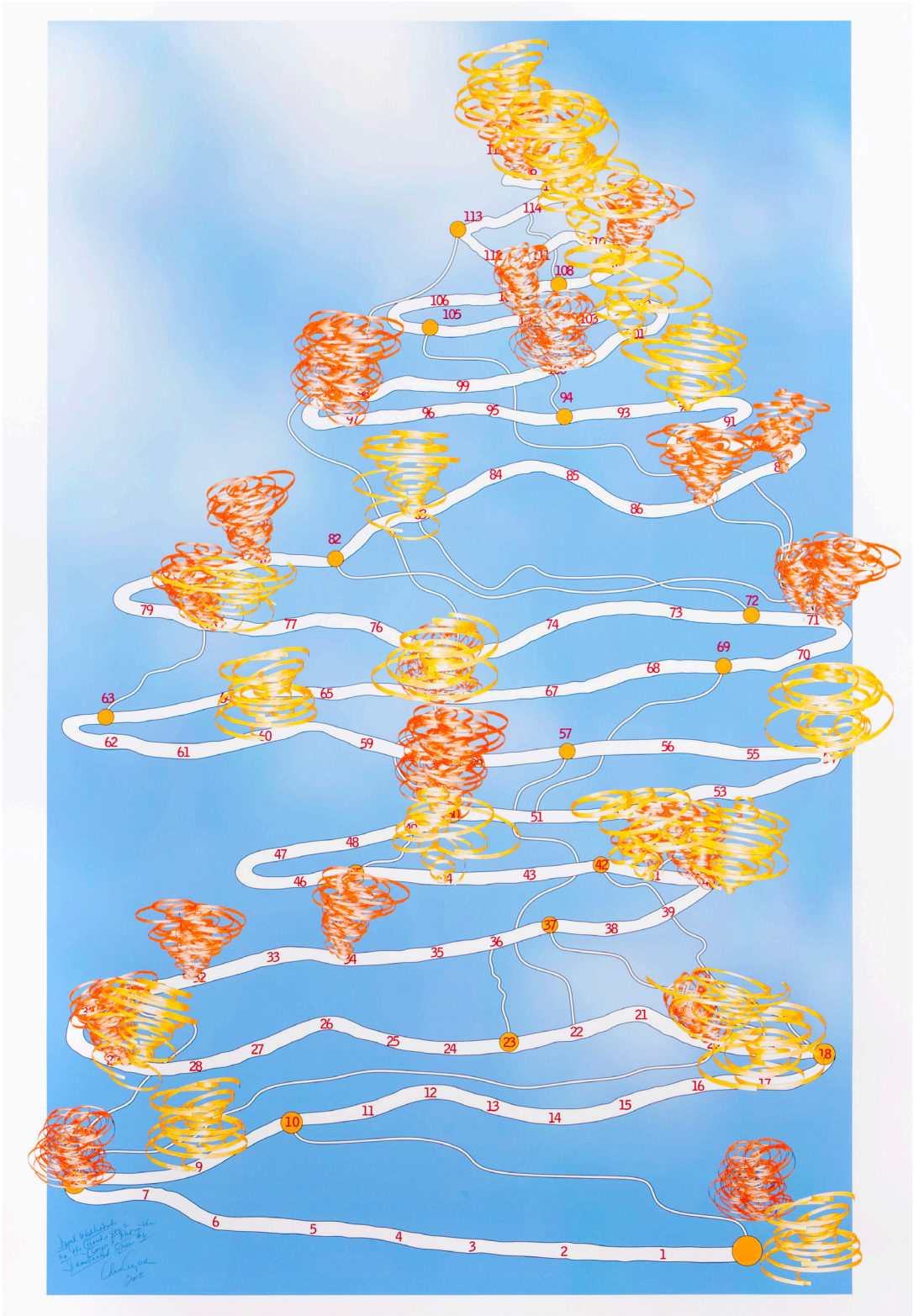
The Legal Canvas

Summer 2012



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Summer 2012 Already?

In this issue of the Legal Canvas, we have chosen to cover some basics – or at least things that are basic for lawyers but may be matters of mystery for others.

In the course of our practice we find that many of our clients have (happily) never been involved in litigation. That's the good news. The bad news is that when a dispute arises, inexperience with the realities of litigation may affect the ability to make good decisions. We therefore offer a primer on litigation – what it is, how it works, its risks and its benefits, and why it is so expensive.

We also find that although many people in the art world owe fiduciary responsibilities to their employers, institutions, or clients, they may not understand the nature of those responsibilities or the potential consequences when they are breached. We discuss the concept of fiduciary duty and look at two cases – one that is currently pending in New York and one that was decided in London in 2010 – that illustrate the sorts of facts that may elicit claims (or findings) of fiduciary breaches.

On other matters, we review a decision by the European Union about the imposition of VAT and customs duty on works that are imported into the EU in component parts. We also report on a federal court decision holding the California Resale Royalties Act to be unconstitutional and a proposal in Congress to institute a national resale royalty scheme. And, we provide updates on new regulations governing deaccessioning by certain museums in New York, and on two restitution cases.

Finally, we look at three different situations that have occurred over the last couple of years in which artists or their work have been suppressed – Ai Weiwei in China, Mustapha Benfodil in Sharjah, and David Wojnarowicz in the United States. We examine the roles of both technology and the law in shaping the art community's responses to these sorts of incidents.

Which again brings us back to basics, and for lawyers in the United States the basics lie in the Constitution. One can argue that the United States is behind the curve in terms of artists' rights. We recognize only a very restricted form of moral rights; only one state has ever provided for resale royalties – a statute that is now in jeopardy. But we have the First Amendment. And that is an artists' right that should be dearly cherished and protected.

Have a good summer. ❖

Hugh Freund Jo Backer Laird John Sare

Experienced art world professionals.
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In this issue ◆ ◆ ◆

Dealing in Hidden Risk: Agency and Fiduciary Liability in the Dealer-Seller Relationship

Last winter, elderly collector Jan Cowles sued Larry Gagosian and the Gagosian Gallery in connection with the sale of a work by Roy Lichtenstein. According to the complaint, when Gagosian got the work on consignment the minimum sales price was established at $3,000,000, of which the Gallery would retain a $500,000 commission. Gagosian ultimately persuaded Mrs. Cowles' son, Charles, to accept $1,000,000 for the work, attributing the lower price to condition issues with the picture that the complaint says did not exist. Gagosian did not tell Charles that he had actually sold the work for $2,000,000 and was retaining a commission of $1,000,0000.

In a brief filed in the case, Mrs. Cowles' lawyers quoted from an e-mail sent by the Gallery to the prospective (and ultimate) purchaser:

> "Seller now in terrible straits and needs cash. Are you interested in making a cruel and offensive offer? Come on, want to try?"

The brief goes on to describe the transaction as a "gross" and "brazen" breach of Gagosian's *fiduciary duty* to its consignor.

This case has not yet been adjudicated, which means that the facts alleged in the complaint have not yet been proved. They remain mere allegations. If the facts are proved to be true, however, it seems likely that the court will find that they constitute a fiduciary breach.

What does it mean to be a fiduciary?

First year law students learn what it means to say that one person has a "fiduciary duty" to another. It is a fundamental legal concept.

Fiduciary relationships abound in the art market. Auction houses and galleries are fiduciaries to their consignors; museum directors and trustees are fiduciaries to their institutions; primary dealers are fiduciaries to their artists.

Yet, it is safe to say that some art market participants are unfamiliar with the word "fiduciary," the legal scope of the responsibilities that it describes, or the possible consequences of failing to fulfill those responsibilities.

Simply put, a fiduciary must always act in the best interests of his or her "principal," or client. It is the highest duty that one person can have to another.

Some people are automatically fiduciaries by reason of their profession. Lawyers have a fiduciary responsibility to their clients. Executors are fiduciaries to the beneficiaries of the estates they administer. Other people acquire fiduciary duties because of the nature of their relationship with another person. One is more likely to have a fiduciary duty when he is acting on behalf of someone who is significantly less sophisticated and who is heavily reliant on the advice that he is receiving.

In most of the transactions in which an art dealer engages, he is acting as an agent. He is selling work that is consigned to him either by an artist or collector, or he is buying work on behalf of a client. By law, an agent has a fiduciary duty to his principal.

An agent's fiduciary duties.

Generally speaking, an agent has strict fiduciary duties of loyalty and good faith. In the art dealer context, this principally means a duty to:

- Care for and manage the principal's property prudently;
- Deal fairly and honestly with the principal;
- Account to the principal as to dispositions of the property; and
- Disclose to the principal all information relevant to the subject matter of the agency.

Most litigation related to fiduciary breaches by art dealers has

involved behavior that is so self-evidently wrong as to require little explanation. For example, a dealer who sells a work of art but does not notify his consignor of the sale or misrepresents the actual sale price cannot be surprised that he is breaching his legal obligations to the consignor (in that case, probably contractual as well as fiduciary). That sort of breach announces itself with neon lights and blaring trumpets that take a conscious act of will to ignore.

