The Legal Canvas

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Welcome Back

When times are good, the art market can seem very separate from the world of law. Deals are done, money changes hands, and there are very few legal impediments that cannot be overcome through negotiation. If one deal goes bad, the next transaction is just around the corner.

When the market slows down, underlying legal issues can become more apparent. The ecosystem of a dynamic market falls away, and market players may be left figuring out what they are entitled to under the law. Sometimes, they are surprised and distressed at what they find.

In this edition of The Legal Canvas, we consider a number of the ways that the worldwide economic downturn has legal implications for the way art market transactions are conducted.

- In a two-part article on selling art in this economy, we first look at the sorts of issues a seller – and particularly a seller who is acting as a fiduciary – may want to consider in deciding whether or not to sell at auction. In the second part of the article, we look at issues presented when art is sold privately.
- The downturn has created any number of problems and potential problems for museums. One of them is the difficulty a museum can face when it finds out that art that it has received as a gift – or expects to receive as a promised gift – is subject to the claims of the donor's creditors. This scenario is one that may become more common in today's economy, and we look at the sorts of steps that museums may want to consider in order to protect their collections.
- Finally, with market values low, collectors may want to revisit their estate plans. In this issue we discuss the pros and cons of putting art in a Grantor Retained Annuity Trust (or GRAT). This popular planning technique may help a collector reduce or even eliminate the gift tax on transfers to children, other family members or friends.

In other areas, we provide updates on two pieces of litigation that could expand the liability of, respectively, auction houses and authentication committees, and we discuss the implications of the recent decision in the Fisk University case.

We hope these articles provoke thought and provide useful general guidance. We also hope that we will have the opportunity to work with you on your art-related legal issues.❖

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We note with great sadness the passing of Jeremy Epstein of Shearman & Sterling. Jeremy was an extraordinary lawyer and scholar. We are grateful to have known him as an art law colleague, and as a friend.

In this Issue . . .

Selling in a Down Market

The abrupt change in the art market has shaken its collective mindset – but not altogether displaced expectations based on the "old normal." As much as people may talk about a bubble, or celebrate the return of sanity and connoisseurship, many art owners may be inclined to resist the notion that the prices from the market's boom years do not necessarily represent "true value." People with art to sell may want to believe that somehow, somewhere, they can still get the prices they were seeing at auction and in galleries not so very long ago. The market may have hit the brakes suddenly, but expectations have not had time to decelerate.

At the same time, patterns are emerging that seem to undermine old assumptions about how best to sell a piece of art and to underscore the importance of protecting yourself when you do. Failing to rethink old assumptions about the market and neglecting to question traditional ways of doing business can have adverse consequences – legal and financial – for sellers, especially if they are acting as an executor, trustee or in some other fiduciary capacity.

In this article we offer our thoughts on the sorts of things fiduciaries and collectors may want to consider when selling art in the current market. First, we look at current trends at auction and whether the auction-room floor remains a presumptive "safe harbor" for fiduciaries. We then look at private sales and the things that sellers should do to protect themselves – particularly in the wake of recent gallery failures. ❖

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Selling at Auction in a Down Market

If you sold art at Christie's or Sotheby's in 2007, used the proceeds to spend two years trekking in the Himalayas oblivious to world events, and returned to New York ready to sell more art, you would be astonished by what you found. The downturn in the economy has brought dramatic change to the way the auction houses are doing business. Those changes raise new questions for potential consignors – particularly for fiduciaries.

How did we get here?

The business model of the major auction houses is based on a fundamental premise: each house needs property to fill an annual schedule of sales and cannot manufacture its own widgets. This leaves them in competition for what is an unpredictable and sometimes very limited supply of available property to sell. Not surprisingly, the competition is most fierce for the most valuable or most high-profile property. That's where the potential for profit lies. Just as importantly, high results and hot publicity attract more consignors for the next sale.

Over the past decade or so, more wealth was attracted into the art market, prices rose, and the major auctions became a kind of high-end spectator sport. The game was judged – and the score was kept – on the basis of market share: at the end of any given season, which auction house had the greater share of sales revenues in any given category. The incentive for each house to get the best consignments increased commensurately, as did the competition for those consignments. The houses responded by moving further and further away from their traditional role as mere middlemen. In the boom market, they offered financial deals (guarantees, advances, and a share of the house's revenue on a sale) that became increasingly generous and increasingly complex.

The music stopped at the fall 2008 auctions, and each major house found itself exposed to financial deals that were signed before the sharp decline in the economy. Having lost tens of millions of dollars, each house announced that it would no longer be giving guarantees. In fact, what that meant was that they would be giving guarantees very selectively. The spring auctions contained far fewer guaranteed lots – but there were *some*. And though the sales totals were significantly lower than they had been in years, the auctions appear to have been less risky and therefore, at least in relative terms, if not in absolute ones, more profitable for the auctioneers.

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One of the notable things about the spring 2009 auctions was how little property was being sold, contrary to some expectations that the market would be flooded by collectors looking to monetize their art in hard times. While some collectors were selling in the private market, others seem to have decided to wait to see where the market would go.

Decisions about whether, when, and how to sell art are key for any collector. Those decisions are legally crucial for someone acting in a fiduciary capacity (such as an executor, a trustee, or the members of a charitable board), because of the risk of legal liability if a decision is later alleged to have been imprudent. Traditionally, selling at auction has been the favored option for fiduciaries, both because of the evident transparency of the auction sales process and the belief that prices at auction may more nearly reflect true "fair market value" – that is, the price where a willing buyer and a willing seller, both having sufficient information about the circumstances and neither being under any compulsion to buy or sell, will enter into a transaction.

A fiduciary, however, may want to re-think traditional assumptions in light of the current market. At the major auctions since the fall of 2008, observers have found that extraordinary objects with good provenance have sold well, while other property has been less successful. For an item to sell well at auction, there have to be at least two people competing to buy it – and ideally, a half dozen or more. The more bidders there are, the higher the price will be. During the boom years, there were plenty of prospective buyers in the market, bidding on a broad range of property at all levels of quality. In the current economy, however, market observers say that fewer people are bidding – and they are bidding with more care. Property that fails to sell at auction may be "burned" – in market terms, shopworn and unmarketable for some period of time. And the auction houses are not providing the sort of financial protection against these risks – or the enhanced rewards to compensate for it – that they did in better economic times.

This is not to say that selling at auction should not remain a favored method for fiduciaries. It is to say that a fiduciary should evaluate his or her options thoroughly – with the objective of maximizing the proceeds of the sale, minimizing transaction costs, and protecting the beneficiaries or charity from unnecessary risk. In deciding whether the auction room is the best place to achieve that goal, there must be a realistic assessment of the property that is being sold, and an understanding of the business imperatives of the auction houses.

