

NOW +

NEXT

ARTS & CULTURAL INSTITUTIONS ALERT | NIXON PEABODY LLP

APRIL 13, 2020



Protecting your art investment in the age of coronavirus (COVID-19)

By Daniel A. Schnapp, Thaddeus Stauber, Robert Christmas

A museum in the Netherlands is robbed of a Van Gogh, cyberattacks are at an all-time high, international airlines are teetering on the brink. It would have been almost impossible to imagine a few months ago, but the entire world is now facing an unprecedented health crisis due to the coronavirus (COVID-19) pandemic, and the economic fallout will be historic as well.

COVID-19 has created significant uncertainty in all asset classes, including the art market. Following the Great Recession of 2007 and 2008, global art and antiques sales fell from \$62bn in 2008 to \$30.5bn in 2009, according to the economist Clare McAndrew. While the art market has continued to be robust since that time, it took almost ten years to recover. In 2017, the global sales numbers were only then reaching their pre-2007 highs.

The question as to how COVID-19 will ultimately affect the sale of fine art is multi-factorial. On one hand, numerous auctions houses are at least temporarily closed, and annual art fairs such as Frieze New York have been cancelled. Further, the travel restrictions currently in place in the United States and throughout the world have frozen out viewing art in person.

There have been some encouraging signs for the art market, however: in a recent article in *Forbes* magazine, it was estimated that, since the outset of the pandemic, prices for Warhol have dropped in auction bidding only around 3%, and prices for Picasso have gone up approximately 41%. Although these are only statistical estimates, it may be that collectors and other art market participants are focusing on certain art as a long-term investment, while the prices of equities fluctuate wildly.

COVID-19 raises critical issues for purchasers, sellers, and others dealing in the sale of fine art. The hypothetical situations are numerous: from shipping and storage problems (what if you purchase a work and the shipping company shuts down while the work is in transit), to bankruptcy filings, cyberattacks, to breaches of purchase and sale agreements.

Here are some strategies to consider when making an investment, or protecting your investment, in art.

Strategies

Fine art insurance

Fine art insurance companies cover a wide range of art and collectibles, from paintings to sculpture to fine wristwatches. Typically, if the covered artwork is irreparably damaged or stolen, an art insurance company may compensate the insured at the current market value of the piece at the time that it was lost or damaged. While art insurance is almost always a prudent choice, due to the sudden shift in travel restrictions due to COVID-19, and the economic hardships facing many companies in the transportation business, artwork may more likely be lost in transit during shipping. Art or other insurance may also help cover the risks of cyberattacks. Moreover, COVID-19 has not stopped art theft, as shown by the recent heist of a Van Gogh in the Netherlands. Acquiring an art insurance policy mitigates these risks.

Filings under the Uniform Commercial Code (“UCC”)

UCC filings perform several functions that protect purchasers and sellers of art. Lien searches allow a purchaser of art to confirm (i) whether the seller of the artwork is in fact the outright owner of the work, or has a legal right to sell, as well as (ii) whether there are any outstanding liens that would otherwise cloud title to the artwork. Every state in the U.S. maintains a database of UCC filings. However, a lien search is not always proof that the true owner of the work is disclosed. For example, an artwork may be the subject of a pledged gift to a museum or institution that may not be reflected by any public filing. Accordingly, using lien searches on their own is not complete, but should be considered as part of an overall suite of options, including provenance research, and well-drafted contracts with warranty provisions.

Further, whether and when a lien has been perfected may be critical to how assets are distributed in the event of bankruptcy. During the last financial crisis, for example, Lawrence B. Salander, who ran the Salander-O’Reilly Galleries, filed for bankruptcy, leading to claims and litigation by people who said they had consigned artworks to the gallery but were never paid for them, or that the gallery had sold their paintings without their permission.

Perfecting a security interest is also a powerful way to place the world on notice, in the event of bankruptcy of a gallery or auction house, of an ownership interest in art.

Consignment agreements

Typically, an art consignment agreement is a contract between an artist and a gallery where the artist’s work will be exhibited and sold. A written consignment agreement is the best way to make explicit the rights and obligations of the parties to the agreement. Important elements of a consignment agreement may include whether or not the parties agree that they have a fiduciary relationship (although in New York, for example, a written agreement is not required to create a trust between an artist and a gallery, and in California, for example, an artist is not required to enter into a written consignment agreement, and a financing statement does not need to be filed to perfect a security interest, for the artist’s work that has been transferred to the gallery for sale), the description of the work, warranties concerning copyright and other matters, transportation and shipping issues, responsibilities for loss, termination, commissions, expenses, and when the work will be exhibited, as well as a number of other important elements. Consignment agreements are even more important in turbulent times because, if litigation or bankruptcy ensues, having a written agreement that clearly spells out ownership and other issues will be a crucial piece of evidence, and can be one aspect of preventing loss of the work to creditors.