Other fiduciary breaches may be more difficult to recognize, even for the most diligent dealer. For example, it is not uncommon for an art transaction to involve a chain of intermediaries who help to locate prospective sellers or buyers, who negotiate the eventual sale, and who each earn a commission on the deal. With each additional link in the chain, the relationship of any particular intermediary with the ultimate principals becomes more attenuated. The more links there are, the less clear it is who is acting on behalf of whom.

It was only a matter of time before this kind of fact pattern led to lawsuit.

Accidia Foundation v. Simon C. Dickinson Limited.

In 2010, the High Court of Justice, Chancery Division, in London issued a decision in the matter of *Accidia Foundation v. Simon C. Dickinson Limited.* The decision was based on laws of agency that are fundamentally the same in both the United Kingdom and the United States.

In *Accidia*, collector/seller Accidia Foundation ("Accidia") contracted with dealer Luxembourg Art Limited ("LAL") to sell a drawing by Leonardo da Vinci. Under its exclusive agreement with Accidia, LAL was to receive a commission of 10% of the purchase price. LAL in turn sought the help of Simon Dickinson Fine Art to find a buyer from among Dickinson's Old Master clients. Dickinson and LAL agreed to a so-called "net return price" arrangement, whereby Dickinson would deliver $6 million in sale proceeds for the drawing. Dickinson would be entitled to keep any amount obtained over the $6 million. The letter agreement memorializing this arrangement described Dickinson as acting "in [its] capacity as agent for the Buyer."

Dickinson eventually secured the sale of the painting for $7 million, forwarding $6 million to LAL, keeping $700,000 as a commission for itself and using the rest to compensate one of its consultants and the buyer's curator. LAL retained $500,000 as a commission from those proceeds and remitted the remainder to Accidia, who understood that the net sale price (after that commission) was $5,500,000.

While Accidia was aware that Dickinson was involved in the sale to the ultimate buyer, it was unaware of the actual sales price paid and the approximately $1 million retained by Dickinson from the initial proceeds. When Accidia discovered this fact eight months later, it sued Dickinson for the $1 million, asserting that Dickinson had been Accidia's agent and had breached its fiduciary duty by retaining a secret commission—this, despite the fact that Accidia had no agreement with Dickinson, had never been in direct contact with Dickinson, and had been informed in at least one email from LAL that Dickinson "act[ed] for the buyer."

However, evidence in the case showed that the sales contract transferring title to the drawing to the buyer was entered into solely between Dickinson and the buyer, and stated that Dickinson acted "as agent for the Owner" and "on behalf of the Owner." The Court ultimately concluded that Dickinson, as the party to the sales contract, had acted as Accidia's agent and therefore owed strict fiduciary duties to Accidia as principal. As such, according to the Court, it had a responsibility to assure that its $1 million commission was disclosed to Accidia – a responsibility that it (as well as LAL) had failed to fulfill.

Dickinson did not directly dispute its agent status but argued that net return price arrangements are common practice in the London art market and that the $1 million commission was in any event fair. Despite the fact that the Court found Mr. Dickinson to be a straightforward, honest witness acting in a way he thought honorable and in accordance with customary practice, it held that the failure to disclose the net return price arrangement to Accidia and obtain Accidia's consent amounted to a breach of fiduciary duty. Addressing the net sale price in particular, the Court said,

> "I am…not satisfied that any custom or practice exists whereby art dealers agree with principals or their agents for a return price on the basis that the dealer may sell the piece at any price without inform-

ing the principal or his agent of that ultimate price or of the level of commission the dealer thereby receives after passing on only the return price…. *Moreover, such arrangements would be objectionable as being unreasonable and unlawful, unless they were concluded with the fully informed consent of the principal seller or the dealer accounted to that principal for the secret profit."* [Emphasis added.]

The Court held that because Dickinson was acting as an agent for Accidia through LAL, and Accidia had contracted to pay only a 10% commission, Dickinson's $1 million commission was unauthorized and unlawful. The court held, however, that Dickinson was entitled to fair compensation for its role in the transaction. Because the seller had agreed in its contract with LAL that 10% was a fair commission, the court determined that the total commission for both dealers should be $700,000. LAL having already received $500,000, the court permitted Dickinson to keep $200,000.

There but for fortune.

The judge in the *Accidia* case was not "satisfied" that net prices are common in the art market. Many art market participants know otherwise. They also know that it is not at all uncommon for one dealer to seek the assistance of another in the sale of a work of art. In most cases, the seller is not aware of the chain of intermediaries between him and the buyer. Accidia found out about Dickinson's commission only when the buyer of the work rescinded the sale because of doubts as to the work's authenticity, and Dickinson sought reimbursement from the seller.

The fact is that many art transactions are structured in a way that makes them fertile ground for fiduciary breaches. Dealers and advisors in the secondary market make a living buying and selling art for their clients. The availability of product is limited and unpredictable; works of art are sold only when their owners choose to sell them. When a work of art comes on the market, there is incentive to get involved in its sale. And the way to get involved (and earn a commission) is to have access to a potential buyer – or even just to "know someone who knows someone." Relationships matter. And, because the relationships are critical to a dealer's business and clients tend to want their affairs to remain private, it is not at all uncommon for the principals in a transaction not to know who is on the other side of the deal.

This is not necessarily as nefarious as it may appear. Sellers and buyers of art benefit from market networks that make it possible for them to find each other. Where it can become a problem is where the intermediaries forget that even though the art may be their stock in trade, they do not own it and they have a responsibility to the person who does. What the Accidia case establishes is that if you forget that very fundamental fact – that you are meant to be serving the interests of the principals to the transaction – you may be subject to significant legal liability.

Special Protection for Artists

New York by statute has prescribed additional duties to protect consignors who are artists. Article 12 of the New York Arts and Cultural Affairs Law ("NYACAL") expressly says that when an artist delivers work to a dealer, it is deemed to be a consignment relationship, and the dealer is deemed to be the artist's agent (and therefore his fiduciary) with respect to the consigned work. Title to the work remains with the consignor until it is sold, and the work becomes trust property in the hands of the dealer; the arist's work and the proceeds of its sale are held in trust for the benefit of the artist. As such, the proceeds cannot be used as the dealer's own funds. Nor can the dealer retain consigned artwork as collateral for claims it may have against the artist. Perhaps most importantly, the statute protects the artist's work and the proceeds of its sale from the claims of any of the dealer's creditors.

Late last month, the New York State Legislature passed a bill that would make a breach of one's obligations under Article 12 subject to the penalties of a misdemeanor. The bill, which is awaiting the governor's signature, will also permit artists and their heirs to bring civil lawsuits under the statute, and would allow them to recover attorney's fees if successful.

How it can be done better.

Have a written agreement consignment agreement. The agreement should be clear about how the dealer will be compensated and whether and how the dealer can compensate intermediaries in the course of the sale.

Be Forthcoming. The dealer should diclose all material information to the principal and make sure that the principal understands the ultimate selling arrangement. If the arrangement with the principal is a "net price" sale, the dealer should be sure that the agreement with the principal makes clear that the dealer will be entitled to retain all of the money received from the buyer in excess of that net price, regardless of how much that might be. The dealer should keep the principal informed of any developments in the transaction, and get the principal's written approval for any changes in the way the sale is being handled

Be clear who the client is. If a dealer is not dealing directly with the principal, the documentation should be very clear from the beginning who the dealer is working for. The dealer should ask the person or persons with whom he is dealing to warrant to the dealer in a written agreement that the dealer's role and commission have been disclosed to and approved by the principal, or, at least, that the payment of the dealer's commission is not inconsistent with the arrangement by which the person is acting for the principal.

Account Separately for Consigned Property and Sales Proceeds. A dealer should maintain detailed, accurate records of consigned artwork and sales proceeds. By the same token, it is wise to keep separate inventory lists for consigned work and gallery-owned art, and use one or more dedicated accounts for consignment proceeds, segregated from the gallery's general operating account.

Report Completed Sales Promptly. The dealer should inform the principal of the closing of a transaction promptly after its occurrence (generally the same day or next business day) and disclose all material information about commissions, fees, or expenses. If the dealer has a large number of consigned works from a particular client, he should report aggregate sales to the client on a regular basis. A dealer should never sit on sales proceeds without informing the seller of their receipt.

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Censorship: Silencing Art

On April 3, 2011, the government of China arrested Ai Weiwei, one of the country's foremost and globally recognized contemporary artists. He was released after 81 days in prison. Since then, he has been under constant surveillance and has been forbidden to leave Beijing. The Chinese government contends that the artist was arrested for tax evasion; most everyone else believes that he was arrested because of the political content of much of his art. As an example, his 2009 work, *Remembering,* consists of 9,000 colorful children's backpacks installed on an outside wall, arranged to spell, in Chinese, the words, "She lived happily for seven years in this world." The words are those of a mother who lost her child during the 2008 earthquakes in Sichuan province. The piece was meant to call attention to badly constructed schools that had collapsed and killed thousands of children.

The arrest of Ai Weiwei came as part of a crackdown in China in which dozens of intellectuals and activists were arrested and detained. The crackdown was believed by many to have been triggered by China's fear that the Arab Spring would lead to similar unrest in China. Ai Weiwei was the best known of the detainees and China's arrest and lengthy detention of Ai challenged the notion that high-profile figures are protected from government reprisal when the "whole world is watching."

