

A photograph of an art gallery with people viewing paintings. The background is a blue gradient with faint silhouettes of people. The title 'Art and Cultural Property' is written in large, bold letters. The word 'Art' is in yellow, and 'and Cultural Property' is in white. Below the title is a yellow sub-headline 'WHAT SECURED LENDERS NEED TO KNOW' and the author's name 'BY KEVIN P. RAY' in white. The main body of text is in white, discussing the art trade, auction prices, and the challenges of art-secured loans.

Art and Cultural Property

WHAT SECURED LENDERS NEED TO KNOW

BY KEVIN P. RAY

With a bustling art trade reaching, in many sectors, higher and higher auction prices, an increasing number of lenders are making art-secured loans. What was once a niche practice within finance is becoming more commonplace. However, art-secured loans present unique issues and risks, including authenticity, attribution, valuation, regulation of certain types of materials (i.e., ivory and other materials from endangered species), and questions of title (i.e., stolen art, Nazi-confiscated art, and illicitly excavated or exported objects). The international nature of many art transactions can even make perfecting a lender's security interest in art collateral challenging. Art-secured transactions often require specialized due diligence and procedures. This article offers lenders a brief introduction to the issues involved in art-secured loans and advises them on how best to protect their investment.

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Self-portrait as
an Artist

January 1889

Oil on canvas

Van Gogh painted this self-portrait shortly before he left Paris for Arles. He described it the following year in his letter to his sister Wilhelmine: "I wore green hair with green eyes, with prominent teeth, wrinkles on forehead and around the mouth, stiff, wooden, & very red beard; quite unattractive and red, but the lips are full & blue around the mouth." "You'll say that this is something like the way the face of a madman..." "But I believe in a higher truth..." "In my more sobering the Mad..." "I was more sobering the Mad..." "I was more sobering the Mad..."



With the dramatic increase in art auction prices, particularly for post-war and contemporary art, lenders are being asked to make more and larger loans secured by art and other cultural property.¹ However, as an asset class,² art and cultural property presents issues that lenders do not commonly encounter, and which require both particular knowledge to identify and specific forms of due diligence to address. Conceptually, “art” is a familiar category. We know what art and the art trade are. “Cultural property” though, is less familiar and requires a

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brief explanation.

The term “cultural property” developed from a need to recognize a broader body of objects, including art, but is not limited to art. It was first used in the 1954 Convention for the Protection of Cultural Property in the Event of Armed Conflict, and was expanded in the 1970 UNESCO Convention on the Means of Prohibiting and Preventing the Illicit Import, Export and Transfer of Ownership of Cultural Property, which identified cultural property as “property which, on religious or secular grounds, is . . . of importance for archaeology, prehistory, history, literature, art or science.” In term of types of objects, “cultural property” includes art, antiquities, books, manuscripts, scientific collections, collections of books or archives, monuments of architecture, groups of

buildings, archeological sites, and ethnological and paleontological objects. In this article, I use “art,” generically, to apply to art and cultural property. I use “cultural property” to refer to non-art cultural property.

What Is An Art-Secured Loan?

There are two types of art-secured loans: (1) “collector” loans and (2) “gallery” loans. A collector loan is made to a collector or investor (who may be an individual, a group of individuals, or a special-purpose entity) to enable that borrower to purchase new/additional art or to leverage currently owned art. The collector loan’s terms will vary, chiefly depending on the net worth of the collector. A further variable is the type of lender -- a private bank/private client lender, a boutique art lender,³ or a commercial asset-based lender.⁴ A gallery loan is a business loan to a gallery or other art merchant, which is secured by, among other things, the gallery’s inventory.

Underwriting

As with any secured loan, a lender’s underwriting for an art-secured loan requires an analysis of the loan risk, and an evaluation of the lender’s collateral position. In most collector loans, the collector will be able to select which objects will serve as collateral (in consultation with the lender), and the maximum amount of the loan will be a percentage (often up to 50%) of the collateral’s appraised value. In both collector loans and gallery loans, the art collateral will be augmented by guaranties. Art-secured loans will generally require that the collateral be re-appraised annually, and may provide for upward adjustments to the maximum principal loan amount if supported by increasing market values.

