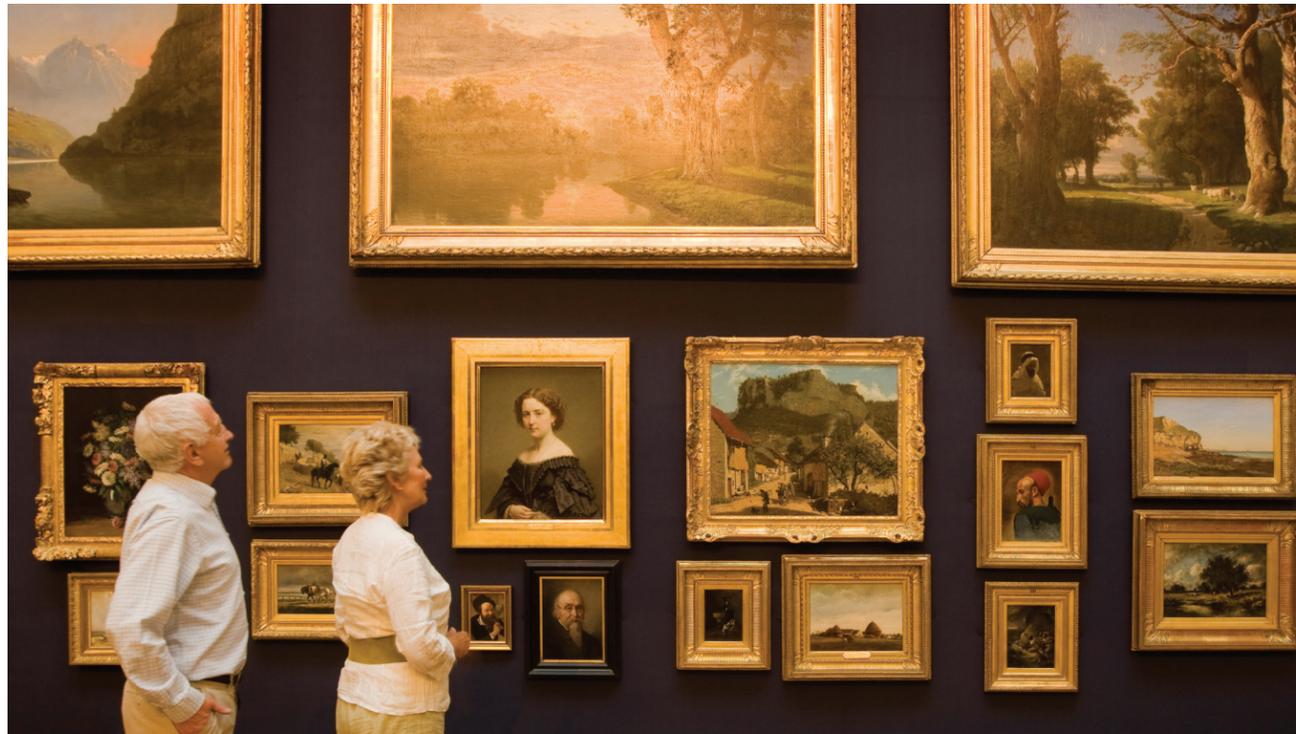
Background

According to the report on the proposed legislation issued by the Art Law Committee of the New York City Bar Association, the history of various legal proceedings, including those involving the involuntary Chapter 11 bankruptcy of the Salander O'Reilly Galleries LLC,⁴ and parallel statutes enacted in approximately 30 other states, formed the impetus for the introduction of the Amendment.⁵ See Report on Legislation by the Art Law Committee (hereinafter, the "Art L. Comm. Rep.").⁶

Before the Amendment was enforced, New York Law provided that consigned art constituted "trust property" and that proceeds of such art, once sold, constituted "trust funds in the hands of the consignee for the benefit of the consignor." The existing law, however, lacked any mechanism to enforce such trust fund provisions or any penalty for abrogating them.⁷