Ai Weiwei's arrest provoked dramatic reactions from both the art community and beyond. A chorus of nations called for his immediate release. Protests were held at Chinese embassies and consulates world-wide. Leading artists engaged in their own protests; Anish Kapoor refused an invitation to show his work at the National Museum in Beijing and dedicated his sculpture, *Leviathan*, commissioned by the Grand Palais in Paris, to Ai. In an interview in December 2011 in *Time Magazine*, Ai said that his release "could only have come from support… from the international art community and political community and also in China."

The most dramatic event, but not the only one.

The arrest and detention of Ai Weiwei may have been the most severe and dramatic instance of censorship of the arts in the past few years, but it has not been the only one.

In the fall of 2010, the National Portrait Gallery in Washington, D.C. mounted an exhibition entitled "Hide/Seek: Difference and Desire in American Portraiture." The show focused on the impact of "sexual difference" on American art from the 1880's to the present, and contained works by, among others, Thomas Eakins, George Wesley Bellows, Romaine Brooks, Marsden Hartley, Walker Evans, Georgia O'Keeffe, Robert Rauschenberg, Jasper Johns, Robert Mapplethorpe, Andy Warhol, Keith Haring, Felix Gonzalez-Torres, and Glenn Ligon.

The show also included a four minute clip from a video by David Wojnarowicz entitled *A Fire in My Belly*. The video, created in response to the artist's AIDS diagnosis, contained religious imagery of anger and anguish. Approximately eleven seconds of the clip consisted of an image of ants crawling on a fallen crucifix. When the Catholic League protested that the video clip was "insulting" and "hate speech," Smithsonian Secretary G. Wayne Clough made a quick and unilateral decision to remove the video from the exhibition, stating later that he did so in order to forestall retaliatory budget cuts at the hands of a politically charged Congress.

Shortly after the arrest of Ai Weiwei, Jack Persekian lost his job as the director of the Sharjah Art Foundation because the ruler of Sharjah objected to Persekian's inclusion in the Sharjah Biennial of a work that was deemed to be sexually and religiously provocative. The work, *Maportaliche/It Has no Importance*, by Algerian

artist Mustapha Benfodil, was installed in a courtyard in front of a mosque. It consisted of headless mannequins in soccer uniforms with what could be seen as sexual and religious words written across the garments and in surrounding graffiti.

Each of these events occurred during a period when the arts community has been expanding and celebrating its global inclusiveness. Chinese art has a solid footing in the international contemporary market. The Sharjah Biennial has begun to establish itself as a regular stop on the "Great Global Art Tour" as collectors and scholars explore contemporary art from Arab and Gulf states. And the exhibition at the National Portrait Gallery was itself an explicit act of inclusion – an acknowledgement of the expression of "difference" in American art. These events have therefore raised interesting and fundamental questions for the art world of when and how to respond when the freedom of artists and museums is restricted. If you are part of a community that is operating on a multi-cultural and global basis – a community that, at its heart, is based on a common belief in the value of artistic engagement and interaction – how should you respond when the freedom to engage is denied to an artist or an arts institution?

The question is too grand to be fully answered in these pages. It is also a question the answers to which will evolve over time and involve philosophical and political debate. What we can usefully do, however, is to discuss, in the context of Ai Weiwei, Wojnarowicz and Benfodil, the roles that technology and law can play in that response.

Global communications as a global tool.

Censorship can work only where the censor can control the public's access to disfavored images. That kind of control is infinitely more difficult in a digitized and globalized world. Once upon a time, all it took to suppress a work of art was to prohibit its exhibition and prevent its reproduction in a limited universe of printed publications. If the control wasn't always absolute, the consequences were limited by the limited reach of those publications. The advent of radio, movies, and television permitted a wider potential platform for any given artist or work of art. But the relatively small number of networks and studios, the reliance of television and radio on government airspace, and the geographical limits of broadcast media provided continued levers of control.

It simply isn't that easy any more. The ability to publish an image in real time to a global audience can be purchased for the price of a cell phone. The ability of any government to control these communications – to block access to the Web or to particular sites -- lasts only as long as it takes someone to figure out an effective "work-around."

This salutary effect of technology has played a role in the events involving Wojnarowicz, Benfodil and Ai Weiwei. Each of the three incidents was reported instantly around the world and provoked immediate reaction. In the same *Time Magazine* article in which Ai Weiwei attributed his release to international pressure, he also acknowledged the power of the Internet in his continued legal struggles with the Chinese government – both in his ability to communicate with the world and in the ability of others to express their support of his activities.

In the case of the National Portrait Gallery, if the intent of the Catholic League was to suppress Wojnarowicz's video, the art community effectively prevented that from happening. Screenings of the work were held in many cities, including an event at the Tate Modern in London; the film was posted on YouTube and elsewhere on the Web; and the Museum of Modern Art pointedly acquired the work to include in its permanent collection. The Brooklyn Museum and the Tacoma Art Museum collaborated to show the Hide/Seek exhibit, and each included *Fire in My Belly*. Similarly, Benfodil's work has received considerably more international attention than it would have had it not been removed from the Sharjah Biennial.

Where the law is a viable tool.

Although the Internet can undermine the impact of censorship, it does not provide a basis on which to challenge censorship directly. For that, one needs a body of law that protects free expression. That is where national boundaries still matter in a global market community.

What makes the Wojnaorwicz matter different from the others is that it happened in the United States, and what

distinguishes the United States is that when a government official seeks to abridge the expressive rights of artists or of the institutions that display their work, his or her ability to do so is limited by the First Amendment of the Constitution.

As an example, in 1991 the City of Miami decided not to the renew the lease of the Cuban Museum of Arts and Culture, which was housed in a city-owned building in Little Havana. The city had been subjected to significant political pressure from Cuban émigrés who were upset by the museum's decision to exhibit art by artists who either still lived in Cuba or who had not yet renounced Castro. The museum had, in fact, been bombed twice, and the city cited its concerns for public safety.

The city's decision was determined by the federal district court in Miami to be unconstitutional. The court held that the museum's curatorial decision was "subject to the full protection of the First Amendment." It further held that the city's decision to allow the lease to terminate was based on that curatorial decision and that the city's excuses and rationales were pretextual.

> "Although the City Commission may have been well intentioned in taking steps to end the controversy and bring peace back to the community, thereby ending the controversy, the intolerant bickering among various groups, and the dissension with the local community, it could not attempt to accomplish such well-intentioned goals by sacrificing those whose views and method of expression had caused others to respond with hostility and scorn."

The court held that the "penalization" of the museum's "First Amendment rights … with the resulting chilling effect on speech" constituted what in the law is called "irreparable harm," i.e., harm that can be compensated only by ordering the offending party to make things right, not by the payment of money damages.

Eight years later, the federal court in Brooklyn reached the same conclusion when the Mayor of the City of New York labeled works in an exhibit at the Brooklyn Museum of Art as "sick" and "disgusting," and aggressively attempted to force the removal of those works from the Museum. The court, citing the First Amendment, blocked him from doing so.

The exhibit, "Sensation: Young British Artists from the Saatchi Collection," had come to Brooklyn after a controversial run at the Royal Academy in London. In London, the controversy was focused on a portrait by Marcus Harvey of convicted child murderer Myra Hindley made up of hundreds of small images of a child's handprint. In New York, Mayor Giuliani focused on a work by Chris Ofili depicting the Virgin Mary which incorporated preserved elephant dung, and ultimately withheld city funds that had already been appropriated to the museum.

Finding that the Mayor had engaged in a deliberate campaign to force the museum to abandon its First Amendment rights and that the loss of those freedoms would constitute irreparable harm, the court ordered the city to restore the funding and abandon a separate action to evict the museum from its city-owned property. In the course of her opinion, Judge Nina Gershon noted,

> "If there is any fixed star in our constitutional constellation, it is that no official, high or petty, can prescribe what shall be orthodox in politics, nationalism, religion or other matters of opinion."

The First Amendment is a powerful weapon against infringements on the most important aspects of artistic freedom. However, the First Amendment does not protect against every act that an artist may feel is a restriction on his or her art. Certain speech (and therefore, art) is not covered by the First Amendment – including obscenity. Art may also be subject to government regulation as to the time, place and manner of its exhibition. In each instance, however, there are limits on what the government can do. A mayor, for example, may not impose his own standards of obscenity, but must follow established constitutional guidelines. A city may not forbid the exhibition of art based on its content in areas designated or traditionally used as places of expression unless the city can establish that the regulation is narrowly drafted to serve a compelling public interest.

Comparing Wojnarowicz and Benfodil.

The underlying circumstances of the events at the National Portrait Gallery and the Sharjah Bienniel have substantial similarities. At base, Smithsonian Secretary

Clough and Jack Persekian each sought to protect his respective institution as a whole.

Secretary Clough's decision to remove *A Fire in My Belly* from the National Portrait Gallery exhibit was perhaps understandable given the prevailing political climate. At the very least, the situation illustrates the chilling effect that funding fears can have on arts institutions where the economy is in distress and political hot buttons are at issue. Indeed, the Republican leadership in Congress explicitly threatened the Smithsonian's federal funding, which amounts to as much as 75% of the institution's budget, if the concerns of the Catholic League were not addressed. Since the removal of the work, Clough has defended his decision as necessary both as a way of protecting his funding and as a way of protecting the remainder of what was a ground-breaking exhibit.