- First, a fiduciary should determine whether the property he is selling is likely to provoke real competition among buyers. He should examine its quality, rarity, art historical importance, freshness to the market, condition and provenance. If bidders are unlikely to compete for the work, then he may want to consider whether he could get a better price in a private sale, possibly even a "private treaty sale" negotiated by an auction house. Where an estate is selling a variety of property, the executor may want to make a similar analysis for individual pieces of art, separating them out for private sale where appropriate. To avoid issues of self-dealing or negligence, the fiduciary should keep a record of the information on which he bases his decision, including clear and detailed memoranda on his dealings with buyers or intermediaries.

- If the fiduciary decides to sell at auction, and if the property is of high quality or is being consigned by a high-profile individual or her estate, the fiduciary may want to put the consignment in play between the auction houses as far in advance as possible. Especially in a shaky economy, each auction house will want to announce a major consignment in order to establish an anchor for each major sale and attract other important property. Also, the auction houses' budgets for guarantees and other financial incentives is limited, evidently more so than during the boom years, so it is important to negotiate with the auction houses before the season's worth of financial deals have been spent.

- If the consignment is made late in the season, an auction house that does not yet have a major consignment for a given sale may be more willing to provide financial incentives than a competitor that has already landed a major piece or collection. Each house needs material for a sale – not only for the immediate moment, but to be able to stay in the game.

- In either event, the fiduciary should not be afraid to make the consignment competitive. It is advisable to speak with at least two auction houses and to at least one reputable gallerist who specializes in the area or, in the case of contemporary art, the primary dealer of the artist whose work is being sold. The fiduciary can compare the differing offers, both with respect to the financial terms and marketing commitments. As a practical matter, in a market where many collectors who have a choice are "waiting it out," fiduciaries who control the sale of property that must be sold (such as estate property that must be sold in order to pay estate taxes or bequests) have something that the auction houses need. There is no reason not to exercise that leverage. Moreover, it is a form of due diligence that will help insulate the fiduciary's decision from a successful challenge down the line. ❖

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Selling Privately in a Down Market

Observing the spring's thin auction catalogs and reduced results, both *The New York Times* and *The Wall Street Journal* have reported a trend towards private sales of art. It is hard to test that premise. After all, the sales are called "private" for a reason, and the dealers and auction houses who are quoted in the articles have good reason to proclaim the health of the art market.

However, sellers may have good reason these days to move property out of the auction rooms and into private galleries (even a private gallery within an auction house). Privacy protects a seller from rumors of financial stress and protects art from the damage of a public failure to sell. A private transaction is more fully within the seller's control. At auction, the seller is protected by the reserve; once it is reached, the property is sold. In a private sale, the seller can negotiate all of the terms of a transaction – price, payment and delivery terms, the provision of title insurance in lieu of a warranty of title, security interests, and protections against default. The timing of a private sale is also, at least theoretically, within the control of the seller. Rather than waiting for an auction that might be months away, a seller can conclude a sale (if there is a buyer) at any time. Moreover, as suggested elsewhere in this issue, certain property may be more suited to private sale when the market is down. Auctions require competition; private sales require only the careful placement of the right piece with the right buyer.

The economic downturn has, however, also underscored the risks of selling through private galleries. A dealer in possession of a work may be able to pass good title to a purchaser, even if the dealer never pays the seller. And, if a dealer goes into bankruptcy, a work of art in his possession may become part of the bankruptcy estate – even if it actually belongs to a consigning seller.

The Uniform Commercial Code

As an initial matter, despite the romance that may swirl around them, purchases and sales of art are commercial transactions. Where they go wrong, stories of trust and betrayal will be less relevant to a court than the rules of law.

In the United States, commercial transactions are generally governed by the Uniform Commercial Code (the "UCC" or the "Code"), a statute that has been adopted, with some variations, in all 50 states. The Code is designed to facilitate commerce by providing universal "rules of the road." Among other things, the Code establishes the rights of buyers, sellers, and creditors when goods are sold or are pledged as collateral for a loan. The Code also provides a mechanism for owners and creditors to protect their interests in property – recording their financial interests by filing a financing statement on a database that is made publicly available by each state and that puts buyers or other potential creditors on notice that someone else has an interest in the property.

Entrustment

Under the UCC, when a collector gives a dealer possession of a work of art, the collector is deemed to have "entrusted" the work to the dealer. This is true whether the dealer is meant to store the work, restore it, exhibit it or sell it. Under the Code, "any entrusting of possession of goods to a merchant who deals in goods of that kind gives him power to transfer all rights of the entruster to a buyer in the ordinary course of business." A "buyer in the ordinary course" is defined as being a "person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in the ordinary course from a person in the business of selling goods of that type." In other words, if someone walks into a gallery and buys your work of art, he gets title to the work, whether or not you meant for it to be sold, and whether or not the dealer ever pays you. You are left with a claim for money damages against the dealer; the buyer gets the art.

This makes sense when the art is on consignment to a dealer – in other words, it is there because the seller *intends* that it be sold. In that case, the sale itself is not in violation of the consignor's rights; the breach is in the dealer's failure to part with the proceeds.

The result may seem astonishing, though, when the work has been placed with a gallery for reasons other than sale – and many shocked collectors have wound up as plaintiffs in litigation against dealers. The Code's rationale is that, as between the seller and an innocent buyer, it is the seller who should bear the risk of a dealer's malfeasance. Indeed, the rules apply even if the dealer obtained possession of the property – or disposed of it – in ways that would be "larcenous under the criminal law." It is the seller who knowingly delivers her property to the dealer, and she assumes the risk of the merchant's acting unscrupulously, because she had the ability to protect herself in ways that the innocent buyer could not.

The result changes if the buyer is not innocent. If he purchases the art knowing that the sale violates someone else's ownership rights or security interest, title will not pass. If a buyer knows, for example, that a painting was left with a dealer solely for purposes of restoration and not for sale, he cannot rely on the UCC to protect his ownership of the picture. With most buyers, courts will look for evidence of actual knowledge. Where the buyer is another art dealer (and therefore considered a merchant under the UCC), courts will consider whether the buyer took reasonable steps to verify the true owner of the work of art. What will be considered reasonable will depend on the circumstances of the transaction. The courts will look to see if there were any "red flags" that should have caused the buying dealer to ask further questions. Was the purchase price too low? Did the negotiations or procedures of the sale differ from previous and uncontroversial agreements between buyer and seller? Did the seller insist on unusual confidentiality provisions or bizarre delivery arrangements? If the selling dealer was unknown to the buying dealer, did the buyer take reasonable steps to verify that the sale was authorized?

Bankruptcy

Artwork consigned to a dealer may be at particular risk if the dealer winds up in bankruptcy. Under the UCC, consigned works are subject to the claims of a gallery's creditors unless (a) the fact that the works are on consignment is posted, (b) the consignor can show that the gallery is generally known by creditors to be "substantially engaged" in selling goods belonging to others, or (c) the consignor has filed a financing statement reflecting his interest in the property. Just as it protects the innocent purchaser who buys entrusted property, the UCC protects the creditor who, unless he is given reason to believe otherwise, should have a right to assume that what he sees in the gallery belongs to the gallery.