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Historically, dealers' common practice was to commingle sales proceeds of consigned artwork with their own working capital and other funds. In a distress situation, for practical purposes, nothing constrained an unscrupulous art dealer from using another person's sale proceeds to fund its failing operations. Moreover, within the context of a bankruptcy, disparate and disorganized creditors, which may include individual artists, their heirs, and personal representatives, may lack sufficient leverage to overcome the claims of competing creditors to sales proceeds or to the artworks in the possession of the failed gallery.⁸

The Amendment

In response to these issues, Articles 11 and 12 of NYACAL were amended to provide that works of art (and their proceeds) consigned by artists, crafts persons, or their "successors in interest" to art merchants are property held in "statutory trust"⁹ that shall not become the property of the consignee or become subject to the claims or security interests of the consignee's creditors.¹⁰ The Amendment expressly overrides contrary provisions of other law, including New York's Uniform Commercial Code.

Moreover, the Amendment specifies that such statutory trust property/funds are not subordinate to "claims, liens or security interests" of an art dealer's (or other consignee's) creditors.¹¹ Subject to certain exceptions, the Amendment permits the artist (or other consignor) to waive the trust fund protections, but the waiver must be clear and conspicuous, and in a writing signed by the consignor.¹²

Accordingly, under the state law, as amended, such consigned assets should not become property of a dealer's bankruptcy estate upon its becoming subject to protection under the Bankruptcy Code.¹³ Arguments that lenders and others had deployed under the earlier state law to defeat the claims of artists and their children to consigned works of art should no longer prevail.¹⁴

In addition, NYACAL § 12.01 (2) submits the consignee to the fiduciary requirements of Section 11-1.6 of New York's EPTL with respect to such consigned property. These provisions require the consignee to segregate such property, and state that any person who violates its provisions is guilty of a misdemeanor.¹⁵ Section



12.01 (3) of the Amendment also provides for a private cause of action for persons injured by its violation, and allows for injunctive relief in addition to recovery of actual damages and attorney's fees.

Recommendations

Generally, art lenders and other financial participants are familiar with problems arising from attempting to perfect a security interest in cash proceeds that are commingled. To avoid having to pursue tracing procedures that often prove unavailing, the prudent lender typically requires that proceeds of any sold collateral or other proceeds be deposited into a segregated bank account.

Given that the Amendment seeks to insulate the rights of the artist consignor and its successors in interest from a lender's adverse claims against the consignor's property in the hands of the gallery or other dealer, it is now critical that the art lender insist that its borrower dealer—particularly one known to deal in artworks consigned by original artists—separate, in a special bank account established for such purpose, any funds of such consignors, including proceeds of sold consigned art, from any funds of the dealer.

In addition, in transactions post-dating the Amendment's effective date, art loan documents should include express representations, warranties, and covenants requiring that such borrower is in compliance with the applicable provisions of NYACAL Articles 11 and 12 and corresponding provisions of the EPTL. Also, the lender may wish to require enhanced reporting with respect to transfers of consigned art to and from its borrower, as well as the borrower's certification of its ongoing compliance with them as a pre-condition to any future advances.

With these protections in place, the lender's collateral and its proceeds should be more easily accessed in the event of a dealer's loan default, and the lender should be able to avoid becoming embroiled in controversies arising from the myriad of claims asserted by artist consignors.