Loan agreements

Loan agreements typically govern the loaning of an artwork to a museum or institution. Loan agreements, like consignment agreements, should be drafted and (during COVID-19) re-reviewed, by counsel.

Although loan agreements typically have numerous complex provisions that are negotiated before the agreement is signed, including security of the artwork, tax implications, and insurance, certain provisions may need to be re-reviewed in light of COVID-19. For example, economic instability of museums or institutions, particularly those that may be state-owned, may raise issues of how to re-acquire an artwork that has been on loan if the museum or institution is permanently closed. If a loan agreement is silent on such issues, then now, more than ever, is the time to reconsider how to be proactive and address such an eventuality.

Provenance research

Provenance research describes the process of confirming the chain of title of ownership. Such research could include lien searches, reviewing a catalogue raisonné, and checking the Art Loss Register.

Economic instability can breed litigation. If there are competing claims to a work, then the risk of judicial seizure is heightened. Certain countries have passed legislation that provides some immunity from seizure including the United States, the U.K., France, Switzerland, Belgium, Austria, Germany, Israel, Australia, and Japan.

During COVID -19, museums and institutions should consider applying to the U.S. Department of State for a determination that art loaned from abroad for exhibition is culturally significant and that the exhibition is in the national interest. If the application is granted, the art is immunized from judicial seizure by the federal government.

Notice of ownership

Putting galleries, museums, storages, warehouses, and shipping companies on notice of claim ownership is also a good practice. For example, just a simple dated letter, sent by registered or overnight mail, that notifies a museum, institution, and gallery of any new issues and also reiterates an ownership interest, may go a long way toward establishing ownership in the event of litigation or other crisis. Even having a gallery place a note on the artwork identifying the titled owner, and then having the gallery email or text a dated photo of the artwork with the note, may be useful.

Purchase and sale agreements

Purchase and sale agreements should explicitly describe the parties' obligations in advance of a sale. Purchase and sale agreements typically include certain warranties, such as warranties that the seller owns the artwork to be sold, and that the artwork is not known to be a forgery or other product of fraud. Certain purchase and sale agreements contain, or should contain, force majeure clauses, which may alleviate certain conditions of sale due to the pandemic.

Now is the time to double check purchase and sale agreements, especially if payment is not yet complete, because, depending on the jurisdiction and/or sale agreement terms, you may not yet be the artwork's owner (resulting in an unsecured claim and potentially no rights in the artwork, in a seller bankruptcy), and your sale or purchase could be subject to being enforced, if the seller wants

to close the deal, or cancelled, if the seller wants to try to sell to a third party. Alternatively, there may be avenues to unwind a pending purchase.

Special situations

COVID -19 may increase the risk of bankruptcies, as it did during the last major economic recession. Thus, in addition to the other strategies listed above, it is critical that secured and unsecured creditors who have a claim on the bankruptcy estate, whether for monies owed, or for the recovery of artwork, must timely file a proof of claim in the bankruptcy case. Absent having a proof of claim, there very likely may be no recovery.

Shipping and storage issues

Art can be lost or stolen during shipping. During this time of great disruption in the supply chain, shipping issues are more prevalent than ever. In addition to tracking and keeping close tabs on an artwork during shipping, being diligent in filing a UCC lien and/or obtaining art insurance are additional methods of attending to a risk of loss during shipping. Similarly, while art is in storage, art insurance can provide valuable coverage in the event of loss or damage.

Art lending

Lastly, for parties who suffer due to the economic fallout of COVID-19, art may be used as collateral for lending purposes. There are numerous lenders, including mid-sized and major banks, that will collateralize a loan obligation using artwork. Art can therefore be used to generate liquidity.

During and after the COVID-19 pandemic, the above steps, taken now, will help ensure that art, and an art investment, is protected.

For more information on the content of this alert, please contact your Nixon Peabody attorney or:

- Daniel Schnapp, 212-940-3026, dschnapp@nixonpeabody.com
- Thaddeus Stauber, 213-629-6053, tstauber@nixonpeabody.com
- Robert Christmas, 212-940-3103, rchristmas@nixonpeabody.com