

What's Next For The Detroit Institute Of Arts?



Law360, New York (April 24, 2014, 2:17 PM ET) -- One of the highest-profile aspects of the city of Detroit's Chapter 9 case[1] has been the intense discussion of the fate of the Detroit Institute of Arts, which is almost unique among U.S. art museums in that its building and collection are owned by the city itself rather than by a charitable not-for-profit entity. City ownership is what has put the DIA's collection "in play," as the city's creditors look to the DIA's rich collection as a potential source of repayment of the city's debts.

The DIA is generally regarded as one of the country's finest encyclopedic art museums. Its holdings include:

- (1) Pieter Bruegel the Elder's "The Wedding Dance";
- (2) Vincent Van Gogh's "Self Portrait with Straw Hat";
- (3) Rembrandt van Rijn's "The Visitation";
- (4) Henri Matisse's "The Window";
- (5) Edgar Degas' "Dancers in the Green Room";
- (6) Claude Monet's "Gladioli";
- (7) Michelangelo's "Scheme for the Decoration of the Ceiling of the Sistine Chapel";
- (8) Neri Di Bicci's "The Palla Alterpiece: Tobias and Three Archangels";
- (9) Giovanni Bellini and Workshop, "Madonna and Child";
- (10) Frans Hals' "Portrait of Hendrik Swalmius"; and

(11) Michiel Sweerts' "In the Studio".

Much of the early debate over the DIA played out in terms of “art versus pensions.” In that discourse, the DIA and its collection could be preserved (to the detriment of the city’s pensioners’ welfare) or the art could be sold (or leased or used as collateral for a city loan) and the proceeds could support pension needs. However, with the emergence and elaboration of what has come to be called the “Grand Bargain,” the dynamic of this public conversation has shifted.

In the city’s plan of adjustment,[2] the Grand Bargain is presented as a means of preserving the DIA and its collection for the public benefit while also raising funds to help shore up the city’s pension system (and to reduce the cuts that the system will suffer). But the Grand Bargain is not yet concluded, and the question of the DIA’s fate increasingly lies in a dispute over the value of the DIA’s art (and how — in fact, whether and to what extent — that value may be unlocked).

In a municipal bankruptcy case, creditors have a circumscribed role. In Chapter 9, creditors cannot propose a competing plan, they cannot convert the debtor’s case, they cannot have a trustee appointed, and, significantly where discussions involving the DIA are concerned, they cannot force the sale of municipal assets.

Unlike Chapter 11, in which creditors can object under Section 1129(a)(7) on grounds that they are receiving less than what they would receive in a hypothetical liquidation, Chapter 9 has a less stringent best interest of creditors standard in Section 943(b)(7), which does not necessarily require the municipality to devote all available resources to payment of claims (although the creditors essentially argue otherwise). Where creditors do have bargaining power is in their ability to attempt to influence public discussion and in their right to vote on confirmation of the city’s plan.

A Chapter 9 debtor restructures its debts by proposing and confirming a plan of adjustment. Importantly, that plan allows the debtor to nonconsensually modify its contractual obligations.[3] So, while a creditor cannot force the city to sell any DIA artworks, it can raise concerns about how those assets are valued, and it can vote against the city’s proposed plan of adjustment.

The valuation and plan treatment of the DIA’s collection are sharp points of contention between the city and some of its creditors, and the differences in their views on both valuation methodology and disposition have come into focus, with the creditors suggesting the art may be worth as much as \$2.5 billion. The city wants to move forward with the Grand Bargain. The city’s creditors, however, look askance at the Grand Bargain, believing it leaves value on the table.

In discussions of the DIA’s fate, three distinct approaches have emerged. First, in an opinion issued a few months prior to the city’s Chapter 9 filing,[4] Michigan Attorney General Bill Schuette concluded that the DIA and its collection are held in a charitable trust for the citizens of the city of Detroit and the state of Michigan, and no part of the DIA or its collection can be sold or otherwise monetized to pay the city’s creditors.