1 The Amendment, which provides that it will become effective 60 days after its enactment, was approved by Governor Cuomo on September 7, 2012. See 2012 N.Y. ALS 450, *3; 2012 N.Y. LAWS 450, *3; 2011 N.Y. A.N. 8604, *3.
2 N.Y. Art & Cult. Aff. §11.01(1) defines "artist" as the "creator of a work of fine art or, in the case of multiples, the person who conceived or created the image which is contained in or which constitutes the master from which the individual print was made."
3 N.Y. Art & Cult. Aff. §11.01 (2) defines "art merchant" as "a person who is in the business of dealing, exclusively or non-exclusively, in works of fine art or multiples, or a person who by his occupation holds himself out as having knowledge or skill peculiar to such works, or to whom such knowledge or skill may be attributed by his employment of an agent or other intermediary who by his occupation holds himself out as having such knowledge or skill." This definition "includes an auctioneer who sells such works at public auction, and except in the case of multiples, includes persons, not otherwise defined or treated as art merchants herein, who are consignors or principals of auctioneers." *Id.*
4 Bankr. S.D.N.Y. 2007 (Case No. 07-30005-CGM).
5 Art Consignment Statutes have been adopted in the following states: Alaska, Arizona, Arkansas, California, Colorado, Connecticut, Florida, Georgia, Idaho, Illinois, Iowa, Kentucky, Louisiana, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, New Hampshire, New Jersey, New

Mexico, New York, North Carolina, Ohio, Oregon, Pennsylvania, Tennessee, Texas, Washington, and Wisconsin. See Art L. Comm. Rep. at 1- 3 and Appendix.
6 Art L. Comm. Rep. at 1 - 3 (May 2012), available at New York City Bar Association website: <http://www.nycbar.org>.
7 See Art L. Comm. Rep. at 2.
8 *Id.*
9 The Amendment added the term "successor in interest" to its "Definitions" section: "a 'personal representative,' 'testamentary beneficiary,' trustee or beneficiary of a 'lifetime trust' or an 'heir' (including heirs who acquire the work of fine art, craft or print from the artist or craftsman or from another heir or beneficiary of the artist or craftsman), which terms shall have the same meanings as set forth in the estates, powers and trusts law." N.Y. Art & Cult. Aff. §11.01 (2012); see also N.Y. EPT Law §§1-2.5 and 2-1.1.
10 N.Y. Art & Cult. Aff. §12.01(1)(v) (2012).
11 N.Y. Art & Cult. Aff. §11.01(4) (2012); UCC §1-201(12).
12 N.Y. Art & Cult. Aff. §12.01(3) (2012).
13 Title 11, United States Code. 11 U.S.C. §§101 et seq.
14 See generally Art L. Comm. Rep.
15 N.Y. Art & Cult. Aff. §12.01(2) (2012); N.Y. EPT Law §11-1.6(a) - (e).

International Art Transactions under CISG

By Yael M. Weitz and Laura Tam

Art transactions are often conducted internationally, with dealers, collectors, and other art market participants buying and selling artwork in different countries around the world. Since 1988, the U.N. Convention on Contracts for the International Sale of Goods (“CISG”) has governed sales of goods, including art, between entities and individuals with places of business in the United States and those with places of business in other contracting states to CISG, including 77 other countries and most of the major trading nations of the world.¹ Due to the global nature of many art transactions, it is important to understand CISG and its implications for these transactions.

The three main areas of CISG encompass: (1) elements of a contract, (2) the seller’s obligations and the buyer’s remedies, and (3) the buyer’s obligations and the seller’s remedies. According to Article 1(3) of CISG, the nationality of the parties is not taken into consideration when determining whether CISG applies. Therefore, CISG could apply to contracts for the sale of goods between two Delaware corporations with relevant places of business in two different signatory nations. Even so, CISG does not apply to purely domestic transactions in the United States or to contracts that are primarily for labor or other services. In addition, Article 2 of CISG expressly provides that the treaty does not apply to, among other things, sales “of goods bought for personal, family or household use, unless the seller, at any time before or at the conclusion of the contract, neither knew nor ought to have known that the goods were bought for any such use,” or sales “by auction.” While collectors and dealers may believe these exceptions to CISG will exempt most transactions involving the sale of artwork, this may not always be the case.