What this means is that in a bankruptcy, your dealer's creditors could end up with rights in your property that are superior to your own – regardless of the customs and practices of the art industry. In recent bankruptcy proceedings involving

Artists' Statutory Protection

Unlike collectors, artists in a number of states have statutory protection in consignment transactions. Under New York Arts and Cultural Affairs Law Section 12.01, whenever an artist, his heirs or personal representatives deliver a work of art to a dealer for the purpose of sale on commission, a consignment relationship is formed. The dealer, as consignee, is deemed to be the agent of the artist, having fiduciary responsibilities, and the artist's work and the proceeds of its sale are trust property held by the dealer for the benefit of the artist. This statutory designation of the relationship between the artist and dealer is important for two principal reasons. First, the work of art (or the proceeds of its sale) will remain trust property notwithstanding purchase by the dealer or sale to a third party until the proceeds from the sale of the work of art are paid to the artist in full. Second, and most importantly, the statute provides that "no such trust property or trust funds shall be subject or subordinate to any claims, liens or security interest of any kind or nature whatsoever." As a result, an artist would have superior rights to any other third-party creditor of a dealer in bankruptcy.

galleries, the bankrupt gallery and its creditors successfully (but perhaps disengenuously) took the position that the creditors did not generally know that the dealer had been "substantially engaged" in selling other people's property. It did not matter to the court that it was not customary in the art market for a consignor to file a financing statement. As a result, the consigned art became assets in the bankruptcy estate, and the consignors were left as unsecured creditors.

Protect Yourself

When a collector is considering consigning artwork to a dealer, she should not abandon her common sense. It is a commercial transaction that should be approached with as much care as any other significant business matter. If things go badly, the collector's rights are going to be judged as a matter of law, and not by the casual and familiar customs of the market.

- **Research.** First, a collector should conduct due diligence with respect to anybody (including a dealer) with whom she is going to do business. Even something as elementary as a web search of the dealer's name may provide useful information. Has the gallery been involved in any recent litigation? Is there a pattern of litigation brought by other collectors, or by landlords, vendors or creditors?

- **Written Agreement.** No matter why artwork is being left with a dealer, the arrangement should be reduced to writing. The writing need not be complicated. It should set forth very clearly the basic terms of the particular arrangement: For what purpose is the property being put into the custody of the dealer? What services, if any, will the dealer be performing, and how will he be compensated? What is the time frame in which the services will be completed? If the property is being loaned for an exhibit, when will the exhibit be over? In addition to these sorts of fundamental provisions, the agreement should include (i) an express statement of the consignor's ownership interest in the work, and (ii) an acknowledgement by the gallery that the owner will file a financing statement to protect her ownership interest. If the property is being consigned to the dealer for sale, the collector may want to require that it not be released to a buyer until the collector has received payment in full from the dealer. In most circumstances under the UCC, title to property passes to a buyer when it is delivered, whether or not the buyer has paid for it.

- **Physical Tagging.** The collector might consider requiring that each work of art be physically tagged or otherwise identified so as to indicate that it is on consignment or on loan to the gallery. In addition, if the gallery publishes a catalog of an exhibition, the collector may want to insist that her works be designated in the catalog as having been consigned or loaned.

- **Filing a Financing Statement.** Perhaps most importantly, a collector should file a financing statement in the proper state to give public notice of her interest in the work. Filing the form is easy and inexpensive. In most states, it can be done on-line by visiting the website of the Secretary of State (or doing a web search for "UCC Filing" plus the name of the state). In New York, each paper filing costs $40, and each electronic filing costs $20. The filing will protect the collector's art from the claims of the dealer's creditors. It can also provide some protection against the risks of entrustment. If a work is with a dealer for purposes other than sale (e.g., an exhibit), and if the filing discloses that fact, then (i) any buyer (including a non-merchant) who does a UCC search prior to purchasing the work will be on actual notice that the sale will be in violation of the collector's ownership rights and (ii) a buyer who is a merchant who does not do a UCC search may be held not to have performed adequate due diligence to assure himself that the sale was authorized. In either case, good title to the work may have been prevented from passing. ❖

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When Museums Collide With a Donor's Creditors

In April 2009, JPMorgan Chase Bank notified the Rijksmuseum in Amsterdam that a painting that the museum had purchased in 2008, "*The Bend on Herengracht*" by Gerrit Berckheyde, had been previously pledged as collateral for a debt that was now past due, and JPMorgan said it wanted to take possession of the painting. The Dutch bank ABN Amro chimed in next, claiming that the Berckheyde was also collateral for *its* loan to the same individual. For about six weeks, the museum and the Dutch press had reason to worry that the picture would be seized. As of the date of this issue of *The Legal Canvas*, JPMorgan had decided not to pursue the painting, and ABN Amro had accepted alternate collateral from the individual.

In the meantime, the M.H. de Young Memorial Museum in San Francisco was having its own problems defending its right to a major pledged gift. John and Marcia Friede, heirs of the Annenberg family, promised to donate to the museum their famed Jolika Collection of over 4,000 pieces of Oceanic and tribal art. After making the pledge to the museum, Friede granted his brothers a security interest in the collection to collateralize a $30 million debt owed to them in connection with an inheritance dispute. After Friede fell behind in making payments on the debt, one of his brothers attempted to seize some of the artworks. So did Sotheby's, to which Friede had apparently *also* granted a security interest in certain pieces of the collection to secure a $25 million loan. In October 2008, a New York court gave Sotheby's the right to take possession of 54 works from the collection, and Sotheby's successfully sold all but one of them at an auction on May 15, 2009. On April 22, 2009, the City of San Francisco, which owns the de Young, announced that it had agreed to sell 76 works from the collection to help settle the inheritance dispute and to protect the remainder of the pledged gift. The museum characterized the works that would be sold as redundant, or as less significant than other pieces of the collection.

Sadly, museums may face scenarios like these more frequently in the coming months. The ever-increasing values in the market over the last several years made lenders more amenable to accepting art as collateral. The strength of the market also led some lenders to accept loan-to-collateral ratios that seem to have been based on the assumption that the value of the art would never decline. Some collectors used the opportunity to leverage their collections. With the downturn in the economy, some borrowers may find themselves unable to make their loan payments, and lenders may find themselves holding property that has lost much of its market value, leaving them under-collateralized. Either set of facts can lead to more defaults and foreclosures.

It may not be possible to protect a museum completely. But there are several things a museum can do to protect itself from accepting art that is subject to liens and to prevent donated or promised art from being seized to satisfy preexisting security interests or used as collateral for future secured loans.