Perfection

As with any secured loan, perfection of the lender’s security interest is a key element, and this is one area in which art-secured loans require great

care. For art-secured loans made in the U.S. and where the art is located in the U.S., a lender has the options provided under Article 9 (“Article 9”) of the Uniform Commercial Code (the “UCC”). Under Article 9, art constitutes “goods,”⁵ particularly in collector loans. For gallery loans, art will instead usually be “inventory.”⁶

For a collector loan, a security interest in art may be perfected by either the lender taking possession of the art (usually, having the art moved to a secure, and climate-controlled art warehouse, pursuant to a tri-party agreement among the collector, the lender and the warehouse), or by filing a financing statement describing the art as collateral in the appropriate filing office. For a gallery loan, where the art is inventory, perfection by possession will rarely be feasible, and perfection by filing is the norm. In describing art collateral in a financing statement, the best practice is to itemize each artwork, and to promptly revise the financing statement whenever art is added to or removed from the collateral pool. Since financing statements are public documents, such itemization of artworks may raise concerns (security or other disclosure-related concerns) for some collectors. It is possible to address these concerns either by using a more generic collateral description (which presents risks for the lender, and is not advisable) or by the collector holding the art through a special-purpose entity, which is the identified debtor in the financing statement.

Perfecting a security interest in art held outside the U.S. is more challenging and variable. While under Article 9, the form of the transaction is irrelevant and the economic reality of the transaction is what governs;⁷ and, while it is also irrelevant whether title to the collateral is in the name of the debtor or the secured party,⁸ this is not true in many countries, which retain a more fragmented concept of “security interest.” In the U.K., for instance, a collector loan where the

art is owned by an individual can only be perfected by the lender taking possession of the art; but, if the art is owned by an entity, a lender's security interest in that art may be perfected by filing.⁹ A similar approach obtains under the laws of Germany¹⁰ and Austria.¹¹ Interestingly, France¹² and Belgium¹³ have enacted reforms in their secured transactions laws that now permit non-possessory security interests in goods owned by individuals.¹⁴

Due Diligence

Art-secured loans present lenders with unique problems of due diligence, requiring specialized knowledge. While there are many issues that may arise (including intellectual property rights and restrictions on types of materials, like ivory), the most common issues of concern to lenders in art-secured loans are: (i) authenticity, authentication, and attribution; and (ii) questions of title.

Authenticity, Authentication, and Attribution

Authenticity is art's defining feature, and the term "authenticity" (which is frequently confused with "attribution" and "authentication,") that an object is genuine. In recent years, there have been several highly-publicized instances of forgery, including the sales of fake works by modern masters like Mark Rothko and Jackson Pollock that brought down the eminent Knoedler Gallery, and the extraordinarily successful fakes of the German painter Wolfgang Beltracchi.¹⁵ For art-secured loans, authenticity is important because of its link to an object's value. A work's authenticity strongly impacts its value, but a lender needs to understand that authentication and appraisal are separate processes, with distinct areas of expertise. Attribution is commonly confused with authenticity, but is distinct. Attribution is the process of evaluating a work and "attributing" it to a particular artist or school (say, a painting by Rem-

brandt or Van Gogh). An object may be authentic, but nevertheless wrongly attributed (a genuine 17th century painting, but not by Rembrandt). Authentication and attribution combine three methods, in varying proportions: provenance, connoisseurship, and materials analysis.

"*Provenance*" is the history of 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 and attribution, but may also raise doubts as to an owner's good title to the object.

"*Connoisseurship*" is the informed opinion of experts. Issuing an expert opinion on a work's authenticity (or lack of authenticity), or attributing it to an artist (or denying such attribution), 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 or attribution 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, and is even less likely to be able to confirm an attribution.

Questions of Title

If a borrower lacks clear title to an object, the value of a lender's collateral pool is doubtful. Particularly when that collateral is art, which changes hands and crosses borders often with minimal documentation, the risk that someone may come forward claiming to be the rightful owner (or the heir of such owner) of a work is substantial. As part of their due diligence on a prospective art-secured loan, lenders should search at least one of the stolen-art databases that are now

available online. But a lender should recognize that, while, an object's appearance on a stolen art list is strong evidence that there are claims to the object, the fact that an object does not appear on such a list does not mean that there is no risk that a claim will be made. The stolen-art databases are incomplete. Each has its own limitations, and they can only address works that have been reported as having been stolen or are known to have been stolen. Many objects have not been reported. This is particularly true of art lost during periods of great

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catastrophe and disruption, such as the vast seizures and forced sales of art during the Second World War.