Similarly, even though the dismissal of Jack Persekian as director of the Sharjah Art Foundation was met with disapproval and anger, Persekian himself ultimately distanced himself from that reaction. For Persekian, his termination was not an inexcusable act of censorship on the part of the emirate, but the result of a misstep on his part in the course of the "respectful dialogue" that he believes is necessary in order to nurture the development of contemporary Arab and Gulf art.

In a statement explaining the removal of the work, and, by extension, the dismissal of Persekian, the President of the Sharjah Art Foundation noted the fact that the work was "sited in a very public courtyard, a place where children play after school, where families wander together on the weekend and where people pass on their way to religious services at the neighboring mosque. This work paired language that was sexually explicit with religious references in an overt and provocative manner."

It would seem that Jack Persekian accepted his termination as graciously as he did in order to protect and preserve the significant progress that the Sharjah Bienniel has engendered in the development and understanding of Arab contemporary art. If that's the case, then his motivation was not far from that of Secretary Clough.

The situations, though similar, are factually distinguishable in a number of ways. As an example, in Sharjah, the issue was whether the work by Benfodil was installed in an inappropriate public place where people would be exposed to it whether they wanted to be or not. Under United States law, the decision in Sharjah could be characterized as a permissible regulation of the "time, place and manner" of expression. By contrast, in Washington, the issue was whether the work by Wojnarowicz could be part of a museum exhibition that people could choose to attend or choose to avoid – a much more significant infringement on artistic expression.

But the most important difference is that under the United States Constitution, Clough had the right and the ability to resist the demand to remove the work and to challenge any retaliatory funding decisions on the part of Congress. A large part of the negative reaction in the art community centered on the fact that he chose not to do so – he chose not to assert the Smithsonian's First Amendment rights and protect the judgments of its curators. The case law, after all, would suggest that had the museum declined to accommodate the demands of the Catholic League, and had the Congress retaliated as Secretary Clough feared, the action of Congress would likely have been held to be unconstitutional. At least one editorial opined that the situation diminished the legitimacy of the Smithsonian as an arts institution. Essentially, in comments that ranged from disappointment to outrage, the point was made that in a country that provided Clough with the legal mechanism to defend basic freedoms, he chose instead to make accommodations. No matter how sympathetic and rational his reasons for doing so, many in the community felt it was not enough.

Some thoughts.

Events deserve responses. If freedom of artistic expression is a fundamental ideal of the global arts community, then it is important for the community to protest (or at least discuss) each time that freedom is infringed. This is how international norms are developed.

Legal remedies aren't the only tool in the toolbox. Technology has provided the arts community with a powerful tool to combat censorship that doesn't require lawyers or lawsuits. In a very basic way, the Internet can be used to broadcast images and ideas that a

government has tried to suppress. Moreover, a government with any sensitivity to world opinion has reason to measure the way it treats its artists against the fact that whatever it does may provoke an instant and global response.

Nevertheless, law makes a profound difference. In nations such as the United States, where one has the right to mount a direct legal challenge to an infringement of free expression, the ability of the government to censor art is circumscribed. That doesn't mean that it doesn't happen. But governmental officials who attempt to restrict free expression do so at the peril of constitutional challenge and judicial scrutiny.

The question at the center of the Smithsonian case is whether the availability of legal rights requires that they always be exercised. Can a museum director in the United States legitimately decide that his institution is best served by accommodating political demands that encroach on the museum's curatorial freedom? Does that kind of decision diminish the institution, or are there circumstances in which it is justified? If we choose not to assert rights do we cause their erosion?

For more information on this topic, contact Jo Laird at 212.336.7614 or jblaird@pbwt.com.
The assistance of summer associate Tiffany Figueroa is gratefully acknowledged.

Quick Update

In the Summer 2009 issue of the Legal Canvas, we wrote about the wisdom of filing a UCC financing statement when art work is consigned to a gallery. Specifically, we said that the filing of a financing statement that reflects the consignor's interest in the work provides protection against the gallery's creditors. Financing statements take no time to prepare and cost less than $50 to file.

It could be money well spent.

On July 9, 2012, a federal court issued a ruling relating to the Salander-O'Reilly Galleries bankruptcy proceedings. When Salander-O'Reilly went into bankruptcy, it was in possession of artwork that it had on consignment. According to the opinion, the Bankruptcy Court issued a protocol that, among other things, established a Working Group that was charged with making initial decisions as to which of those works would be considered part of the bankruptcy estate and therefore available to satisfy the claims of the gallery's creditors. If a consignor had "perfected" his security interest in his artwork by filing a UCC financing statement, the work was excluded from the bankruptcy estate.

The consignor of a 16th Century work by Botticelli titled *Mother and Child* and valued at $9.5 million had not filed a financing statement, and the work was included by the Working Group as an asset of the estate. The consignor of the work subsequently moved to have the question of whether the work was part of the estate determined in arbitration in Jersey, the Channel Islands, under an arbitration clause in his consignment agreement. The Bankruptcy Court denied the motion, and the federal district court agreed, leaving the consignor enmeshed in the bankruptcy proceeding.

We will provide a more thorough discussion of the opinion in the next issue of the Legal Canvas. But the bottom line here is that if the consignor had filed a financing statement at the time he delivered the painting on consignment, his involvement in the bankruptcy (and his legal bills) might already be over. Instead, his saga continues and his stake in his Botticelli remains at risk.

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Thinking About Litigation? Think Twice. It's Alright

If you have never been involved in a lawsuit, your perception of what it is like may be based largely on television courtroom dramas. Once the scene is set with the client's first meeting with the lawyers, the factual investigation sleekly homes in on key evidence, briefs and legal papers seem to appear out of nowhere, depositions last ten minutes, and a trial comes to a dramatic conclusion just in time for the credits to roll.

Would that it were so.

In reality, litigation is usually a messy, prolonged, and unpredictable process. It is designed to get at the truth, but doesn't always do so. It is imperfect, it is expensive, but sometimes it is simply necessary. It is the way that a society based on the rule of law has chosen to resolve disputes. Although it may be imperfect, but it is better than pistols at twenty paces.

Happily, most participants in the art market are novices at litigation. This is partly due to the fact that the art world is a relatively small community – made up largely of individuals and small businesses – in which relationships matter, and litigation tends to disrupt relationships. Nevertheless, litigation happens. There are some dis-

Basic Steps In The Litigation Process

The course of a lawsuit will vary depending on its facts and on the procedural rules of the court in which it is being tried. As a general matter, though, litigation will include some or all of the following very basic steps.

The Complaint. This is the first statement of the actual claim, the facts on which it is based, and the damages or other forms of relief that are sought.

Emergency Relief: Temporary Restraining Order and Preliminary Injunction. These forms of emergency relief only granted where the plaintiff (the person that brings the lawsuit) can show that he is both likely to win the case and that if the defendant (the person being sued) is not stopped from doing whatever is being enjoined (e.g., destroying a work of art), the plaintiff will suffer irreparable harm, i.e., harm that cannot be cured by the payment of compensation. Litigating a motion for a preliminary injunction normally requires formal motion papers, affidavits (fact statements from witnesses and counsel), and briefs (memoranda that make legal arguments). Usually, the plaintiff submits papers, the defendant submits briefs and affidavits in response, and the plaintiff has a chance to submit briefs and affidavits to rebut the defendants arguments. Once all of these submissions are made, the motion is considered to be "fully briefed." At that point, the court can decide whether to hold a hearing at which the lawyers can present live witnesses and argue their cases – all to permit the judge to make a determination of who is likely to win the case if it is litigated.

Motion to Dismiss. Once a complaint is brought, the defendant may either answer it (see below) or move to dismiss it. In a motion to dismiss, the court must accept as true all facts as alleged by the plaintiff, and then decide whether those facts make out a "cause of action," i.e., a claim for which the court can provide compensation. Motions to dismiss can be based on a failure of the plaintiff to allege facts that would support a necessary element of the particular cause of action at issue. For example, a plaintiff suing for a breach of contract has to allege facts that show that there was a contract. Motions to dismiss can also be based on other grounds, such as the complaint

putes that simply cannot be resolved any other way. One or both parties may feel that their position in the dispute is simply too fundamental to their business to compromise. Someone who owes you money may simply not pay unless a court orders him to do so. And sometimes, you will simply be sued.

Patterson Belknap does a lot of litigation. We are very good at it. But it is important to us that our clients understand the process, especially if they have never experienced it before.

If you are thinking about filing a lawsuit – or deciding how to respond if someone threatens to sue you – you should know what lies ahead.

What it is.

Litigation is nothing more (and nothing less) than the presentation of a dispute to a judge or jury who first decide, based on the evidence, what they believe really happened, and then apply the law to those facts in order to determine how the dispute will be resolved.

To assure that all of the facts are disclosed and the appropriate law is considered, litigants follow a strict, predefined process. As a general matter, the process is designed to permit the resolution of a matter at the earliest possible point. A court will dismiss a complaint that has no legal validity even if all the facts alleged by the plaintiff are true. Similarly, a court will rule in favor of one or the other party if the facts of the matter are not in dispute and the resolution of the case requires only the application of the law to those facts—what lawyers call "summary judgment." At any point in the process – as the court's views on the law become clearer and as

having been brought beyond the applicable statute of limitations, the legal period during which a claim can be raised. Again, a motion to dismiss will be fully briefed, and a judge may hold oral argument once all the briefs are submitted.