- **Check to see if the property is subject to any liens or claims.**

First, when a museum is purchasing or accepting a piece of art, it should check the commercial filings in each state in which a lender to the seller or donor would be required to file a Financing Statement under the Uniform Commercial Code in order to perfect a security interest in the property. At a minimum, this due diligence should include every state where the seller or donor is either a resident or conducts business. These filings are generally made with the Secretary of State in the applicable location, and are usually searchable on-line at no cost on the state's website. As a general matter, the rights of any *subsequent* buyer or donee are subordinate to the rights of the holder of a prior perfected security interest.

- **Draft a comprehensive and thoughtful agreement.**

When a museum accepts a gift of property or the promise of a future gift, it should document the arrangement with a formal written agreement. The agreement should include provisions designed to protect the museum's interest in the work, including:

  - A representation and warranty that the donor owns the property free and clear and that no third party has any interest in the property.
  - An agreement by the donor not to grant a security interest to any other party in the work that he has donated or promised to donate.
  - An indemnification provision that protects the museum against costs and damages in the event that the donor has granted or does grant a security interest in the property. In appropriate circumstances, the museum might seek a provision that would require the donor to pay liquidated damages to the museum in the amount of the value of the promised gift, should the donor violate the terms of the agreement in a way that prevents the museum from acquiring or keeping the promised property.

- **Consider filing a UCC Financing Statement.**

The museum may wish to consider filing an "informational" UCC Financing Statement. An informational filing will alert subsequent lenders that there is a preexisting, *competing* interest in the property, even if not an enforceable prior lien. With this notice, potential lenders or buyers may be more likely to make further inquiries about the status of the property before going forward with a contemplated transaction. Note, though, that filed Financing Statements are public and should be considered with caution if there is good reason on the donor's part to keep the donation or promised gift confidential for the time being. Alternatively, in appropriate circumstances a museum may wish to explore asking the donor to grant a security interest in the promised property, so that the property becomes collateral to secure the donor's promised gift to the museum. In that case, unless the museum has possession of the property, a UCC Financing Statement would be filed in order to perfect the security interest.

- **Consider acquiring art title insurance.**

Museums may wish to purchase title insurance for donated or promised works from an insurance company with specialized expertise in art title risks. Such policies are designed to provide third-party assurance against the loss of the artwork due to liens or encumbrances (as well as more traditional ownership risks) and against the costs of defending against title claims.

- **Check every now and again to be sure there are no problems on the horizon.**

After accepting the pledge of a work – even where the museum has physical possession of the art – a museum should consider periodically checking the status of the work by searching for any UCC Financing Statements related to the donor. This will enable the museum to stay abreast of the status of the property and perhaps pre-empt potential problems. ❖

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Estate Planning: Is It Time For an Art GRAT?

Disappointing as the economic downturn has been, it may present an estate planning opportunity for many art collectors. The depressed value of art means that outright gifts generate less gift tax than they would in a stronger economy, so for collectors who believe the economy will recover this may be an optimum time to give works of art outright to friends and family. By the same token, an art collector who believes his collection will recover its value at an annual rate greater than the prevailing IRS discount rate (ranging from 2.8% to 3.4% this summer) has an opportunity to create a Grantor Retained Annuity Trust (or "GRAT"), which is designed to shift part of the anticipated increase in value to friends or family without incurring any gift tax at all. With a Federal gift and estate tax rate of 45% and state transfer taxes on top of that in some states (including New York), a savvy collector who plans his giving thoughtfully may be able to realize substantial economic benefits right now.

Briefly, a GRAT works as follows: (i) the collector, as grantor, transfers assets to the GRAT and retains the right to receive an annuity payment each year during the term of the trust, (ii) the annuity payments are typically calibrated so that the "present value" of the annuity payments, determined using an assumed rate of return published monthly by the IRS, is exactly equal to the value of the property that the grantor is transferring to the trust, and (iii) the trust terminates after a period of years and anything left in the trust passes to the remainder beneficiaries, who are often the grantor's children or trusts for their benefit.

Because the grantor retains an annuity interest that, for tax purposes, is exactly equal in value to the assets used to establish the GRAT, the remainder interest is assigned a tax value of zero. The remainder interest, in other words, is a gift that attracts no gift tax. This technique is known as "zeroing-out" the GRAT. If the assets in the GRAT appreciate in value during the term of the GRAT at a rate in excess of the IRS rate-of-return assumptions used when the GRAT was set up, the "excess appreciation" will be left in the GRAT at the end of the trust term and will pass to the remainder beneficiaries without gift or estate tax.

When a GRAT is funded with artwork, consideration must be given to the mechanics of paying an annuity with works of art. One method is to make the annuity payments by transferring fractional interests in the artwork back to the grantor. However, this is administratively cumbersome. Use of a limited liability company ("LLC") might be a better alternative. In this scenario, the grantor forms a single-member LLC and transfers the artwork to the LLC in exchange for a 100% interest in the LLC. The grantor then transfers his or her interest in the LLC to the GRAT. If this method is employed, the artwork remains owned by the LLC, and the GRAT satisfies its annuity obligation by transferring LLC interests back to the grantor – a simple paper transfer that avoids "fractionalizing" the artworks themselves. At the end of the trust term, the grantor owns a percentage of the LLC interests corresponding to the sum of his annuity distributions, and the GRAT distributes the remaining LLC interests to the remainder beneficiaries. To the extent there has been appreciation in the art during the GRAT term, the remainder beneficiaries (in effect) receive a portion of the appreciation, without gift tax.

To illustrate how a GRAT works, let's assume that a collector establishes an LLC that we will call "ArtCo" and contributes several paintings in exchange for a 100% interest in ArtCo. The collector then establishes a three-year, zeroed-out GRAT and transfers his 100% interest in ArtCo to the GRAT. The value of the paintings transferred to ArtCo must be substantiated by an appraisal prepared by a qualified art appraiser. Let's assume that the paintings appraise for a total of $10,000,000 and the value of the 100% interest in ArtCo transferred to the GRAT is also $10,000,000. Based on the IRS assumed rate of return for June 2009 of 2.8%, the grantor would need to retain the right to receive an annuity payment of approximately $3,520,000 each year for three years in order to "zero-out" the GRAT so that there would be no gift made when the GRAT is funded.

Let's assume that the paintings held by the LLC appreciate in value over the next three years by 10% per year. After the first year, the paintings are worth $11,000,000, substantiated by another appraisal. The first annuity payment of $3,520,000 is due to the grantor from the GRAT. The GRAT holds a 100% interest in ArtCo. Thus, to make the annuity payment, the GRAT transfers back to the grantor a 32% interest in ArtCo, which is worth $3,520,000 – calculated by dividing $3,520,000 by $11,000,000.