Title to art often requires intricate analysis. The first step is to examine the object (gallery labels and other markings, generally on the back of a work or otherwise out of sight, can provide important information about its history) and to conduct a thorough search of the object's provenance (bills of sale, gallery, dealer, and auction records, records of restoration, wills, and other legal documents offer evidence of the work's past ownership). 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 (the country in which it was discovered/excavated in modern times). For all types of cultural prop-

erty, special attention should be given to the provenance of objects that were present in continental Europe during the period 1933-1945, 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

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claim may be limited by statutes of limitations or the doctrine of laches).¹⁶ Civil law countries, by contrast, typically allow a good-faith purchaser to acquire title to a stolen work after a period of possession.¹⁷

The legal norms concerning the art and cultural property trade have changed dramatically since the UNESCO Convention was promulgated in 1970. Significant shifts have occurred in both national ownership laws and restrictions on export and import of certain classes of cultural property,¹⁸ and in international agreements restricting the transfer of certain classes of materials.¹⁹ Transactions in cultural

property generally, and ancient and/or excavated objects in particular, are evaluated in a variety of ways and scrutinized differently than was true in the past. Where antiquities are concerned, the risk that objects are tainted by illicit trade means that many lenders will not lend against antiquities.

Conclusion

The art trade is bustling, and interest in it remains high. As more and more lenders make art-secured loans, it is important that they understand the unique issues and risks that this sometimes glamorous collateral entails, that they engage in appropriate due diligence, seek out expert opinion, and know the applicable laws in order to comply with them and protect their investment. **TSL**

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¹ The European Fine Art Foundation (“TEFAF”) has estimated that global art sales (public auctions, private gallery sales, and dealer sales) in 2013 were roughly £47.4 billion (ca. \$63.9 billion), an increase of 8% over the previous year, and an increase of 150% from a decade before. TEFAF ART MARKET REPORT 2014, 24 (2014). The “current size of the art lending market is estimated at £6 billion (\$9.6 billion) a year.” Kathryn Tully, “How Easy Is It To Get An Art-Backed Loan?” *Forbes*, Oct. 27, 2014, available at <http://www.forbes.com/sites/kathryntully/2014/10/27/how-easy-is-it-to-get-an-art-backed-loan/>. Deloitte Luxembourg and ArtTactic report that 36% of private banks now offer art-secured lending services. DELOITTE LUXEMBOURG AND ARTTACTIC, ART & FINANCE REPORT 2014, 16 (2014).

- ² Analysts disagree as to whether art should be regarded as a distinct asset class for purposes of financial planning and investment. See, e.g., Kathryn Tully, “Could Fine Art and Collectibles Become a New Asset Class?” *Forbes*, Nov. 26, 2012, available at <http://www.forbes.com/sites/kathryntully/2012/11/26/could-fine-art-and-collectibles-become-a-new-asset-class/>; James B. Stewart, “With Art, Investing in Genius,” *The New York Times*, Nov. 28, 2014, available at http://www.nytimes.com/2014/11/29/business/with-art-investing-in-genius.html?_r=0; but see Arthur Korteweg, Roman Kräussl, and Patrick Verwijmeren, “Research: Is Art a Good Investment?” Insights by *Stanford Business*, Oct. 21, 2013, available at <http://www.gsb.stanford.edu/insights/research-art-good-investment>.
- ³ There are several types of boutique art lenders, and they have different orientations and objectives. Some are traditional lenders while others are more like private equity investors. Each type of lender's terms and relationship to the borrower and the collateral will be quite different.
- ⁴ See, e.g., Clare McAndrew, FINE ART AND HIGH FINANCE: EXPERT ADVICE ON THE ECONOMICS OF OWNERSHIP 121 (2010) (adding that “Loans structured within banking institutions house the majority of art financing by value at present . . . however, there are also a number of boutique lenders and auction houses that carry out art financing activities.”). Some auction houses may also provide loans to consignors (and sometimes to purchasers) of cultural property objects. Kate Taylor, “Borrowing with Fine Art as Collateral,” *New York Sun*, July 22, 2008, available at <http://www.nysun.com/arts/borrowing-with-fine-art-as-collateral/82333/> (visited February 19, 2014) (noting that “Christie's will typically advance between 30%