Second, the city has advanced the position that only that portion of the DIA's collection acquired with city funds and free of donative and charitable restrictions can be considered for purposes of valuation. Roughly 5 percent of the DIA's total collection meets this criterion. The city retained Christie's to appraise this city-purchased portion of the DIA collection (which resulted in a valuation range of between \$454 million and \$867 million).[5]

The Christie's appraisal forms the basis for the Grand Bargain (which proposes payment to the city of \$816 million over time by a group of 12 regional and national foundations, DIA donors and the state of Michigan on the condition that the DIA's assets are conveyed to a separate charitable not-for-profit corporation).[6]

Third, a group of the city's creditors are insisting that no donor or charitable restrictions should be considered, and instead assert that all items in the DIA's collection are available to be monetized to satisfy the city's debts and must be included in any valuation. These creditors retained a financial adviser to solicit nonbinding expressions of interest from parties to either purchase all or part of the DIA's collection or advance the city a loan secured by the DIA's collection (with a value of up to \$2 billion).[7] Below, I consider the strengths and weaknesses of each approach and identify the issues that must be resolved to bring this matter to conclusion.

(1) The Attorney General Opinion

In his June 13, 2013, opinion, the attorney general reviewed the legal history of the DIA, concluding that the DIA's collection cannot be "sold, conveyed or transferred to satisfy the city's debts or obligations." That conclusion derives in large measure from the nature of the DIA's predecessor, the Detroit Museum of Art (the "museum"), which was founded in 1885 as a private, not-for-profit charitable corporation dedicated to the acquisition and display of works of art.

While it was not wholly dependent upon public funding, the museum received appropriations of public funds. That public funding was challenged, and the Michigan Supreme Court held that such appropriations violated the state Constitution's restrictions on the lending of credit by a municipality to an entity that was not a municipal agency.[8]

In response, the Michigan Legislature amended the not-for-profit corporations statute under which the museums had been formed[9] to allow such private not-for-profit cultural or educational corporations to convey their property to the state or its municipalities.[10] The amended statute provided that "said property so conveyed shall ... be faithfully used for the purposes for which such corporation was organized."[11]

In 1919, the museum conveyed its buildings and collection to the city, forming the core of the DIA. The museum's not-for-profit corporation, renamed the Founders Society, then took on a secondary, supporting role for the DIA.

The attorney general opinion reasons that when the city agreed to receive the museum's collection, the city agreed, under the authorizing statute, to be bound by the museum's charitable purpose. The attorney general opinion, however, goes farther, arguing that the city assumed the museum's charitable purpose more broadly, and that such assumed charitable purpose attaches to all subsequent acquisitions. This would mean that all DIA acquisitions after 1919, regardless of source or donor intent, would be subsumed within the DIA's general charitable purpose.

That this should inevitably be the result, however, is not clear under either Michigan charitable trust law or the Bankruptcy Code. The existence and nature of a Chapter 9 debtor's interest in property is determined by nonbankruptcy law (generally, state law).

Under Michigan law, "a charitable trust may be created by (a) declaration by the owner of property that he holds it upon a charitable trust; or (b) a transfer inter vivos by the owner of property to another person to hold it upon a charitable trust." [12] Express trusts are created through "an explicit declaration of trust, or circumstances [that] show beyond reasonable doubt that a trust was intended to be created."

No particular words or forms are required to create a charitable trust, rather "[i]t is sufficient if [the settlor] shows an intention that the property should be held subject to a legal obligation to devote it to purposes which are charitable." [13]

In fact, some courts (including in the context of a bankruptcy case) have found that a charitable trust may arise even where the "the purported trust property was not donated by one settlor at one time, but rather is the accumulation of numerous donations over a period" of time, provided that the circumstances of the solicitation of those donations clearly evidences the donors' intentions that the donations be used for specific charitable uses. [14]

The bankruptcy court will need to determine whether the language and circumstances of the 1919 conveyance from the museum to the city and/or subsequent donations of funds and/or artwork to the DIA evince sufficient intent on the part of the relevant donors and the city for a charitable trust to exist. This will be a fact-intensive determination, and the bankruptcy court may reach different conclusions with regard to distinct classes of conveyances and donations.