Although CISG generally would **not**, under the “personal use” exception, apply to a sale of an artwork by an art dealer from a signatory nation to a private collector in the United States (or any other signatory nation), at least one international opinion has suggested that the determination of whether the exception applies is less than straightforward. In a 1997 decision by the Austrian Supreme Court of

Justice, the court stated that a seller could dispute the application of the “personal use” exception by proffering evidence that he or she did not know or ought not to have known that the goods were purchased for personal use.² If the seller was able to make this showing, the “personal use” exception would not apply and the transaction would be governed by CISG. Therefore, if an art dealer can show that he or she did not know that the artwork was purchased for a collector’s personal use, CISG could apply to the contract.

Likewise, interpretation of the sales “by auction” exception may require additional analysis under certain circumstances. For example, in *Kunsthaus Math. Lempertz OHG v. Wilhemina van der Geld*, a Dutch seller consigned a painting to a German auctioneer. The painting was then purchased by a second German auctioneer and offered for auction. Prior to the auction, however, the attribution of the painting was disputed. When the initial German auctioneer brought suit against the Dutch seller, the court determined that CISG was applicable, notwithstanding the sales “by auction” exception of Article 2 of CISG, because the case “did not concern a sale on an auction but an order to sell by auction.”³

Two recent German decisions involving stolen property may also have implications for art transactions governed by CISG. According to Article 41 of CISG, a seller is required “to deliver goods which are free from any right or claim of a third party.” In a 2006 case, car dealers with places of business in different contracting states entered into a contract for the sale of a used car, which was subsequently identified as stolen and seized by authorities. Two months after the seizure, the buyer demanded repayment from the seller and initiated an action in Germany for termination of the contract and for damages. Applying CISG, the court held that the buyer of the stolen vehicle could not avoid the contract and seek damages. Though the buyer argued that the seller had breached the contract by failing to deliver conforming goods pursuant to Article 41, the court determined that the buyer lost the right to rely on



Article 41 because he had failed to provide timely notice to the seller of the third party’s claim as required under Article 43 of CISG. The court did not reach the issue of whether the buyer had acquired title to the car.⁴

But, in a 2008 case involving stolen property, the court did address this issue, suggesting that CISG governs only the formation of the contract and the rights and obligations arising from that contract, not the later effect the contract may have on the property. In that case, car dealers from signatory nations entered into a contract for a sale of a used car, which turned out to be stolen. In the litigation that followed, the court found that CISG applied to the formation of the contract, but did not apply to the effect of the transfer of the property (i.e., whether the good-faith purchaser had acquired good title), and that German law governed the issue of title. Applying German law, the court found that title to the stolen property was not transferred.⁵

Significant Differences Between the UCC and CISG

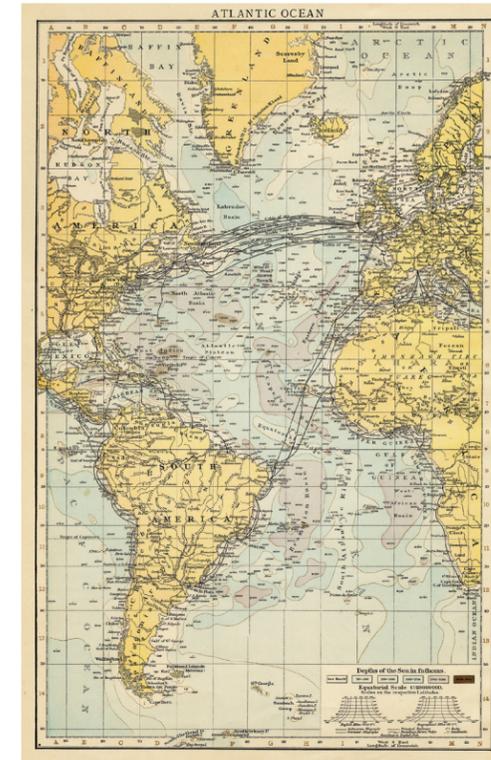
In the United States, domestic sales of goods, including works of art, are generally governed by Article 2 of the Uniform Commercial Code (UCC). There are several important differences between the UCC and the CISG, a few of which are discussed below.