After the second year, the paintings appreciate 10% and are worth $12,100,000, substantiated by another appraisal. The second annuity payment of $3,520,000 is due to the grantor from the GRAT. The GRAT now holds a 68% interest in ArtCo. Thus, to make the annuity payment, the GRAT transfers back to the grantor a 29% interest (rounded) in ArtCo, which is worth $3,520,000 – calculated by dividing $3,520,000 by $12,100,000.

After the third year, the paintings appreciate 10% and are worth $13,310,000, substantiated by another appraisal. The third and final annuity payment of $3,520,000 is due to the grantor from the GRAT. The GRAT now holds a 39% interest in ArtCo. Thus, to make the annuity payment, the GRAT transfers back to the grantor a 26% interest (rounded) in ArtCo, which is worth $3,520,000 – calculated by dividing $3,520,000 by $13,210,000.

After the third annuity payment is made, the GRAT terminates, and the remaining 13% interest in ArtCo held by the GRAT passes to the grantor's named beneficiaries. In effect, the grantor has transferred 13% of the value of the paintings, now worth $13,210,000, to the beneficiaries without paying any gift tax. A 13% interest in ArtCo is worth $1,730,000; thus, assuming a 45% Federal gift tax rate, the Federal tax savings on the transfer are approximately $780,000.

Of course, in the real world, assets do not often change value in such a consistent pattern. The key to the success of a GRAT is that the assets must appreciate at a rate in excess of the IRS's assumed rate of return in effect when the GRAT is created – 2.8% for June 2009 in our example above. If the assets out-perform the IRS's assumed rate of return, the GRAT will succeed and there will be something left at the end of the GRAT to pass to the grantor's beneficiaries. If they do not, the grantor will end up getting back everything that he originally contributed to the GRAT, and the remainder beneficiaries will receive nothing. It is important to note, however, that the grantor and the remainder beneficiaries can never be financially harmed by a GRAT – the worst that can happen is that the GRAT assets fail to out-perform the IRS rate-of-return assumption, the grantor incurs some transaction costs, and the remainder beneficiaries get nothing when the trust terminates.

The question of valuation sometimes poses a challenge for GRATs funded with artwork. Unlike a share of publicly traded stock, the value of which can be easily ascertained, each work of art is unique and must be appraised by analyzing comparable sales. Sometimes the data required to substantiate the change in value of a work of art from year to year are not available, particularly with artists whose works are obscure or rarely sold. In addition, the annual costs of appraising the artwork in a GRAT may be substantial, particularly if multiple works are contributed. Thus, when choosing artwork to put in a GRAT, it is important to determine in advance, by consulting with an appraiser, whether there are any potential valuation challenges and what the appraisal costs will be.

With any estate planning technique that relies on an appraisal, there is always a risk that the IRS will audit the collector's tax return and challenge the appraisal. Fortunately, the GRAT has built-in protection against appraisal risk, because the annuity is stated as a percentage of the value of the property transferred to the GRAT. Thus, if the value of the property transferred to the GRAT is increased on audit, the annuity payments retained by the grantor will increase correspondingly and the gift to the remainder beneficiaries will remain zero. Consequently, the only effect of a valuation increase on audit would be a decrease in the amount passing tax-free to the grantor's beneficiaries when the GRAT terminates.

One disadvantage of GRATs is that there is a mortality risk associated with them. If the grantor dies during the term of a GRAT, all of the property in the GRAT is subject to estate tax in the grantor's estate and the tax benefits are lost. Thus, to maximize the chances that the grantor will survive the GRAT term, it is usually more effective to establish a series of short-term GRATs, each with a two- or three-year duration, rather than a single long-term GRAT. Studies have also shown that employing a series of short-term GRATs – known as "rolling GRATs" – is more effective than a long-term GRAT for capturing excess appreciation for the benefit of the grantor's beneficiaries, because investment returns tend to average out over longer periods. (Note, however, that there is speculation Congress may soon mandate a minimum ten-year term for GRATs, thereby effectively legislating rolling GRATs out of existence.)

GRATs funded with artwork also present another planning issue having to do with the use and possession of the art once its ownership is divided between the grantor and the remainder beneficiaries. Under Federal estate tax law, if an individual gives away property but retains the right to use it for his or her lifetime, the property may be subject to estate tax at the individual's death. In order to avoid application of this rule, the grantor should enter into a written agreement with the remainder beneficiaries to provide that the grantor and the remainder beneficiaries will take physical possession of the collection for periods commensurate with their respective

The CLAT Alternative

The same economic factors that make GRATs appealing right now also make it a good time for those of a philanthropic bent to think about setting up a CLAT – an acronym that stands for Charitable Lead Annuity Trust.

Analytically, a CLAT is similar to a GRAT, except that the annuity is paid to charity rather than to the grantor. When the charitable term ends, the remainder of the CLAT is distributed to friends or family members of the grantor. As with a GRAT, the CLAT remainder can be "zeroed out" – so that, for tax purposes, the gift of the remainder is made without incurring any gift tax. If the CLAT's assets out-perform the IRS's assumed rate of return, the remainder beneficiaries receive a share of the trust assets free of gift tax. And depending on how the CLAT is structured, the grantor may also get a sizeable charitable deduction based on the value of the charity's annuity interest.

ownership interests. If the grantor retains full-time possession of the collection, he should pay the remainder beneficiaries a fair market rent for their share. If the art is held by an LLC, the LLC operating agreement should specify that the LLC members have rights of possession corresponding to their ownership interests in the LLC, and, if actual possession exceeds a member's right to possession, some form of fair market compensation should be specified. Of course, if the art is purely an investment asset, the easiest course of action may simply be for it to be put in storage.

Funding a GRAT with artwork is certainly more complicated than funding a GRAT with publicly traded securities. The valuation issues described above may be particularly challenging. However, if a collector owns a valuable collection and believes that it will appreciate in value at a rate greater than the IRS assumed rate of return, a GRAT may be an estate planning technique well worth considering. ❖

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Antitrust and Authenticity: Warhol Case Survives Motion to Dismiss

In the Spring issue of *The Legal Canvas*, we reported on an antitrust case against the Andy Warhol Foundation, the Andy Warhol Art Authentication Board, the artist's estate and its executors. The action was brought as a class action by collector Joe Simon-Whelan, who alleged that the Foundation and the Board had "conspired to control the market for Andy Warhol artwork" by inappropriately refusing to authenticate pictures in order to "create a scarcity in the market for Warhol artwork and inflate the value of the Warhol works in the Foundation's possession."

On May 26, 2009, Judge Laura Taylor Swain of the United States District Court for the Southern District of New York permitted an important part of the claim to go forward, denying large portions of the defendants' motion to dismiss.