(2) The Grand Bargain

In anticipation of its Chapter 9 filing, the city engaged Christie's to prepare an appraisal of that portion of the DIA's collection acquired with city funds — which is 2,773 works (approximately 5 percent of the DIA's total holdings). Christie's delivered its final appraisal to the city in December 2013, placing a value range on those 2,773 works of between \$454 million and \$867 million. The Christie's appraisal notes that the 11 works identified earlier in this article comprise 75 percent of the total appraised value of the city-owned portion of the DIA collection.

The Christie's appraisal has provided the financial terms for the Grand Bargain. Under the city's plan, a

group of 12 foundations (including the Ford Foundation and the Kresge Foundation) would provide at least \$366 million, the DIA and certain DIA funders would contribute at least \$100 million, and the state of Michigan would provide up to \$350 million.[15] These amounts would be funded over a 20-year period.

In return, on the plan's effective date, the DIA's collection and building would be conveyed to the DIA (a Michigan not-for-profit corporation) "to be held in perpetual charitable trust for the benefit of the people of the city and the state, including the citizens of the tricounties, permanently free and clear of all liens, encumbrances, claims and interests of the city and its creditors." [16] The funds provided to the city will be committed to supporting the city's pension obligations.

(3) The Creditors' Proposal

On April 9, 2014, a group of the city's creditors asked the bankruptcy court to direct the city to cooperate in the due diligence needs of certain parties from whom the creditors solicited expressions of interest in the DIA collection. In an earlier form, the creditors has asked the bankruptcy court to direct the city to form an art advisory committee that would have included the creditors in determining how the DIA collection should be valued and monetized.[17]

In January, the bankruptcy court denied that motion. At oral argument, Judge Steven Rhodes stated that the bankruptcy court has not yet ruled on the arguments put forward in the attorney general opinion and reserved judgment on their merits.

In the intervening months, the creditors independently engaged their financial adviser to compile a catalog (the "creditors' catalog") of 327 DIA artworks (the "masterworks") not included in the Christie's appraisal. Using the creditors' catalog as its prospectus, the financial adviser solicited offers from parties believed to have an interest in the DIA collection in order to facilitate "the development of indications of interest for the purpose of ultimately proposing transactions to the city that would generate more value than the transaction contemplated by the plan." [18]

The creditors received four nonbinding proposals, including (a) three offers to purchase all or part of the DIA collection for up to \$1.75 billion (one offer was to purchase the entire collection, another was to purchase only the DIA's Chinese artworks, and the third was to purchase 116 selected artworks), and (b) an offer from a specialty art lender to provide the city with a loan of up to \$2 billion, secured by all of the DIA's collection.

The creditors' catalog provides an opportunity to take a more nuanced look at what restrictions may apply and how they may (or may not) have arisen. Examining only the acquisition information included in the creditors' catalog, four classes of potential transfer restrictions can be identified:

(1) works acquired prior to 1919 (55 works);

(2) works given by Robert H. Tannahill (a prominent DIA donor who prohibited deaccessioning as a

condition of his gift) (32 works);

(3) works acquired by the DIA using funds from the Robert H Tannahill Foundation Fund (the DIA's charitable planned giving program, named in honor of Robert H. Tannahill) (15 works); and

(4) works acquired by the Founders Society for the DIA using funds raised by the Founders Society (111 works).

Of the 327 masterworks included in the creditors' catalog, 213 are potentially subject to restrictions. The creditors have served the DIA and the city with discovery requests, seeking detailed acquisition information and documents.

The Way Forward

As we move into the final stages of the debate over the DIA's fate, the questions that will need to be answered have become clearer. Did the museum, established as a charitable corporation, hold its collection in a charitable trust? If so, when the city accepted the museum's collection in 1919, did it also assume the museum's role as fiduciary of that charitable trust or was that role terminated at the time of the conveyance? If the fiduciary role was not terminated, did it continue only as to the corpus of the museum's collection or is it a continuing role, attaching to subsequent acquisitions?

Are a donor's restrictions concerning the disposition of artworks binding upon a municipal donee and enforceable in bankruptcy? Are a donor's restrictions on donated funds binding and enforceable? If so, are they also binding and enforceable when they are aggregated among many donors and over perhaps long periods of time, as in an institutional charitable or planned giving program? How definite and specific must a donor's intent be, and how must it manifested?

It is likely that in the coming months, we will have a better understanding of at least some of these questions.