Answer. An answer is filed in response to the complaint, either directly or after an unsuccessful motion to dismiss. The answer typically responds to each and every one of the allegations in the complaint, either admitting or denying the allegation, or stating that the defendant does not have sufficient information to respond either way. The answer can also include affirmative defenses, such as wrongful conduct on the part of the plaintiff that caused the defendant's actions. Finally, the answer can raise counterclaims against the defendant or cross-claims against third parties, which essentially become "complaints" against those parties.

Discovery. Discovery is the process by which the parties exchange information. The information and materials that are exchanged can be used at trial and can also inform the parties' decisions as to whether to settle the case.

Summary Judgment. At the end of discovery, either or both parties may make motions for summary judgment. Summary judgment is granted where there are no material issues of fact and the judge can decide the case as a matter of law. Summary judgement motions generally require the submission of affidavits, a full briefing schedule, and a hearing. An order granting summary judgment is appealable to a higher court.

Trial. Where discovery has been completed and the lawsuit has neither been settled nor dismissed, it goes to trial. The trial is a hearing in which each side presents evidence, and the judge or a jury makes a determination about what happened. The law is then applied to those facts – either directly by the judge (where the trial is being heard without a jury) or by the jury which must follow the directions of the judge as to the law. The outcome at the trial court level can be appealed to a higher court.

more facts are disclosed – the parties themselves can make judgments as to their own likelihood of success and seek to settle the case before trial.

That is not to say that the process is designed to be inexpensive. It is not.

Litigation is expensive for a reason.

Most law firms, including ours, charge time-based fees, and litigation is extremely time-intensive. You need to know all of the key facts and all of the applicable law in order to navigate every stage of the litigation.

There is no such thing as "litigation lite."

Gathering your facts. Developing the facts starts with your own memory and your own files. You (and your lawyer) need to be very clear on what happened that caused the dispute and what you will be able to prove to a judge or jury. Who did what? Who said what to whom? What is in writing, and what is not?

During this process your lawyer will ask you a lot of questions to test your own memory and flesh out the story. If there are others who may have information about what happened, your lawyer may want to interview them as well. You and your lawyer will certainly need to search through your own files for documents, e-mails, and any other form of evidence that might be relevant to the case. You want to know as much as you possibly can as early as possible. If there are documents that will undermine your position, you and your lawyers want to know about them up front rather than be surprised by them later.

This factual investigation will allow your lawyer to make several determinations: whether your grievance amounts to what lawyers call a "cause of action," i.e., is it something for which the law provides compensation; how likely you are to be able to prove your case and win a lawsuit that you bring or that may be brought against you; can you prove (as you will have to) that you have actually suffered damages that can be identified and quantified with some specificity; and, the best strategy for pursuing or defending your position.

Knowing the law. The legal system in the United States is referred to as a "common law" system. Simply put, this means that the law is developed primarily by "case law" – the courts determine on a case-by-case basis how the law is to be applied to a particular set of facts. Each case becomes a precedent for the next one that presents similar facts – a precedent that the next court can follow, reject, or distinguish based on sometimes very small differences in the fact pattern.

A courtroom is not an art fair. The court will apply the law, and only rarely will be influenced by customs and practices of the art community that are inconsistent with legal doctrine. Knowing the law that will be applied in your case will inform your decisions as to whether to litigate or settle and the best strategy to follow in either event. It will be your lawyer's job to persuade the court at various points in the litigation (or your opponent in settlement discussions) which cases to apply and which to distinguish or reject.

Finding the applicable case law is not always easy. Think of the process as looking for one particular vein of gold in a massive mine. As an attorney, you start with some very broad sense of what you are looking for – e.g., cases involving breach of contract in a sale of art, or cases involving fraud or negligence. You narrow the search as you go along, trying to find cases with fact patterns that are as similar to your own as possible. You need to search broadly enough to know that you are catching everything, and narrowly enough to know that you are not missing the one case that a court will think is determinative.

Once you find those cases, you need to be sure that they are still good law by checking to see if they have been overturned on appeal or if the case law has changed by, for example, a more senior court deciding the relevant issue in a different way. You need to find the cases that will help you, as well as the cases that will help your opponent.

Some of this process can now be accomplished on-line through dedicated legal websites. But, at the end of the day, every case has to be read and analyzed. And, as every judicial opinion will cite other cases as precedent, legal counsel needs to read those cases as well to be sure that there is nothing in them that will hurt your argument.

Arguments on the law are presented to the court through briefs and oral presentations each time you "make a motion" to the court – i.e., each time you ask the court to rule on something. Motions occur throughout the case: you may ask the court to dismiss the case, to grant you summary judgment, to rule on the scope of discovery (described below) or the admissibility of evidence at trial. We once made a stack of all of the opinions that were cited in just one brief in a relatively simple lawsuit. Those cases by themselves accounted for about a foot of paper, and each page required close reading and understanding. If we had collected the actual statutes, cases and other materials that had to be read in order to find and hone the law, the pile may have been four times that high.

"Discovery" of the other party's facts. Once a lawsuit is filed and is not dismissed, the parties will engage in discovery. "Discovery" is the process by which each party gets access to the evidence the other party has that could either prove or disprove his case. As part of discovery, each side can request documents, e-mails and any other form of printed or recorded evidence that may be in the possession of the other party, take the depositions of the other party (testimony under oath before a court reporter), depose other witnesses who may have knowledge of the matter in dispute, and seek sworn answers to written interrogatories. Discovery can also include court-authorized inspections of premises or of works of art.

Discovery can be very expensive, depending on the factual complexity of the case, the number of witnesses, the volume of relevant documents that each side has to assemble and produce, etc. Every document has to be carefully reviewed – does it support or undermine the other side's case? Deposition questions must be prepared to elicit the testimony that you will need to support your case in a motion for summary judgment or at trial.

Similarly, your own files have to be combed to assure that you are producing all of the documents that are called for by the discovery demands of the other side. Your own witnesses have to be prepared to be deposed; they have to learn how to respond to questions in a very structured setting and be refreshed on facts that may have occurred months or years before.

Discovery is a regulated process, and either party can be sanctioned if it fails to comply with the rules. If you are asked for "all" documents that relate to the sale of a work of art, for example, you cannot pick and choose which documents to provide. You have to provide all of them – even the ones that have your notes and doodles on them. Either party may object to discovery demands, but the threshold for permissible discovery is fairly low. The information requested must be reasonably calculated to lead to the discovery of admissible evidence. In most instances, if the requested information is not privileged (i.e., subject to a legal protection of confidentiality such as the attorney-client privilege) it will have to be produced. In some cases, the court will permit the production to take place subject to a mutually agreed protective order that will keep it from being disclosed to the public.

Trial. Less than 2% of civil lawsuits in the United States make it to trial. The vast majority of cases are dismissed or settled along the way. Where a case has not been dismissed, the parties have an incentive to settle as trials require substantial and costly preparation. On courtroom dramas, lawyers may seem to ask questions off the cuff, and opening and closing arguments are short and sweet. In real life, it takes long and intense hours of preparation. And every trial involves risk, no matter how confident one might be about its outcome.

Appeal. Even when you win at trial, the case may continue through an appeal process. If it does, each appeal to a higher court will involve a full briefing schedule and, in most cases, oral argument. In other words, you have not fully won until the trial court's decision has been upheld by the highest court that hears it. The entire process can take years.

Pay your own way. In the United States, the general rule is that each party pays its own legal fees. The exceptions are where a specific statute that governs the case allows for the recovery of legal fees, or where the dispute involves a contract in which the parties have agreed that the losing party will pay the winner's legal bill. The Visual Artists Rights Act is an example of a statute that allows for the recovery of legal fees when a violation of the statute is proved.

Litigation is not predictable or controllable.

In most art-related transactions, you can usually predict with some certainty what the process will entail and how much it will cost to complete it. You can anticipate and account for the relevant risks in how you draft a contract or invoice. If the buyer can't pay the purchase price, or the work can't be legally exported to the buyer's country of residence, the deal can be cancelled and the contract between the parties determines whether one party owes anything to the other.

In litigation there is no such certainty – either as to outcome or cost.

You can't script the other side. You can control only your own actions in litigation; you can't control your adversary. Your opponent can make motions or discovery demands that you may not have anticipated or that may even be procedurally objectionable. But you have to respond anyway. You can't ignore them. You can object, answer, make your own motions to the court – but you have to respond. Once you are involved in litigation, either as a plaintiff or a defendant, you have only three choices: default, contest, or settle. You can't simply walk away without consequence.

You can't script the court. There is always risk in litigation. No matter how strong you are on the facts and the law, there is always a risk that a judge or a jury will see things differently. There are ample war stories of litigants stunned by the outcome of a case, and even more stunned when the decision is upheld on appeal.

You and your lawyers can do everything right, and still lose.