Simon-Whelan's claim arose from his attempt in 2001 to sell a painting by Warhol. Simon-Whelan alleged that the painting had been authenticated by the Authentication Board and by the Warhol Estate and had passed through a number of dealers familiar with works by Warhol before Simon-Whelan acquired it in 1989. Despite this history, Simon-Whelan alleged, the Authentication Board told him he would have to re-submit the picture for authentication. When he did, the Board determined that the picture was not authentic – and reconfirmed that determination a year later when Simon-Whelan presented it again with additional documentation. The Foundation, as a result, did not include the picture in the *catalog raisonné* of Warhol's work.

In his complaint, Simon-Whelan alleged that the Foundation and the Board conspired to reduce artificially the number of authenticated Warhols on the market, thereby restraining trade. He also alleged that the defendants engaged in anticompetitive conduct in order to monopolize the submarket for the "offering for sale … of Andy Warhol works." The court held that the facts alleged in the complaint were sufficient to create a plausible antitrust claim. It also held that Simon-Whelan had alleged the sort of injury – being prevented from "competing as a seller in the lucrative market for authentic Warhols" – that the antitrust laws are meant to prevent. The case will therefore go to trial.

This case is not the first to bring antitrust allegations against an art authentication committee, but it is believed to be the first to survive a motion to dismiss. Two cases brought in the Southern District against The Pollock-Krasner Foundation in the mid-1990s were thrown out – the first because of the statute of limitations, the second because of defects in the pleadings. In the latter case, *Kramer v. The Pollock-Krasner Foundation*, the plaintiff failed to allege a "relevant geographic and product market in which trade was unreasonably restrained or monopolized" as required by the antitrust laws. The plaintiff defined the market as being sales of Pollock works at auction in Manhattan and included Christie's and Sotheby's as co-conspirator defendants. The court dismissed the case, finding, among other things, that the market definition failed because Pollock paintings could be sold privately and in places other than Manhattan.

The Simon-Whelan case is important for a second reason. The Warhol Authentication Board will not consider a work for authentication unless the applicant signs a submission agreement that waives all claims against the Board, the Foundation and the Warhol Estate for any action taken by the Board. The agreement also requires the applicant to indemnify each of the entities against claims that may be brought by others, i.e., to pay their legal fees and the cost of any judgment that may be brought against them. Simon-Whelan sought a declaration by the court that these provisions of the agreement are invalid, alleging that they are used to conceal the intentional illegal actions of the Board and the Foundation and protect the defendants from the consequences of those actions. He also alleged that it was always the intent of the Board to deny his picture's authenticity and that he was therefore fraudulently induced to sign the agreement. Citing law to the effect that an exculpatory agreement cannot, as a matter of public policy, be used to protect against claims of intentional misconduct, the court held that Simon-Whelan's allegations were sufficient to go to trial.

Submission agreements are not uncommon among authentication boards and other experts. They exist for a reason: to provide experts with assurance that they can exercise their best professional judgment without fear of being sued. Even though experts tend to win lawsuits as long as they can show that they acted reasonably and in good faith, that may be cold comfort to individuals and not-for-profit foundations that are faced with the potentially crippling costs of a trial in cases where the waiver and indemnification provisions of a submission agreement are at risk of being disregarded.

The art market has an interest in protecting the ability of experts to provide their professional opinions. Without protection, experts may simply decline to participate in the authentication process, which is critical to the industry. The market also has an interest, however, in holding experts accountable for improper conduct that can have both a financial and art-historical impact. It is a hard balance to strike, and the Simon-Whelan decision may tip the scales in favor of increased accountability. ❖

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Christie's Faces Trial Over "Fraud on the Market" Allegations by a Buyer Who Didn't Buy at Christie's

When you buy art at Christie's, Sotheby's or almost any other auction house, you are automatically bound by the conditions of sale that are printed in the auction catalog and posted on-line. The conditions of sale set out your rights and obligations as a buyer and constitute your contract with the auction house. Among other things, the conditions of sale of both major houses define what your rights are when you think that the art you purchased is inauthentic. You are required, for example, to provide written opinions of experts and to return the art in the same condition as when you purchased it. If it turns out that the art is inauthentic or incorrectly attributed, you are entitled to rescind the sale and recover the purchase price. The warranty is stated to be *only* for your benefit as the buyer – and not for the benefit of subsequent owners – and you are required to make your claim within five years of the date of the sale.

From time to time, buyers have sought to get around the time limitation by alleging that an auction house acted fraudulently. In cases of fraud, the New York statute of limitations does not begin to run until the buyer discovers (or should have discovered) that the art is inauthentic. That discovery can occur years – or even decades – after the sale, putting the auction houses at risk for a virtually unlimited time.

A recent decision by the Supreme Court of the State of New York for New York County has broadened that risk even further, by allowing a claim of fraud to be brought *not* by the person who had bought a picture 17 years earlier at an auction, but by the collector to whom he sold it a year after the auction. In effect, the court held that an auction house can be liable to anyone who purchases anything that was ever sold at auction, if that person can allege that he relied on the auction house's warranty of authenticity. In the parlance of the securities industry, the court has introduced the concept of "fraud on the market" to the art world.

Facts of the Case

Two years after the death of Jean-Michel Basquiat, one of his primary dealers, Tony Shafrazi, purchased a painting attributed to the artist at an auction at Christie's. Later that year, Shafrazi exhibited the picture as part of a Basquiat show at his gallery and sold it to Italian collector Guido Orsi. The Basquiat Authentication Committee was not formed until 1994, and first saw the picture in 2006, when Orsi was asked to lend it to a museum for an exhibit. The Committee determined that the picture was inauthentic. Orsi first sued Shafrazi, but dropped that claim to join forces with Shafrazi in a suit against Christie's.

In their respective fraud claims, Shafrazi and Orsi alleged that, during the pre-auction exhibit in 1990, the artist's father, Gerard Basquiat, and John Cheim, a dealer who represented the Basquiat estate, had told someone at Christie's that they believed the picture was not authentic. Christie's allegedly sold the picture in spite of this communication.

The court dismissed Shafrazi's claim on grounds that he had not been damaged, because Orsi was not looking to Shafrazi for his money back.

However, the court permitted Orsi to pursue his claim against Christie's.

> "Plaintiffs allege that when Shafrazi sold the Painting, he described it as 'Purchased from Christie's Contemporary Art ...' Plaintiffs have submitted affidavits to the effect that art purchasers rely on the expertise of a prestigious auction house such as Christie's, which they term a 'market maker,' and that when Christie's provides a warranty concerning the authenticity or provenance of a painting, the custom and practice of the art industry is that the provenance of the work of art has been firmly and permanently established. Plaintiffs allege that Orsi purchased the Painting, relying on Christie's representations. If, as plaintiffs allege, Christie's fraudulently misrepresented the Painting's provenance, and published that misrepresentation in its catalogue, which Christie's could reasonably anticipate would be relied upon by bidders at its auction, as well as subsequent purchasers, it may be liable to those who relied upon its misrepresentation"

Christie's moved for reargument, but in an opinion issued on April 14, 2009, the court affirmed its original decision. Acknowledging the validity of Christie's concern that permitting the claim to go forward could create liability that "could stretch out in perpetuity," the court said that the issue before it was more limited.