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[1] In re City of Detroit, No. 13-53846 (Bankr. E.D. Mich., filed July 18, 2013).

[2] Plan for the Adjustment of Debts of the City of Detroit, filed Feb. 21, 2014 [Docket No. 2708], amended by Amended Plan for the Adjustment of Debts of the City of Detroit, filed March 31, 2014 [Docket No. 3380](including a Term Sheet for the DIA Settlement as Exhibit I.A.79) (as amended, the

“Plan”).

[3] *In re Jefferson Cty.*, 465 B.R. 243, 293 n.21 (Bankr. N.D. Ala. 2012).

[4] Conveyance or transfer of Detroit Institute of Arts collection, Mich. Att’y Gen. Op. No. 7272 (June 13, 2013) (“attorney general opinion”).

[5] Christie’s Appraisals Inc., Fair Market Value for Financial Planning, Dec. 17, 2013 (“Christie’s appraisal”).

[6] Plan, Exhibit I.A.79.

[7] Corrected Motion of Creditors for Entry of an Order Pursuant to Section 105(a) of the Bankruptcy Code Directing Debtor to Cooperate with Interested Parties Seeking to Conduct Due Diligence on the Art Collection Housed at the Detroit Institute of Arts, filed April 9, 2014 [Docket No. 3925] (the “Creditors’ Motion”).

[8] *Detroit Museum of Art v. Engel*, 153 N.W. 700, 703 (Mich. 1915).

[9] 1885 PA 3, as amended by 1913 PA 245 (the statute authorizing the formation of “corporations for the cultivation of art”).

[10] 1919 PA 67.

[11] *Id.* at Section 20.

[12] *Scarney v Clarke*, 282 Mich. 56, 63 (Mich. 1937)(quoting 2 Restatement of the Law of Trusts, p. 1096, § 349).

[13] *Nash v. Duncan Park Commission*, Case Nos., 10-002119-NO, 12-002801-NO, 2014 WL 1097444, *8 (Mich. Ct. App. Mar. 20, 2014)(quoting *Knights of Equity Mem. Scholarship Comm. V. Univ. of Detroit*, 359 Mich. 235 (1960)).

[14] *Hunter v. St. Vincent Medical Center (In re Parkview Hospital)*, 211 B.R. 619, 632 (Bankr. N.D. Ohio 1997); *Salisbury v. Ameritrust Texas, N.A. (In re Bishop College)*, 151 B.R. 394, (Bankr. N.D. Tex. 1993)(denying bankruptcy trustee’s request to apply charitable trust monies to satisfy dissolved college’s creditors where “the trusts require trust income to benefit educational purposes.”); *In re Friends for Long Island’s Heritage*, 911 N.Y.S.2d 412, 420(N.Y. App. Div. 2010)(in dissolution of not-for-profit museum, stating that “New York’s long-standing policy honoring donors’ restrictions on the use of the property they donate has greater weight than the claims of creditors. To hold otherwise would be to sanction a gap in the protection of the donors’ expressed limitations.”). But see *In re Crossroads Health Ministry Inc.*, 319 B.R. 778, 782 (Bankr. D.D.C. 2005)(holding that, under District of Columbia law, “funds subject to a charitable use limitation are considered assets of the estate, and are not funds held in trust,

to the extent necessary to satisfy claims against the estate.”).

[15] In the Creditors' Motion, the creditors note assert that since the Grand Bargain amounts would be paid over a 20-year period, “the net present value of each contribution (using a 5 percent discount rate) is: (i) \$233.7 million from the foundations, (ii) \$63.8 million from DIA Corp., and (iii) \$223.5 million from the state, for a total of approximately \$521 million.” Creditor Motion at para. 13.

[16] Plan, Exhibit I.A.79.

[17] Motion of Creditors for Entry of an Order Pursuant to Section 105(a) of the Bankruptcy Code Appointing and Directing the Debtor to Cooperate with a Committee of Creditors and Interested Persons to Assess the Art Collection of the Detroit Institute of Arts Based on Arms-Length Market Transactions to Establish a Benchmark Valuation, para. 3 [Docket No. 1833].

[18] Creditors' Motion at n. 8.