

## Rare Window Onto Artwork Valuation Issues In Insolvency

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In the city of Detroit's Chapter 9 bankruptcy case, the future of the Detroit Institute of Arts has been a key point of contention between the city and several of its bondholders for many months. Almost unique among American art museums, the DIA's collection is owned directly by the city, and the preliminary question has been whether the DIA's collection can be sold or otherwise monetized to pay down the city's debts.

On this point, there is, as yet, no agreement, and the question has not yet been placed directly before the bankruptcy court. There are three distinct positions — (1) Michigan's attorney general has stated that the entire DIA collection is held in a public trust and cannot be used to pay the city's debts; (2) the city has stated that only those artworks that were purchased with the city's own funds ("COD works") may be monetized to pay the city's debts, which position is embodied in the proposal that has come to be called the "Grand Bargain" and is incorporated into the city's plan of adjustment ("plan"); and (3) certain of the city's creditors have stated that the entire DIA collection must be considered available to be monetized.[1]



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In recent weeks, with the confirmation hearing on the plan scheduled to commence on Aug. 21, the discussion has shifted to (a) how the collection should be valued and (b) what effect a distressed sale may have on that value. In December, at the city's request, the auction house Christie's issued an appraisal of the COD works (2,773 objects, roughly 5 percent of the collection), placing the value at between \$454 million and \$867 million.[2]

In response to objections raised by creditors, the city engaged Artvest Partners LLC to appraise the entire DIA collection. On July 8, Artvest delivered its expert witness report,[3] which places the value of the DIA collection within a range, from a low estimate of \$2,760,978,432 to a high estimate of \$4,607,953,704, with a mid estimate of \$3,684,466,069.[4] These figures, the report states, do not include deductions for works that are "ultimately determined not to be subject to sale" or "discount factors related to general market conditions or issues specific to the DIA collection." [5]

Artvest estimates that, after accounting for such factors, the value of the DIA collection would be between \$1.1 billion (in an orderly liquidation after some delay from litigation over sale restrictions) and

\$1.8 billion (in an orderly sale process without litigation delay).[6] It is important to note that even Artvest's lowest valuation still assumes that all artworks in the DIA collection are ultimately determined to be available to be sold. The Artvest report opines that "liquidating the DIA collection in a timely manner is unlikely, given the multiple levels of legal challenges as well as the financial risks and uncertain auction outcomes." [7]

Following the release of the Artvest report, one of the objecting creditors, Financial Guaranty Insurance Corp., engaged Victor Wiener Associates (VWA) to appraise the DIA's collection.[8] The VWA report is not yet publicly available; however, news accounts indicate that it values the DIA collection at \$8.5 billion, nearly double Artvest's high estimate, and proposes that the collection be used as collateral for a loan to the city.[9] The Detroit News, which obtained a copy of the VWA report, has reported that it "characterized the Artvest assessment, which took into consideration a number of factors it argued would reduce sales prices, as unduly pessimistic." [10]

### **A Window onto the Valuation of Artworks in Distressed Situations**

Importantly, the Artvest report, the VWA report, and the expert testimony that will be offered at the confirmation hearing provide a rare window onto the issues that impact the value of artworks in distressed situations. In the art market, high auction prices for individual artworks garner headlines and public attention, but the nuances of valuation remain behind the scenes.

Particularly in distressed situations, the valuation of artworks is influenced by the following factors: (1) sharp disparities between art market sectors, which reflect the uncertainties of trends and changing tastes, (2) the timing of sales, (3) the impact on value and salability when a work fails to sell at auction, (4) the participation of market leaders (private and institutional), and (5) the risk of litigation clouding title to works.

#### ***(1) Art Market Sectors***

Tastes change, in art as in everything. Analyses of art market sales (particularly auction sales) show year-on-year and multiyear trends, but also reveal stark disparities between prices paid for different types of art, with the headline-grabbing high values being concentrated in a narrow band of the market. As Artvest notes, "[v]alue in the art market, in museum and private collections, as well as in annual turnover in fine and decorative art sales, is concentrated in small number of rare, high-quality items. ... Works sold for over \$14 million account for 43.8% of the value but only 0.42% of market volume." [11]

Art market analysts divide the market into sectors, generally by period, sometimes additionally by nationality or medium (i.e., impressionist and post-impressionist; pre-war American painting). However, how sectors are defined can vary greatly from analyst to analyst.[12]

The Artvest report divides the DIA collection into 12 sectors: (1) European painting (28 percent); (2) European modern art to 1950 (24 percent); (3) contemporary art after 1950 (16 percent); (4) American art before 1950 (15 percent); (5) European sculpture and decorative arts (4 percent); (6) ancient near Eastern art (4 percent); (7) Asian art (3 percent); (8) Africa, Oceania and indigenous Americas (3 percent); (9) prints, drawings and photographs (2 percent); (10) Greco-Roman and ancient European (1 percent); (11) African-American art (less than 1 percent); and (12) Islamic art (less than 1 percent).[13]

In Artvest's analysis, 98 percent of the value of the DIA collection lies in just four sectors — European modern art, impressionist and post-impressionist art, European old master paintings, and post-war and

contemporary Art.[14] However, while post-war and contemporary art has been the highest-performing art market sector over the last decade, the other sectors have languished.[15] Even within that high-performing sector the highest value lay in the works of only a few artists (i.e., Francis Bacon, Roy Lichtenstein, Andy Warhol, Jean-Michel Basquiat, Gerhard Richter, Zeng Fanzhi).[16] European modern art, impressionist and post-impressionist art, European old master paintings “have declined in value since 2011.”[17]

## ***(2) The Timing of Sales***

Distressed sales rarely have the luxury of time. With artworks, an accelerated sale schedule can have several negative effects on the value realized for the works. The Artvest report identifies two categories of discounts that may be applicable — (1) an “immediate liquidation” discount, and (2) a “blockage” discount.