> "The nexus between Christie's and Orsi is not only close, but also limited and finite. Christie's may not have known of Orsi specifically, but he may be able to establish that it would or should have known that Shafrazi – particularly as a gallery – would resell the Painting to someone."

The court also affirmed its earlier ruling that Orsi can seek consequential and punitive damages against Christie's, not just the original purchase price. Orsi paid $185,000 in 1991; he is seeking damages in the amount of $2,000,000.

Of course, if the case goes to trial, Orsi will have to prove that Christie's intentionally sold the picture knowing that it was inauthentic and that Orsi's decision to purchase the picture from Shafrazi was based on his reliance on the statements in the Christie's catalog. It may be an uphill battle. Shafrazi, in addition to being one of Basquiat's primary dealers, was known to be closely associated with the artist. Because the Basquiat Authentication Committee had not been formed at the time of the sale, Shafrazi himself would have been one of the people to whom the art world would have turned to confirm the work's authenticity. In 1999, Shafrazi published a significant volume on the artist's work and included an image of the painting now at issue in the Orsi lawsuit. The forward to the book acknowledges the assistance of Gerard Basquiat, as well as other members of the Authentication Committee. Each of these facts could be relevant to an assessment of Christie's belief in the authenticity of the picture (and whether that belief was reasonable). They are also arguably relevant to the question of whether Orsi was really relying on Christie's reputation and not on the expertise of his dealer.

What's Next?

As of the publication of this issue of *The Legal Canvas*, Christie's has not yet appealed the April order. Even assuming that the auction house will prevail on the facts at trial, these court rulings can create significant exposure going forward. While the judge on rehearing made it clear that she envisioned some limitation on the ability of future owners of auction property to sue, she did not provide any analytic basis on which some future judge might draw the line. If these opinions stand, the auction houses could find themselves facing any number of claims brought by remote parties relating to auction sales that took place many years ago – and as to which evidence may be difficult to retrieve. Employees will have left, and documents may have long since been lawfully discarded. Lawsuits are expensive – trials particularly so – and any trip to court is risky.

And, lest anyone be tempted to engage in any *shadenfreude*, the court's reasoning does not provide any real basis to distinguish between Christie's (or any other auction house) and other market participants in whom the market places confidence. Major dealers who may also be deemed to be "prestigious" or "market makers" may find themselves defending claims by distant third parties who purchased works later in the chain of ownership. Museums that have deaccessioned works may find that the fact that they purchased and held the art as authentic is enough to form the basis of a claim by a later owner who says he relied on the museum's expertise. In fact, one can imagine that the only market players who can rest easy are those whom the market deems to be untrustworthy – or those who are willing to offer the defense that "everybody knows that you can't rely on *my* word."❖

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Deaccessioning Watch: Defeat for O'Keeffe Museum Puts Stieglitz Collection One Step Closer to Having a Home in Two States

A university that inherited a valuable art collection many years ago is now facing financial troubles and says it needs to sell the art. The question is: where can the art go? Until July 14, 2009, the answer was nowhere, as a trial court had enjoined the sale of the collection and required it to remain at the university. Now, with a reversal by a higher court, this question has been put back on the table.

The collection at issue consists of 101 works given to Fisk University (the "University"), 97 of which had been part of the estate of famed photographer Alfred Stieglitz, and four of which had been given to the University by his equally renowned wife Georgia O'Keeffe. Depending on whom you ask, the collection should stay put at the University's galleries in Nashville, Tennessee, despite the University's financial difficulties; end up at the planned Crystal Bridges Museum ("Crystal Bridges") in Arkansas, at least for part of the year; or perhaps find a home at some other museum in Nashville, Tennessee, or elsewhere in the South.

Until the recent decision by the Tennessee Court of Appeals, there had been as many parties to the case as there had been preferences for where the art should go. In its July ruling, the appellate court not only vacated the lower court's injunction and reopened the issue of the University's proposed sale, but it also removed one litigant from the fray when it decided that the Georgia O'Keeffe Museum (the "O'Keeffe Museum"), whose predecessor, the Georgia O'Keeffe Foundation (the "Foundation"), had successfully intervened in the case in 2005, was not a proper party to the case.

Since the University seems committed to moving ahead with a deal it arrived at with Crystal Bridges nearly two years ago, this will continue to be a case to watch, as it raises important legal questions about donor intent and the remedies available to a charitable institution in financial distress. Although the case is being decided in Tennessee, the courts there have concluded that the outcome is governed by substantive New York law, so decisions in this case have particular resonance for New York donors and New York institutions.

Origins of the Case: The University's Initial Attempt to Sell Two Paintings

The case, *Georgia O'Keeffe Foundation (Museum) v. Fisk University*, 2009 WL 2047376 (Tenn. Ct. App. Jul. 14, 2009), originated in 2005 when the University sought court permission to sell two valuable paintings from the collection, which otherwise apparently could not be sold according to the terms under which the University had accepted the gift. The University's stated purpose in selling the paintings, *Radiator Building-Night, New York* by O'Keeffe and *Painting No. 3* by Marsden Hartley, was to generate funds for its "business plan" to restore its endowment, improve its mathematics, biology, and business administration departments, and build a new science building.

Everyone Gets Involved

The Foundation sought to intervene and block the sale, arguing that it had a stake in the matter due to the way in which the Stieglitz collection had made its way into the University's hands.

Alfred Stieglitz died in 1946. Under his Will, Mr. Stieglitz bequeathed to Ms. O'Keeffe, his wife, a life interest in his art collection. The Will stipulated that at her death, the collection (approximately 900 works) would go to one or more charitable corporations that would receive the works "under such arrangements as will assure to the public . . . access thereto to promote the study of art." His Will also bestowed on Ms. O'Keeffe the power during her lifetime to transfer all or a portion of the art to charitable corporations meeting those specifications, a so-called "power of appointment." She chose to exercise that power of appointment, and in 1949 she divided the collection and gave portions of it to each of six nonprofit institutions, including Fisk University. At the time of the donation, Ms. O'Keeffe sent a series of letters to the University's president, setting forth her understanding that the University would never sell the art and specifying a number of terms, including a requirement that the collection would always be exhibited intact. The University confirmed its acceptance of Ms. O'Keeffe's understanding and its acceptance of her terms.

When Ms. O'Keeffe died in 1986, her residuary estate passed to the Foundation, which later assigned all its assets to the O'Keeffe Museum. In support of its motion to enter the case, the O'Keeffe Museum argued that, upon breach of the terms Ms. O'Keeffe imposed when she exercised her power of appointment, the collection would "revert" to Ms. O'Keeffe; and because she had died, to her estate; and because the Foundation was the estate's residuary beneficiary, to the Foundation; and because the Foundation had assigned its assets to the O'Keeffe Museum, to the Museum.