Significantly, CISG abandons the statute of frauds approach of the UCC, which generally requires contracts for the sale of goods valued at \$500 or more to be evidenced by a writing. Instead, according to Article 11 of CISG, “[a] contract of sale need not be concluded in or evidenced by writing and is not subject to any other requirement as to form. It may be proved by any means,

including witnesses.” Therefore, CISG’s definition of a contract is broader than the UCC’s, and has serious implications regarding the parol evidence rule, which has not been incorporated into CISG. Once there is a final written agreement, the parol evidence rule generally prohibits the consideration of extrinsic materials or prior agreements that contradict the agreement. Under CISG, however, evidence of terms and conditions negotiated prior to execution of the written contract may be admissible. Furthermore, under Article 8(1) of CISG, the interpretation of contracts focuses on the subjective intent of the parties, contrary to the general principles of contract interpretation followed by many jurisdictions in the United States.

Also, CISG does not adhere to UCC rules with respect to disclaimers of implied warranties. Under § 2-316(2) of the UCC, a disclaimer of the warranty of merchantability is effective if it mentions the word “merchantability” and is deemed to be “conspicuous” and in writing. A disclaimer of the warranty of fitness for a particular purpose pursuant to the UCC is effective if it is both conspicuous and in writing. Under Article 35(2) of CISG, the presumption is that the goods “are fit for the purpose for which goods of the same description would ordinarily be used” and are “fit for any particular purpose expressly or impliedly made known to the seller at the time of the conclusion of the contract.” Since under CISG this presumption is neither a “warranty” nor “implied,” the commonly used language disclaiming warranties under the UCC may not be effective.

Like the UCC, a buyer may sue for breach of contract under Article 45 of CISG, but the right to terminate the contract and reject the goods is limited. The buyer may reject goods and require delivery of substitute





goods if the contract has been “fundamentally breached.” Under Article 46(2) of CISG, a breach is fundamental “if it results in such detriment to the other party as substantially to deprive him of what he is entitled to expect under the contract.” Under Article 48(1), however, CISG allows the seller who fails to perform on time, or who delivers nonconforming goods, to correct the performance as long as it does not cause the buyer an unreasonable delay or inconvenience. In addition, the buyer can also avoid the contract if, after demanding that the seller perform the contract within a reasonable time, the seller refuses to do so. See Article 49(b). In contrast, § 2-601 of the UCC provides that a buyer has the right to terminate when the seller has breached a “condition” of the sale, no matter how minor or insignificant.

Under § 2-204(3) of the UCC, a contract will not fail for indefiniteness even if one or more terms are not included, so long as “the parties have intended to make a contract and there is a reasonably certain basis for giving an appropriate remedy.” In contrast, Article 14 of CISG provides that a definite offer is one that “indicates the goods and expressly or implicitly fixes or makes provision for determining the quantity and the price.” CISG does, however, provide some flexibility where the parties have a valid contract that does not fix a price. Under such circumstances, the parties are considered “to have impliedly made reference to the price generally charged at the time of the conclusion of the contract for such goods sold under comparable circumstances in the trade concerned.”

Under both the UCC and CISG, a buyer must give notice of a breach within a reasonable time, but CISG provides an outer time limit on when notice must be given. Under Article 39(2), the buyer will lose “the right to rely on a lack of conformity of the goods if he does not give the seller notice thereof within a period of two years from the date on which the goods were actually handed over to the buyer,” absent any contractual agreement to the contrary.