There will almost always be some surprise along the way. A surprise is a surprise because, by definition, you did not expect it to occur. An important document is disclosed during discovery that you didn't know existed. A witness tells a different version of the facts (or lies) during testimony. A witness dies; a party changes counsel; your expert witness submits a report that could undermine your position on, for example, the authenticity of a work. Surprises can have an impact on the outcome of a case. And surprises can cost money as your lawyer decides how to respond to them.

Litigation can be disruptive.

No matter how well your lawyer shoulders the burden of the litigation, it will necessarily cost you both time and energy that you could be spending on other business or personal matters. More than that, though, it can also interfere with other business relationships.

Suppose, for example, that you are a dealer and an artist sues you for an alleged breach of contract or breach of fiduciary duty. The complaint alleges that you sold the artist's work for an amount that is greater than the amount that you reported to the artist. The documents in your own files support your defense that you did nothing of the sort. Under the rules of discovery, the artist may be permitted to obtain the list of the clients to whom you sold her work and to subpoena documents in their possession relevant to the sales. While it is customary in the industry never to release those names, the names are not subject to any legal privilege and a court could require you to disclose them. Even if you are able to have the information disclosed under a protective order, you may not be able to protect your clients from the burden or expense of producing documents that relate to transactions that they thought would be confidential.

Litigation is public.

Litigation is meant to be a public forum. Most court filings are available to the public (including journalists), and courtrooms are open to visitors and observers. You have to assume that everything about the case – all the allegations, everything that is disclosed in discovery or entered as evidence at trial – will become public.

Especially if you are the defendant in an action – i.e., you are the one who is being sued – you should be prepared with a media strategy. Because of the way litigation is structured, the plaintiff's allegations will always be the first thing that people hear. The facts that support the defendant's position may not become public for weeks or months after that. You may be very anxious to speak to the press and get your side of the story out while people are still paying attention. But, doing so may cause problems in the litigation down the line. In most cases, your lawyer will likely advise you not to talk to the

press or issue a prepared written statement. The right strategy will differ from case to case.

Litigation can be emotional, but should not be approached emotionally.

Large companies see litigation as an inevitable cost of doing business in the United States. When you are an individual or a small institution or gallery, it can seem much more personal. If you are sued, someone is saying you did something wrong. If someone has wronged you, you want to get him to make things right. In either case, it can feel very much like a matter of principle.

Some cases *do* involve matters of principle, but you need to identify them with care. You should approach litigation the same way you approach any other business decision – what is the potential risk, what is the potential reward, and what is the best way to get to the desired result.

In the next issue of the Legal Canvas we will discuss alternate forms of dispute resolution – arbitration and mediation.

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Artist Resale Royalties in America: California Law Struck Down. National Legislation Proposed.

There is an old legal adage that you should never ask a question in court if you don't know what the answer will be. That adage can perhaps be applied to a recent lawsuit that could lead to the demise of the California Resale Royalties Act.

In October 2011, identical complaints were filed against Sotheby's and Christie's in federal court in California. The complaints alleged that the auction houses had deliberately failed to comply with the California Resale Royalties Act by failing to pay royalties when due – either to the appropriate artists or to the California Arts Council, the state entity charged with collecting and distributing the funds when the artist cannot be located. The complaints also alleged that the auction houses had deliberately concealed whether a seller at auction was a resident of California, a fact which would trigger the royalty no matter where in the United States the auction was held. This act of concealment was alleged to have prevented artists from knowing when a royalty should have been paid on the sale of their works.

As we noted in the Winter 2010-2011 issue of the Legal Canvas, the California Resale Royalties Act was a statute that generally went unenforced, in large part because its enforcement relied on actions brought by the artists themselves. Artists were reluctant to bring those actions, both for fear of alienating a collector or gallery, and because the amount of any given royalty rarely justified the cost of litigation. The complaints filed last October, however, were filed as "class actions," that is, they purported to be brought not only on behalf of the named plaintiffs, but also on behalf of any artist or artist's estate that was not paid a resale royalty that was due to be paid by one of the auction houses during the three years prior to the filing of the complaints. The class action mechanism shifts the calculus of litigation: the aggregation of the individual claims makes the case

worth litigating, the costs are shared, and all but the named plaintiffs remain anonymous.

While providing a way for the artists' rights under the statute to be enforced, the lawsuits proved to be a risky venture. The dearth of prior litigation under the statute meant that there was little opportunity to challenge the validity of the law itself. The auction houses took the opportunity here to do so, and on May 17, 2012, the District Court for the Central District of California declared that the statute violated the Commerce Clause of the Constitution of the United States, and was therefore unconstitutional. Under the Commerce Clause, a state may not purport to regulate commerce outside its own boundaries, and the court held that the California Resale Royalties Act did just that. The court illustrated the point by noting that the statute would require an auction house or dealer located in New York to pay a royalty to an artist living in New York on a work sold in New York as long as the consignor of the work lived in California.

Having found that the application of the statute to transactions outside the state was unconstitutional, the court had the option of invalidating only that portion of the statute. Nevertheless, it chose to strike down the statute as a whole. The court cited law to the effect that a court should invalidate only a part of a law if it is clear that the legislature would have passed the remaining portion on its own. In the case of the California Resale Royalties Act, the state legislature explicitly rejected a version of the bill that would have applied solely to transactions in California for fear that it would drive business out of the state.

The court's decision was not unforeseeable. In fact, the court referred to a letter written by California's Legislative Counsel in 1976 when the bill was being considered. In the letter, the Legislative Counsel advised that the state had no interest in the fiscal welfare of artists living outside California and that the application of the statute to transactions outside California would be unconstitutional.

The plaintiffs have announced their intention to appeal the judge's ruling. If they do, there is reason to believe that it will be upheld by the Ninth Circuit Court of Appeals. The appellate court faced an analogous issue in 2009 when it struck down a special statute of limitations for Holocaust-related claims. Although the constitutional provision at issue in that case related to the exclusive rights of the federal government in the realm of foreign affairs, the flaw in the statute arguably lay in the fact that it was deliberately drafted to apply to museums and galleries both inside and outside the state. (As described in our article on page 24, a federal district court has since ruled that a revised version of that statute is also unconstitutional.)

A Proposal for federal legislation.

On December 15, 2011, Senator Herb Kohl and Congressman Jerry Nadler introduced the Equity for Visual Artists Act of 2011. The Act would impose a 7% resale royalty on the sale of a work of art for at least $10,000 – as long as the sale takes place at an auction house that sells in excess of $25,000,000 of property per year in sales that are not conducted over the internet. In other words, the royalty would only apply to sales at major auction houses – Christie's, Sotheby's, Phillips, Bonhams, and a handful of others. Sales by private galleries, collectors, or internet auction sites would not be subject to the royalty. Failure on the part of the auction houses to pay royalties would be considered a copyright violation, which means that the copyright holder could, if the failure was intentional, sue for three times the amount of the royalty.

The royalties would be collected and distributed by "visual artists collecting societies" that satisfy certain criteria set forth in the statute – criteria that are clearly designed to include only the large and pre-existing agencies that appear to have been major proponents of the legislation. These agencies would be entitled to retain up to 18% of the funds collected to pay their own operating expenses.

After the deduction of the collecting society's share of the proceeds, the net amount would be divided, with 50% paid to the artist, and 50% paid into an escrow fund established by the respective collecting society in order to provide grants to non-profit museums in the United States to purchase works by living American artists.

The legislation is striking in a number of ways. First, it

is interesting that the purpose of the bill, according to Congressman Nadler, is to create equality between the rights of visual artists and those of "composers, lyricists, playrights and screenwriters" who regularly collect payment when their creations are performed or published. The "starving artist" who has historically provided the impetus for resale royalty legislation is notably absent.

Second, the fact that the royalty would be imposed only on sales by the major auction houses is meant to make the legislation easier to enforce. In our Winter 2010-2011 issue, we wrote that one of the central difficulties in enforcing the payment of resale royalties is the fact that so much of the art market – particularly for the modern and contemporary artists who are the intended beneficiaries of the royalty – is private and is therefore nearly impossible to track. In that article, we noted that the Australian resale royalties scheme attempted to deal with the enforcement issue by imposing broad-based reporting obligations on all sales of art. The proposed US legislation deals with it by eliminating the "hard part." This has a number of implications. Very few living artists ever make it to the resale market. Fewer still are ever sold by the major auction houses. So, the number of artists who would benefit from the bill is very limited, as is the percentage of transactions that will be covered. Even without the proposed royalty, private sales make up a huge portion of the resale market for works by living artists – including some of the most important and expensive works. If a royalty is imposed on auction sales, it is likely that the auction houses will pass the fee on to consignors (or, more likely, its buyers). As a result, more sellers are likely to choose to sell privately – as will the auction houses. The royalty will therefore miss a large chunk of the market and chase more sales out of public view.

The shift to private sales may or may not be of general concern, but the prospect of losing 7% of the proceeds of sales at auction may be significant for museums and other entities that have tended to prefer to sell at auction because the transparency of a public sale is less likely to raise questions as to whether museum trustees or estate executors acted appropriately.