The Tennessee Attorney General, which itself intervened in the case in 2007 to protect the interests of the charitable beneficiaries and the people of Tennessee, disagreed. The trial court sided with the O'Keeffe Museum, but the Tennessee Court of Appeals reversed the lower court in its July decision.

The appellate court first analyzed whether Ms. O'Keeffe had a "reversionary interest" in the art. In other words, did Ms. O'Keeffe have the right to get the art back if the University did not comply with its promises? The court concluded that she did not. Her life estate in the art ended with her death, and her power of appointment ended once the gifts had been allocated to the six institutions. She had authority to dispose of the art as directed by the Will, but she did not have the right to take it back. Because the interest claimed by the O'Keeffe Museum was based on Ms. O'Keeffe's alleged reversionary interest, the O'Keeffe Museum likewise had no right to get the art back. It therefore had no "standing," which means that it had no concrete stake in the outcome of the matter and could not be part of the litigation.

The Proposed Sale to Crystal Bridges

Unless the O'Keeffe Museum successfully appeals the July decision, its participation in the case is at an end. Hence, the O'Keeffe Museum will not be able to participate in the resolution of the substantive issue in the case, which is whether the University can escape the terms imposed by Ms. O'Keeffe and enter into the proposed arrangement with Crystal Bridges. In this arrangement, Crystal Bridges would pay $30 million for a half interest in the Stieglitz collection, which would then rotate every six months between Arkansas and Tennessee.

The lower court had ruled against the University, determining that the University did not merit relief under the equitable doctrine of *cy pres*, which permits release of donor-imposed restrictions if certain factors are met. (The term "*cy pres*" is an abbreviated version of an old Anglo-French phrase "*cy pres comme possible*," which means "as nearly as possible.") The Court of Appeals, however, disagreed with the technical issue on which the lower court had thrown out the University's case and has now sent the issue back for consideration anew.

To win approval of its proposed agreement with Crystal Bridges, the University will need to show that its financial straits have rendered compliance with the gift's conditions "impossible or impracticable." It will then need to show that the proposed agreement will cure the impossibility or impracticability and most effectively accomplish the donor's intent. The Attorney General, which had previously indicated that it would prefer the collection to remain in Tennessee, is still a party to the case, and can therefore be expected to take a position on whether the University meets the applicable standard.

Even though the lower court has already expressed disapproval of the Crystal Bridges arrangement, the appellate court appeared to give the lower court some guidance when it said that the donor's purpose was to make the Collection available "to the public in *Nashville* and *the South* for the benefit of those who did not have access to comparable collections to promote the general study of art" (emphasis in original). Arkansas ordinarily being considered part of the South, the appellate court may have been signaling that it would support a decision that enabled the collection to end up somewhere else in the South, at least part of the time.

If the case goes forward, the lower court will have to thread its way through some difficult questions. Whose donative intent really matters here – Stieglitz, O'Keeffe, or both? Does the proposed arrangement with Crystal Bridges fulfill the donor's intent? Would the donor have preferred the collection to remain intact even if this meant that the collection would spend a significant amount of time outside of Tennessee? Or would the donor have intended the collection to remain in Tennessee even if this meant splintering the collection among multiple Tennessee institutions? For that matter, would the donor have preferred the collection to remain in Tennessee even if this meant that the University did not get the best deal on the table or, perhaps, if it meant that the art would not be given optimal presentation to the public? The donor appeared to want the collection to benefit the public in Tennessee, remain at the University, and exist in perpetuity as a collection. In other words, the donor wanted *all* of those things. But when an institution is in peril and is able to persuade a court that something has to give, which elements of donor intent should be given priority?

A Lurking Issue – Use of the Sales Proceeds

Another question is also lurking below the surface: If a portion of the Stieglitz collection is allowed to be sold, will the court impose any limitation on the use of the sales proceeds? This issue throws the *Fisk University* case squarely into the fiery debate about deaccessioning by financially troubled museums and universities, which we covered in the Spring 2009 edition of *The Legal Canvas*. In that article we discussed the situation of Brandeis University, which as of this writing has been sued by three members of the Board of Overseers of its Rose Museum for Brandeis's attempt to close the museum.

In the deaccessioning debate, the objection to use of the proceeds of deaccessioned works for some purpose other than buying more art stems in part from the notion that donors who donate works of art intend to give a special asset with a specific intended use (i.e., display of the work), not a fungible asset that the recipient can convert to cash at will. For art museums, there are ethical limits and, for some art museums in New York State, legal prohibitions on the use of deaccessioning proceeds, as well as whatever written limitations a donor may have imposed.

In the *Fisk University* case, of course, neither Mr. Stieglitz or Ms. O'Keeffe imposed any express limitation on the University's use of the proceeds of sale if the collection were sold (which is hardly surprising, since Ms. O'Keeffe's terms required that the collection *not* be sold). These two artists clearly, however, envisioned that their gift would promote art and art education. One might therefore argue that this aspect of their intent ought to govern the use of the proceeds if the collection is ever sold. Yet a court order authorizing the sale to Crystal Bridges but requiring that the proceeds be applied only to the promotion of art and art education might not be sufficient to stabilize the University's financial condition. Thus, if the University were to prevail but be subject to those limitations, permission to sell to Crystal Bridges could well be pointless. If, however, the University prevails on every point, the case may stand for the proposition that economic necessity can take precedence over the wishes of those who donate their art to museums. ❖

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On the Cover

The painting on the cover of this issue is an untitled work by Robert McCurdy. Completed in 2003, it is part of a private collection in New York. McCurdy's series of *Portraits* began in 1997, and in recent years his subjects have included internationally recognized figures such as the Dalai Lama, Gabriel Garcia Marquez, Toni Morrison, Neil Armstrong, and Nelson Mandela. His portrait of Toni Morrison is currently on long-term loan to the National Portrait Gallery in Washington. McCurdy has described his portraits as images taken from a "sustainable moment" discovered during the portrait sitting, a moment "where there is no before or after. It is why there is no movement, expression or gesture…The image is reported rather than interpreted." McCurdy is also an accomplished photographer. In addition to the National Portrait Gallery, McCurdy's work has been exhibited at the Frye Museum, the Norton Museum of Art, and the Wexner Center for the Arts. He is represented by the Venetia Kapernekas Gallery in New York.

The Legal Canvas is a newsletter prepared by attorneys in the Art and Museum Law Group of Patterson Belknap Webb & Tyler LLP for our clients and other interested friends.

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This newsletter is for general informational purposes only and should not be construed as specific legal advice. If you have any questions about any of the articles in *The Legal Canvas* or wish any further information, please contact any of the following attorneys:

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