Relevant Limitation Period

Statutes of limitation can be determinative in many art litigations, especially in the Holocaust-era and cultural property contexts. Thus, it is important to understand the applicable limitation period for transactions governed by CISG. This issue is covered by a separate treaty: the U.N. Convention on the Limitation Period in the International Sale of Goods (“LPISG”).⁶ Of the 77 nations that are parties to CISG, 28 nations, including the United States, are also parties to LPISG. Like CISG, LPISG applies to contracts for the sale of goods between contracting parties whose places of business are in different signatory nations. LPISG sets the limitation period within which parties must assert claims regarding such contracts. LPISG does not apply to purely United States domestic transactions; sales of goods bought for personal, family, or household use; or sales by auctions. See LPISG, Article 4.

Under § 2-725 of the UCC, the statute of limitations for “an action for breach of any contract for sale” is four years from the date the cause of action accrues. The limitation period under Article 8 of LPISG is also four years. As provided in Article 10 of LPISG, a claim for breach of contract accrues “on the date on which such breach occurs.” Likewise, for claims arising from a defect or lack of conformity, accrual is “on the date on which the goods are actually handed over to, or their tender is refused by, the buyer.” But, for claims of fraud, accrual is “on the date on which the fraud was or reasonably could have been discovered.” Unlike LPISG, the UCC does not have a separate provision regarding the statute of limitations for fraud.

Pursuant to Articles 13 to 21 of LPISG, the limitation period may be tolled or extended under certain circumstances, including during bankruptcy or liquidation proceedings, by written acknowledgment of the obligation of the debtor to the creditor, or by payment of the interest or partial performance. Article 23, however, limits the total limitation period to 10 years from the date the claim accrued.



Conclusion

There are many significant differences between the UCC and CISG that could have far-reaching consequences for art market participants based in the United States. Unless both parties to a transaction expressly agree that CISG and LPISG will not apply, CISG and LPISG will be the governing law for all commercial contracts for the sale of goods, including art, between parties having their places of business in different countries that have adopted CISG and LPISG. To avoid application of CISG and LPISG, both of which are treaties and therefore the law throughout the United States, a specific disclaimer must be included in the contract. Parties should consult with a legal professional regarding the language of such a disclaimer.

- 1 United Nations Convention on Contracts for the International Sale of Goods, Apr. 11, 1980, S. Treaty Doc. No. 98-9 (1983) (entered into force on Jan. 1, 1988), available at 15 U.S.C.A. App. at 49 (West Supp. 1996), 52 Fed. Reg. 6262-80, 7737 (1987).
- 2 [Parties not listed], Oberster Gerichtshof (Austria, 1997). Abstract available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=283&step=Abstract>.
- 3 *Kunsthaus Math. Lempertz OHG v. Wilhemina van der Geld*, Arrondissementsrechtbank Arnhem (Netherlands, 1997). Abstract available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=355&step=Abstract>.
- 4 [Parties not listed], Bundesgerichtshof (Germany, 2006). Abstract available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=1098&step=Abstract>.
- 5 [Parties not listed], Oberlandesgericht München (Germany, 2008). Abstract available at <http://www.unilex.info/case.cfm?pid=1&do=case&id=1342&step=Abstract>.
- 6 United Nations Convention on the Limitation Period in the International Sale of Goods, June 14, 1974, and Protocol amending the Convention on the Limitation Period in the International Sale of Goods, Apr. 11, 1980, S. Treaty Doc. No. 103-10 (1993) (entered into force on Dec. 1, 1994), – http://www.uncitral.org/pdf/english/texts/sales/limit/limit_conv_E_Ebook.pdf.

On June 27, 2012, Herrick, Feinstein’s client, the Royal Library of Sweden, announced that, with the assistance of the United States Government and Herrick, it recovered a 415-year-old atlas that had been stolen along with dozens of other rare volumes 10 years ago. Created by Cornelius van Wytfliet and known as the “Wytfliet Atlas,” the book had been part of the Royal Library collection for more than 300 years prior to its theft. The Wytfliet Atlas is the first printed atlas solely devoted to depicting maps of North America and South America. It contains 19 rare maps, including the first printed map of California. The successful return of the atlas is the result of an ongoing investigation and recovery effort launched by the Royal Library in cooperation with U.S. officials, and with Herrick’s assistance, in hopes of locating all of the stolen books. The story behind the atlas’s recovery was reported on the front page of the Arts section of the *New York Times*, and is available at http://www.nytimes.com/2012/06/27/books/swedish-royal-library-recovers-stolen-1597-atlas-in-new-york.html?_r=1. For a complete list of the stolen books, as well as images of several pages from the Wytfliet Atlas, please visit www.wytflietatlas.com.