Third, while the concept of contributing 50% of the net royalty to non-profit museums is appealing, the true measure of its value will lie in its implementation. One's comfort level that the funds will be distributed fairly and in a way that promotes the best interests of the museums and the public is only as high as one's confidence in the collection societies themselves. Under the legislation, each collecting society is charged to work with the Office of Copyright to develop procedures and criteria for determining which museums are allotted how much money to purchase which works of art. The collection societies will then control the distribution of the funds, subject only to annual reporting requirements. The delegation of this sort of official authority to private, profit-making organizations may be seen by some as troubling.

Indeed, if one were so inclined, there are other reasons to be cynical about the legislation. The *Los Angeles Times* reported that sales by private dealers were excluded in part to forestall their opposition to the bill and that the grants to museums were included in part to garner their endorsement. The legislation was drafted with the assistance of the "Visual Artists Rights Coalition, a group of artists and two major American organizations that represent artists in copyright matters." In other words, it was drafted with the help of the likely future collecting societies. And the burden of the legislation falls squarely and solely on the major auction houses – the institutions that everybody loves to hate and few bother to defend.

On its introduction, the bill was referred to the Judiciary Committee of the House. On May 17, Senator Kohl and Congressman Nadler asked the U.S. Copyright Office to conduct a comprehensive review to "assess how existing law affects and supports visual artists and how a federal resale royalty provision would affect copyright law, visual artists and those involved in the sale of artwork." The letter suggested that as an initial step, the Copyright Office "meet with and solicit comments from stakeholders." A similar review by the Copyright Office in 1992 recommended against the introduction of federal resale royalty legislation.

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New York Board of Regents Adopts New Deaccessioning Rules

In three out of the four previous editions of the Legal Canvas, we have written about issues relating to the deaccessioning of art by museums. Deaccessioning is the removal of a work from a museum's collection. A core ethic among museum professionals is that works in a collection should not be sold except where the proceeds are used to purchase other works or, in some formulations, to otherwise care for or preserve the collection. This principle has been expressed in the ethical codes of the American Association of Museums ("AAM") and the Association of Art Museum Directors ("AAMD"), among others. Violations have led to censure by those groups – a significant event in the museum community.

New rules on deaccessioning have been promulgated by the New York Board of Regents, which oversees most museums in the state that were formed after 1889. If a museum violates these rules, it risks losing its charter.

The New York Board of Regents

In 2008, the Board of Regents sought to respond to a proposal by Fort Ticonderoga (a historical site and museum) to sell artifacts and artwork to make up for a budget shortfall. At first, the Regents considered enacting emergency rules that would have permitted museums "with the approval of the Board of Regents, to sell or transfer items or material in its collections to another museum or historical society for purposes of obtaining funds to pay outstanding debt, and thereby provide an alternative to the institution's bankruptcy or dissolution, and the possible loss or liquidation of a collection because of debt."

Under considerable pressure, the Board of Regents withdrew this proposal, which one commentator called the "desperation deaccession" rule. Instead, it issued a different set of emergency rules that were even more stringent than the ethical guidelines of the AAMD. Under the adopted emergency rules, not only were museums required to use proceeds from the sale of art only for the purchase of other art, but deaccession could occur only in four defined circumstances: (1) the item or material is not relevant to the mission of the institution; (2) the item or material has failed to retain its identity, or has been lost or stolen and has not been recovered; (3) the item or material duplicates other items or material in the collection of the institution and is not necessary for research or educational purposes; and/or (4) the institution is unable to conserve the item or material in a responsible manner.

Notably absent in the temporary rules were provisions permitting deaccession for the refinement of collections or the return of objects to their rightful owners. As a result, the Regents' efforts were harshly criticized by some of New York's most prominent museums. Museum of Modern Art director Glenn Lowry, for example, wrote in a letter to Dr. Merryl H. Tisch, the chancellor of the Board of Regents, that "this rule would remove from Regents-governed institutions the curatorial discretion that has made them among the most respected in the world."

When the Regents allowed the temporary rules to expire in October 2010, Tisch appointed an ad-hoc committee to review the issue from scratch and to come up with new rules that acknowledged the interests of both sides of the debate.

New rules from the Regents.

Those new rules were approved on May 17, 2011, and went into effect on June 8, 2011. The rules are meant to provide museums with the discretion to refine their collections over time, while at the same time ensuring that museums' collections are preserved for the public.

The new rules continue to make clear that proceeds from deaccessioning may never be used to pay operating expenses, and may only be used for "the acquisition of collections, or the preservation, conservation or direct care of collections." However, the rules expand the circumstances in which deaccession can take place:

(1) the item is inconsistent with the mission of the institution as set forth in its mission statement;
(2) the item has failed to retain its identity;
(3) the item is redundant;
(4) the item's preservation and conservation needs are beyond the capacity of the institution to provide;
(5) the item is deaccessioned to accomplish refinement of collections;
(6) it has been established that the item is inauthentic;
(7) the institution is repatriating the item or returning the item to its rightful owner;
(8) the institution is returning the item to the donor, or the donor's heirs or assigns, to fulfill donor restrictions relating to the item which the institution is no longer able to meet;
(9) the item presents a hazard to people or other collection items; and/or
(10) the item has been lost or stolen and has not been recovered.

In another significant change, the new rules require that each institution shall include in its annual report to the State Education Commissioner a list of all deaccessions in the prior year.

Principle v. process.

Although the new rules are more forgiving than the temporary rules that were allowed to expire, the specificity of the circumstances in which deaccession is permitted make them still arguably more stringent than the ethical guidelines of the AAM and the AAMD. They also have the force of law – in other words, they are not rules that a museum *should* follow, they are rules that a Regents-governed museum *must* follow if it wants to remain open.

Not surprisingly, those in favor of further government regulation of museum deaccessions applauded the implementation of the new rules. Former Assemblyman Richard Brodsky, who had proposed deaccessioning legislation, called the measure "an extraordinary moment in the cultural history of the state," and stated that the Regents "have vindicated fundamental cultural values and helped preserve New York's museum collections for future generations." Others reacted more coolly. Both the AAM and the AAMD issued tepid statements stating that they would prefer that deaccessioning standards be left to museum professionals rather than government regulators, but endorsing the principles behind the new rules.

From the point of view of a museum trustee, the new rules have the advantage of clarity. What they don't provide is flexibility when a museum is faced with dire financial circumstances. Successful fundraising ended Fort Ticonderoga's fiscal emergency before any sales had to take place. But where a board of trustees really does face a choice between selling some art and closing the doors, will the Regents' rules force New York institutions to close?

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The World's Most Expensive Light Bulbs: How the European Union is Applying VAT to Imported Works of Art

In 1926 U.S. customs officials refused to classify Constantin Brancusi's *Bird in Space* as artwork. Instead, the officials classified the seminal abstract bronze sculpture as "kitchen utensils and hospital supplies," thereby subjecting the art to U.S. customs duties and triggering a long court battle. When the U.S. Customs Court considered the issue, it faced the impossible question of "what is art?" Various experts testified before the court and the judge ultimately decided that Brancusi's abstract sculpture could be "art" for purposes of the U.S. customs law.

Over eighty years later, history appears to be repeating itself in Europe, but with a much different result. The European Commission ruled in 2010 that works by U.S. video installation artist Bill Viola and U.S. minimalist sculptor Dan Flavin were not "art" for purposes of European Union customs duties and the value-added tax ("VAT"). The surprising decision, which is binding on all European Union ("EU") countries, could cause European galleries and collectors to pay EU customs duties and VAT at the highest rate on any video, light and technology based works imported from outside the EU.

Value added tax or "VAT."

Galleries and collectors within the European Union must pay VAT on most goods imported from outside the EU. The VAT is a broad based consumption tax, assessed on the value added to goods and services and typically collected by the seller upon a sale. When goods are imported into the EU, VAT must be paid so that the imported goods are immediately placed on the same economic footing as equivalent goods produced in the EU.

The United Kingdom's highest VAT rate is 20%. However, sculptures are taxed at a lower 5% rate (and are not subject to any customs duties) when imported into the EU. The recent European Commission decision essentially hinged upon whether the works of Bill Viola and Dan Flavin, on import into the EU, constituted art (and more specifically, "sculptures") for purposes of the lower 5% VAT rate. The European Commission answered the question in the negative, thereby subjecting the Viola and Flavin works to full customs duties and VAT taxes.

The 2008 Tax Tribunal decision.

The case started in 2006, with a dispute between Haunch of Venison Partners Limited and the British HM Revenue and Customs Office (HMRC). Haunch of Venison imported artwork by Bill Viola into the United Kingdom and intended to import a fluorescent light sculpture by Dan Flavin.

Both the works by Viola and Flavin were shipped as component pieces to be assembled (or in the case of Viola, operated and projected) upon arrival. The Viola works were image projections recorded on a DVD. The projections from the DVD were intended to be shown only on sophisticated equipment specifically created for that purpose. That equipment, and a detailed instruction manual for its use, was included in the shipment, along with the DVD. The shipment of Flavin's work, titled *six alternating cool white/warm white fluorescent lights vertical and centered* (1973), included the bulbs and a detailed set of instructions.

In a case heard before the VAT and Duties Tribunal (England) in 2008, Haunch of Venison argued that the artwork qualified for exemption from customs duties (and qualified for the lower 5% VAT rate) under either of two exempt categories under customs law: (i) "original

sculptures and statuary, in any material" or (ii) "collectors' pieces of historical interest."