- and 50% of the low estimate of a consignment,” and “Sotheby’s will typically advance between 50% and 60% of the low estimate, depending on the amount of risk involved.”).
5. “Goods” means all things that are movable at the time the security interest attaches. UCC § 9-102(a)(44).
 6. “Inventory” means, generally, goods held by a person for sale or lease, or consisting of raw materials, work in process, or materials consumed in business. UCC § 9-102(a)(48).
 7. UCC §§ 1-201(b) and 9-109(a)(1).
 8. UCC § 9-202.
 9. See, e.g., N. ORKUN AKSELL, INTERNATIONAL SECURED TRANSACTIONS LAW: FACILITATION OF CREDIT AND INTERNATIONAL CONVENTIONS AND INSTRUMENTS 24 (2012); MICHAEL BRIDGE AND ROBERT STEVENS, CROSS-BORDER SECURITY AND INSOLVENCY 17-24 (2001).
 10. See, e.g., MICHAEL BRIDGE AND ROBERT STEVENS, CROSS-BORDER SECURITY AND INSOLVENCY 91-94 (2001).
 11. See Arnold S. Rosenberg, Where to File Against non-U.S. Debtors: Applying UCC § 9-307(c) [Rev] to Foreign Filing, Recording, and Registration Systems, 39 No. 2 UCC L.J. ART 1, *17 (Fall 2006).
 12. See Muriel Renaudin, The Modernisation of French Secured Credit Law: Law as a Competitive Tool in Global Markets, 24(11) I.C.C.L.R. 385-387 (2013).
 13. See Arnold S. Rosenberg, Where to File Against non-U.S. Debtors: Applying UCC § 9-307(c) [Rev] to Foreign Filing, Recording, and Registration Systems, 39 No. 2 UCC L.J. ART 1, *20 (Fall 2006).
 14. As international trade has grown, there have been efforts to harmonize secured transactions laws. These efforts have been strongly influenced by the principles, and to some extent the practices, of Article 9. The United National Commission on International Trade Law (“UNCITRAL”), the European Bank

- for Reconstruction and Development (“EBRD”), the Organization of American States (“OAS”), and the Organization for the Harmonization of Business Law in Africa (“OHADA”) have all promulgated model secured transactions laws drawing upon Article 9’s guiding principles. At the national level, Albania, Australia, Bosnia-Herzegovina, Canada, the Federated States of Micronesia, Kosovo, the Marshall Islands, New Guinea, New Zealand, Palau, Papua, the Solomon Islands, Tonga and Vanuatu have enacted secured transactions laws that strongly resemble or have been influenced by Article 9. However, harmonization efforts are far from uniform or complete. See Louis F. Del Duca, Marie T. Reilly, Edwin E. Smith, and Peter Winship, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE AND INTERNATIONAL COMMERCE 223-224 (2nd ed. 2011); Spiros V. Bazinas, *Law Applicable to Security Rights in Movable Assets Under the UNCITRAL Legislative Guide on Secured Transactions*, 30 No. 6 BANKING & FIN. SERVICES POL’Y REP. 7, 12-13 (June 2011); and Boris Kozolchik, Implementation of the OAS Model Law in Latin America: Current Status, 28 ARIZ. J. INT’L & COMP. L. 1, 13 (Spring 2011).
15. See Patricia Cohen, “A Gallery That Helped Create the American Art World Closes Shop After 165 Years,” *New York Times*, Nov. 30, 2011, available at <http://www.nytimes.com/2011/12/01/arts/design/knoedler-art-gallery-in-nyc-closes-after-165-years.html>; Joshua Hammer, “The Greatest Fake-Art Scam in History?,” *Vanity Fair*, Oct. 10, 2012, available at <http://www.vanityfair.com/culture/2012/10/wolfgang-beltracchi-helene-art-scam>.
 16. See *Solomon R. Guggenheim Found. v. Lubell*, 569 N.E.2d 426, 431 (N.Y. 1991); *Bakalar v. Vavra*, 819 F. Supp. 2d 293, 304 (S.D.N.Y. 2011), aff’d, 500 Fed.Appx. 6 (2nd Cir. Oct. 11, 2012) (holding that laches barred the

- claims of heirs of a rightful owner of a drawing although the heirs had such notice before they knew of the drawing’s specific whereabouts.
17. See Deborah A. DeMott, “Artful Good Faith: An Essay on Law, Custom, and Intermediaries in Art Markets,” 62 DUKE L. J. 607, 632 (2012) (citing Alan Schwartz & Robert E. Scott, Rethinking the Laws of Good Faith Purchase, 111 Colum. L. Rev. 1332, 1337 (2011)).
 18. See, e.g., *U.S. v. McClain*, 545 F.2d 988 (5th Cir. 1977); *U.S. v. An Antique Platter of Gold*, known as a Gold Phiale Mesomphalos c. 400 B.C., 184 F.3d 131 (2d Cir. 1999); *U.S. v. Schulz*, 333 F.3d 393 (2d Cir. 2003).
 19. See UNIDROIT CONVENTION ON STOLEN OR ILLEGALLY EXPORTED CULTURAL OBJECTS, JUNE 24, 1995 (the “UNIDROIT Convention”); CONVENTION ON THE PROTECTION OF THE UNDERWATER CULTURAL HERITAGE, NOV. 2, 2001, 41 INT’L LEGAL MATERIALS 40 (2002) (the “Underwater Cultural Property Convention”); CONVENTION CONCERNING THE PROTECTION OF WORLD CULTURAL AND NATURAL HERITAGE, NOV. 16, 1972, 1037 U.N.T.S. 151 (1972) (the “World Heritage Convention”).