In an immediate liquidation, appraisers and art lenders apply a 50 percent discount to the value of artworks, reflecting industry experience that an artwork “will bring 50% of its low auction estimate in an immediate liquidation scenario.”[18] The discount may be even greater where value is lost “due to sloppy due diligence and cataloguing and property that is not saleable in a short time period.”[19] A “blockage” discount arises where a large group of similar artworks are brought onto the market in a limited period of time, thereby depressing the market.[20]

The effect of an accelerated sale of artworks, as with many other types of assets, is that the seller realizes only a fraction of the artworks’ value, while passing along the “ultimate value to third parties who [are] capable of providing a large block of capital for the art on relatively short notice and selling the objects in a less urgent, strategic fashion over a multiyear time frame.”[21] Artvest recommends that to minimize the effects of immediate liquidation and blockage discounts, any sale of the DIA collection would require a minimum of five to eight years.[22]

## ***(3) Unsold Rates and the Risk of Failure to Sell at Auction***

Art market analysts track not only sales, but also the rates at which artworks brought to auction fail to sell. When a work goes unsold at auction, the trade regards it as “burned,” and its value is generally discounted by at least 20 percent. Even with such a discount, an unsold work “is considered essentially unsellable for a period of three to five years after it first appeared at auction, if even then.”[23] The sectors reflected in the DIA collection had unsold rates of between 20 percent and 25 percent during 2013.[24]

## ***(4) The Participation of Market Leaders***

The forced sale of the DIA collection, in whole or in part, would be controversial, particularly within the museum profession. A museum’s selling (“deaccessioning”) of artworks for any purpose other than the acquisition of other artworks is strongly disfavored. Both the American Association of Museum Directors and the American Alliance of Museums have promulgated ethical guidelines prohibiting the use of proceeds from deaccessioned artworks for nonacquisition uses, and sanction museums that deviate from this policy.

This position is embodied in the DIA’s Collections Management Policy, which states that “[n]et proceeds derived from the sale of a deaccessioned object ... shall not be used as operating funds. Such net proceeds shall ... be used only for the replenishment of the art collection.”[25] Artvest believes that in a

sale of the DIA collection, few if any American museums will participate, chiefly because of these ethical rules concerning deaccessioning.[26]

### ***(5) The Risk of Litigation Clouding Title to Works***

The uncertainty surrounding possible restrictions on the salability of the DIA collection is a further consideration impacting value. Before an auction house will accept a work for sale, the consignor must have clear title to the work and the ability to convey clear title to a third party. An auction will not be able to go forward if either the seller's title or ability to convey the work is uncertain. "This is a standard provision of any auction house consignment contract," Artvest notes, "and thus property with the prospect of pending or future litigation clouding title will not be acceptable for sale until such issues are cleared in the courts." [27]

Objections to a proposed sale will likely be raised by the Michigan attorney general, who has stated that the DIA collection is held in public trust, and also by "[h]eirs of former donors as well as current donors ... and the DIA corporation itself, [who] are likely to pursue every legal option necessary to stop or delay the sale of any of the art, potentially leading to years of litigation." [28]

### **Conclusion**

Artworks and the art market have distinct qualities and practices. In a distressed sale of artworks, procedures must be informed by these art market practices in order to maximize value. The competing expert witness reports and expert testimony concerning treatment of the DIA collection offer a unique opportunity to better understand the needs of such sales.

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[1] I have previously discussed in this space the background to these issues, and the specific issues the bankruptcy court will need to address in order to determine whether the DIA's collection, in whole or in part, is held in public trust or otherwise restricted and unavailable to be monetized. For a more in-depth analysis, see Kevin P. Ray, "What Next For The Detroit Institute of Arts?" Law360, April 24, 2014.

[2] Christie's Appraisals Inc. Fair Market Value for Financial Planning, Dec. 17, 2013 ("Christie's Appraisal")

[3] Expert Witness Report of Michael Plummer, July 8, 2014 ("Artvest Report").

[4] Id. at 19.

[5] Id.

[6] Id. at 48.

[7] Id.

[8] "Report for Detroit creditor nearly doubles value of DIA collection at \$8.5B," The Detroit News, July 27, 2014, available at <http://www.detroitnews.com/article/20140727/METRO01/307270008>.

[9] Id.

[10] Id.

[11] Artvest Report, at 6.

[12] Clare McAndrew, TEFAF Art Market Report 2014, 44 (2014).

[13] Artvest Report, at 23. The percentages reflect the relative value of the sectors within the DIA collection.

[14] Id. at 7.

[15] TEFAF Art Market Report 2014, at 47.

[16] Id.

[17] Artvest Report, at 7.

[18] Id. at 27.

[19] Id.

[20] Id.

[21] Id. at 26.

[22] Id. at 31.

[23] Id. at 28.

[24] Id.

[25] The Detroit Institute of Arts Collections Management Policy, November 16, 2005, available at <http://usmuseumsurvey.claimscon.org/PDF/1326-58.pdf>.

[26] Artvest Report, at 25.

[27] Id. at 39.

[28] Id.