

## THE ART OF DISTRESS - CULTURAL PROPERTY IN WORKOUTS AND INSOLVENCIES

BY KEVIN P. RAY

The last decade has seen an increasing number of insolvencies involving art and other cultural property. The debtors in these cases are private collectors (Marc Dreier, Ralph Esmerian), art galleries (Salander O'Reilly Galleries, Inc., Edenhurst Gallery, Berry-Hill Gallery), and public or institutional collectors (City of Detroit (Detroit Institute of Arts)). While "art" is a familiar concept, "cultural property" is not. It developed as an umbrella term not only for artworks, but antiquities, books, manuscripts, scientific collections, collections of books or archives, monuments of architecture, groups of buildings, archeological sites, and ethnological and paleontological objects.

In a workout or insolvency situation, cultural property presents unique issues, including: (i) authenticity, (ii) title, (iii) security interests, consignment and entrustment, (iv) intellectual property, (v) charitable restrictions, and (vi) national and international restrictions. Below is a brief introduction to some of these issues.

- Authenticity is the defining feature of cultural property. Fakes and forgeries are a tremendous risk, as the recent cases of Wolfgang Beltracchi and the Knoedler Gallery have shown. It is important to distinguish an object's authenticity (which may include its attribution to a particular artist) from an appraisal of its value. While authenticity strongly impacts an object's value, authentication and appraisal are separate processes and distinct areas of expertise. Authentication typically combines three methods: provenance, connoisseurship, and materials analysis.

- "Provenance" is the history an object's ownership from its creation to the present day. For recent works, the chain of ownership may be clear. But for many older objects, documentation may be spotty. Gaps in an object's provenance raise doubts about the object's authenticity, but also title to the object.

- "Connoisseurship" is the informed opinion of experts. Issuing an expert opinion on a work's authenticity (or lack of authenticity) has become so fraught with legal risk that many experts and authentication boards have ceased issuing opinions. New York has introduced legislation to protect authentication experts, but it is still often impossible to obtain an expert opinion on the authenticity of a work.

- "Materials analysis" applies scientific methods to evaluate

an object's constituent materials. While materials analysis can provide important information, it cannot alone conclusively establish an object's authenticity.

- By contrast, an appraisal places a market value on the object, whether for purposes of insurance, tax, or sale.

- Title to cultural property often requires intricate analysis. The first step in evaluating whether a current possessor of an object has good title to that object is to conduct a thorough search of the object's documentary provenance. In the case of antiquities, this may also include when and from where the object was excavated and when it was removed from its country of origin. For all types of cultural property, special attention should be given to the provenance of objects that were present in continental Europe during the period 1939-1945, particularly if they changed hands or if there is a gap in provenance records. Many cultural objects during this period were confiscated by the Nazis, acquired in forced sales, or expropriated or pillaged by conquering troops or others during the war's upheaval.

- For stolen property, the difference between common law and civil law can be decisive. In common law countries (including the U.S.), a thief can never convey good title to a stolen object, even to a good faith purchaser. Therefore, if an object was stolen, it is irrelevant that the current possessor had no knowledge of the theft. The original possessor's legal right is superior (although the right to bring the claim may be limited by statutes of limitations or the doctrine of laches). Civil law countries, by contrast, typically allow a good-faith purchaser to acquire title to a stolen work after a period of possession.

- Security interests, consignments, and entrustment are common features of the art trade, and can give rise to difficult issues in workouts and insolvencies. Most objects sold through art dealers, galleries, and auction houses are consigned to them for sale. Often lenders to these art merchants will have blanket security interests in their assets, which extend to cultural property held as inventory. This poses a risk to the unwary consignor who fails to recognize that consignment can alter its rights. If the art merchant files for bankruptcy, the consignor's

ability to get the consigned work (or its proceeds) back from the gallery's bankruptcy estate may depend on whether it has filed a UCC-1 financing statement perfecting the consignment interest. Without a filed financing statement in the proper jurisdiction, the consignor's unperfected interest may be subordinate to the claims of the bankruptcy trustee or the debtor's creditors. Some states give greater protection to artists who consign their own works. These protections also extend to the artist's heirs and estate.

- Unlike most assets in a workout or insolvency, cultural property is frequently the subject of charitable gifts. Determining whether charitable gift restrictions are enforceable in bankruptcy can be difficult, requiring complex factual and analysis. A promised gift to a museum may be challenged or undone. Although Ralph Esmerian had executed a gift agreement in favor of the American Folk Art Museum and placed a portion of his collection on loan to the museum, secured creditors in his bankruptcy case objected to the gift and asserted claims to the works. The dispute was ultimately settled, with the museum retaining only some of the promised works and the remainder sold at auction. Indeed, the impact of bankruptcy and creditor claims on donor intent and charitable restrictions has been a key issue in the litigation over the Detroit Institute of Arts in Detroit's chapter 9 case. Where a debtor is a museum, professional ethics rules and policies prohibiting the deaccessioning (sale) of works from the collection for any purpose other than the acquisition of new works will present a further complication.

- Although intellectual property rights are common features of assets in workouts and insolvencies, cultural property often entails more elusive rights - including *droite morale* (artist's right to control a work's integrity, enacted in the U.S. as the Visual Artists Rights Act) and *droite de suite* (artist's right to receive a royalty on the resale of an artwork). The impact of these rights can be significant. Moral rights may prohibit alteration of a work without the artist's consent, which may arise with site-specific works (i.e., murals, installations, earthworks, or site-specific sculptures). These restrictions also may negatively impact the value of works. Although the U.S. does not currently recognize resale rights, federal legislation to provide for resale rights has been proposed.

- Export regulations may also be of concern, since many countries closely regulate the export of cultural property, requiring an export license before an object may be removed from the country. National institutions often have a preemptive right to match the purchase price and acquire the work. If an offer is

made and declined, export is refused. The owner may still own the work, but may not export it. For ancient and archaeological material, a number of countries have national ownership law under which such objects cannot be owned, transferred, or exported without authorization.

- Although the U.S. does not restrict export of cultural property, federal statutes do give the federal government title to archaeological and paleontological objects and sites located on federally owned and controlled lands (including tribal lands). Federal law also protects Native American human remains and associated burial items found on federally owned and controlled lands (including tribal lands).

- Under the 1970 UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property, a number of countries (including the U.S.) prohibit importation of designated objects. In the U.S., objects imported in violation of this law are subject to civil forfeiture. Additionally, however, under other federal statutes, the importation of stolen property may subject the importer to criminal penalties. For instance, objects subject to national ownership laws that are improperly exported from their source country may be deemed to be stolen property for purposes of the National Stolen Property Act. And not only importers are at risk. Persons receiving, possessing, or storing such stolen cultural property may also be subject to prosecution. This means that art merchants, collectors, and museums may have criminal liability if they receive, possess, or store cultural property that lacks proper export documentation.

- Objects that include protected endangered species (i.e., ivory, tortoise shell, coral, feathers) may be restricted under federal statutes or the Convention on International Trade in Endangered Species. Many statutes include an antiques exception for objects documented to be more than 100 years old.

- A distress sale of cultural property can negatively impact the value realized, including an immediate liquidation discount of as much as 50%, and a blockage discount if a large group of similar objects are brought onto the market in a limited period of time.

Cultural property is vast in scope and subject to complex regulation. When it is involved in a workout or insolvency, parties need to recognize that specialized due diligence and attention to infrequently-encountered issues will be required.

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