New York: 212.592.1400 | Newark: 973.274.2000 | Princeton: 609.452.3800 | www.herrick.com

Art Law Events

Events Involving Herrick's Art Law Group

October 4, 2012

Stephen Brodie moderated a panel discussion sponsored by the Art Investment Council entitled "Is the Art Market in a Bubble?," held at Herrick's New York office.

October 28, 2012

Larry Kaye spoke at the Tel Aviv Museum of Art in Israel on "Restitution of Nazi Looted Art: Ongoing Challenges."

November 1-3, 2012

Howard Spiegler, President of the Art Law Commission of the Union Internationale des Advocats (UIA), moderated a program at the 56th Annual UIA Congress in Dresden, Germany, entitled "Art as an Asset: What Your Clients Need to Know About Collecting, Transacting and Investing in Art." Larry Kaye and Stephen Brodie both made presentations at the program.

November 11, 2012

Stephen Brodie spoke on a panel entitled "Art Financing and the Appraiser" at the American Appraisers Association's Annual National Conference at the New York Athletic Club.

November 14, 2012

Darlene Fairman spoke on a panel at the Rutgers School of Law at a program entitled "Unspoken Trade: Stolen Art in America."

November 16, 2012

Darlene Fairman spoke on a panel entitled "The Law of Antiquities" at the New York County Lawyer's Association's Fifth Annual Art Litigation and Dispute Resolution Practice Institute.

November 27, 2012

Larry Kaye spoke on a panel at an international symposium sponsored by the Dutch Restitutions Committee at the Palace in The Hague, Netherlands, entitled "Fair and just solutions? Alternatives to litigations in Nazi looted art disputes: status quo and new developments."

November 29, 2012

Darlene Fairman and Michelle Bergeron Spell spoke on a panel entitled "The Next Generation Philanthropy Community: Art, Law & the Lessons of the Holocaust," which was co-sponsored by Herrick and the Anti-Defamation League and held at Herrick's New York office.

December 3, 2012

Frank Lord was a panelist at the Harvard Business School Club of New York's Art Investment Roundtable held at Herrick's New York office.

December 3, 2012

Howard Spiegler, Mari-Claudia Jiménez, Larry Kaye, and Stephen Brodie all spoke at "Beyond Frida: Major Issues Facing the International Art Market in Latin America and Beyond," presented by the UIA in Mexico City, Mexico, and co-sponsored by Herrick, Christie's, and ARIS.

December 6, 2012

Stephen Brodie spoke at an event held by the Royal Bank of Canada in Miami, where he offered an overview of the kinds of loans that are available to collectors, where art is used as collateral.

December 11, 2012

Howard Spiegler was the featured speaker at a program about the "Portrait of Wally" case at the Jewish Community Center in Harrisburg, Pennsylvania, presented by the Cardozo Society of the Jewish Federation of Greater Harrisburg and the Linda Schwab Education Fund of the Jewish Community Foundation of Central Pennsylvania.

For questions about
Art & Advocacy,
please contact the
Editor-in-Chief:

Darlene Fairman
dfairman@herrick.com
212.592.1436

For questions about
upcoming events and
other art law matters,
please contact:

Lawrence Kaye
lkaye@herrick.com
212.592.1410

Howard Spiegler
hspiegler@herrick.com
212.592.1444

Additional information on
Herrick's Art Law Group,
including biographical
information, news, and
articles, can be found at
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