The HMRC took the position, however, that the works became art only when they were put together for display. Since the works had been transported in parts, the VAT analysis and classification should be based on the status of those separate parts, and therefore subject to the full VAT rates and customs duty. With respect to the Viola works, HMRC further argued that the works were not "sculptures" even when put together because they were not three-dimensional. Finally, the government noted that if the works as presented to customs authorities (i.e., in separate pieces) were treated as art, then any importer could declare any goods to be art and thereby circumvent the customs duty and full amount of VAT.

Interestingly, the HMRC further argued that the VAT and customs duty should be calculated based on the value of the shipment not as component parts, but as works of art. In other words, they may just be light bulbs or DVD players, but if someone is willing to pay huge prices for them as artwork, then those huge prices should be used as their value at import.

The Tribunal ultimately found HMRC's arguments unpersuasive. The Tribunal heard expert testimony from Sandy Nairne, director of the National Portrait Gallery in London, Martin Caiger-Smith, independent curator and art critic, and Robert Cumming, writer and art critic. Nairne's testimony included the following:

> "We have a history of well over 100 years of art that can appear to be made of ordinary things that have other uses. It is very common for sculptures to be shipped in parts. The fact that the work in transit is not like a work of art could apply to a large bronze figurative sculpture -- an Anthony Caro piece would not necessarily travel as a whole sculpture in a single box.... The question of 'is this the sculpture?' is not to do with what it looks like when it is in customs but what it looks like assembled."

The Tribunal agreed, ultimately holding that it would be "absurd to classify any of these works as components ignoring the fact that the components make a work of art." The Tribunal then found that Viola's works (as assembled) constituted a "sculpture" based on expert testimony. (The status of Flavin's assembled works as a sculpture was not disputed by HMRC.) Finally, the Tribunal found HMRC's concern that any goods could become art as "grossly exaggerated." The burden would be on the importer to prove that the goods qualified as art and expert testimony could be elicited to reach a proper determination.

The European Commission ruling.

In December 2010 the European Commission overruled the Tribunal's decision. Despite the general consensus among art dealers, critics and the public at large that the Viola and Flavin works are art, the Commission held that the Viola and Flavin works cannot be classified as "art" (or, specifically, "sculpture") on importation into the EU. With respect to Viola's works, the Commission said that it cannot be considered sculpture "as it is not the installation that constitutes a 'work of art' but the result of the operations (the light effect) carried out by it." The Commission described the Flavin work as having "the characteristics of lighting fittings" and therefore classifiable as light fittings. In other words, if it looks like a light bulb, we will tax it like a light bulb.

Or maybe not. The Commission also accepted the view of the HMRC that even though the works cannot be characterized as sculpture on import, the full VAT rate should be calculated based on the value of the shipments as sculpture. The ruling has been very heavily criticized in the European community. As Sandy Nairne has said, "The logic does not hold up." One of the original lawyers who represented Haunch of Venison called the Commission's reasoning "absurd" and said, "To suggest...that a work by Dan Flavin is a work of art only when switched on, is comical." Christopher Battiscombe, director of the Society of London Art Dealers, described the ruling as "regrettable" and said it could hinder the EU art trade.

Unless reversed, the Commission's ruling will mean that any gallery or collector importing video, light, or technology based artwork into the European Community must pay both customs duty and the standard VAT rate on the full value of the work of art. According to *The Guardian*, St. Paul's Cathedral in London will be one of

the first organizations directly affected by the ruling. The Cathedral commissioned two altar pieces from Bill Viola and, unless the ruling is successfully challenged in the courts, the Cathedral likely will pay VAT on the pieces at the highest rate.

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Time Limits on Holocaust Claims: News from Both Coasts

The Cassirer case in California.

In the Spring 2010 issue of the Legal Canvas, we reported on a case in which Marei von Saher, the sole surviving heir of Jacques Goudstikker, sued the Norton Simon Museum of Art in California for the return of a diptych by Louis Cranach which had been seized by Herman Goerhing when Goudstikker fled the Netherlands during World War II. The lawsuit was filed within the time allowed by a special statute of limitations enacted in 2002 by the California legislature for Holocaust-related claims. In 2009, the United States Court of Appeals for the Ninth Circuit affirmed the dismissal of the case and struck down the statute as unconstitutional, holding that it impinged on the federal government's conduct of foreign affairs, as well as its "power to wage and resolve war, including the power to legislate restitution and reparation claims."

Responding to the court's decision, the California legislature in 2010 enacted new legislation that did not explicitly single out World War II claims. Under the new law, claims against a museum, gallery, auctioneer or dealer for the return of art stolen by "fraud or duress" within the last 100 years could be brought within six years of the time at which the claimant became aware of both the location of the work and the fact that he or she had a claim for its possession. Under the legislation, this special extended limitations period was meant to last until December 31, 2017.

In an opinion issued on May 24, 2012, a federal district court characterized the new legislation as an attempt to do an impermissible "end run around" the decision in the *Von Saher* case and held that the new statute was equally unconstitutional.

Cassirer's Claim. The decision was issued in the case of *Cassirer v. Thyssen-Bornemisza Collection Foundation*. The case involves a San Diego family that is seeking to reclaim a painting that their grandmother, Lilly Cassirer Neubauer, was forced to sell when she fled Germany in 1939.

In 1898, the plaintiffs' great-great grandfather, Julius Cassirer, purchased a work by French impressionist Camille Pissarro titled *Rue Saint-Honoré, après-midi, effet de pluie.* The painting remained with the Cassirer family until 1939, when Ms. Neubauer was forced to sell it to the Nazi's official art appraiser for 900 Reichsmarks (approximately $360) as a condition to obtaining an exit visa so she could flee to England. Ms. Neubauer made substantial efforts to find the painting thereafter, but died in the United States in 1962 without learning of its whereabouts.

In 1988, Baron Hans-Heinrich Thyssen-Bornemisza, a Swiss art collector who had owned the painting for over

ten years at the time, loaned the Pissarro to the Kingdom of Spain, which displayed it and the rest of his collection in the Thyssen-Bornemisza Museum in Madrid. In 1993, the Foundation that runs the museum paid the Baron $327,000,000 to purchase the entire collection.

Ms. Neubauer's grandson, Claude Cassirer, learned for the first time in 2000 that the museum had the painting. In May 2005, Claude filed suit in California, seeking to have the court force the museum to return the work. When Claude died in 2011, his children David and Ava took over the lawsuit as successors to his interest in the painting.

California's shifting time limits. The general statute of limitations in California for the recovery of stolen property, including art, is three years from the time that the location of the stolen property is discovered. Under that rule, the Cassirers' claim to the Pissarro would have expired in 2003, since they learned of its location in 2000. Their lawsuit, which was filed in 2005, would have been barred under the traditional California rule.

However, when the case was filed in 2005 it was timely under the special 2002 legislation that extended until December 31, 2010, the limitations period for claims brought in California courts to recover works of fine art that were stolen during the "Holocaust era" (1929 to 1945). It was this specific focus on Holocaust era claims that led the Court of Appeals to strike down the statute in 2009 in the *Von Saher* case.

In 2009, the parties in the *Cassirer* case were busy litigating other motions by the Foundation to dismiss the case. Those motions were finally decided in August 2010 in favor of Cassirer. By that time, the California legislature had already passed the *new* special statute which, when it took effect in 2011, applied retroactively to all relevant claims, including the claims raised by Cassirer.

In September, 2011, the Foundation made a new motion to dismiss Cassirer's claims, arguing, among other things, that the new statute of limitations was unconstitutional for the same reason as the 2002 law. The federal district court agreed. Though the 2010 law did not limit itself to Holocaust-era claims, nor even reference the Holocaust or World War II, the court found that the "real purpose" of the law was to provide recourse to the same Holocaust-era theft victims as the 2002 statute. In reaching its conclusion, the court looked to the impact of the statute itself, as well as the statements made by the legislature explaining the intent and purpose of the law. Those statements included direct references to the *Von Saher* opinion, to the fact that the statute was meant to protect "victims that the Legislature [had] already intended to protect" in the 2002 statute, and the fact that the idea for the statute originated with a lawyer who regularly represents claimants in Holocaust cases and who had represented Cassirer in another matter. The court concluded that the 2010 law was simply an attempt to make an "end run around" the problems of the 2002 law. Because the 2010 law was meant to affect claims that involved foreign affairs that would otherwise be time-barred, it was declared unconstitutional and the case was dismissed.

As this issue of the Legal Canvas goes to press, the Cassirers have made a motion to the district court to amend its decision.

The Flamenbaum case in New York.

On May 30, 2012, a New York state appellate court issued an opinion ordering the family of a survivor of Auschwitz to return to a German museum an artifact that had disappeared from the museum during World War II. The artifact was a small gold tablet, excavated by a German team of archaeologists in 1914 from the foundation of the Ishtar Temple, near the city of Ashtur in what is now northern Iraq and was once part of the Ottoman Empire. The tablet is inscribed with descriptions of the Ishtar Temple's construction, and dates to the 12th Century BCE.

After excavation, the tablet was loaded on a freighter bound for Germany, but was sequestered in Portugal during World War I, where it remained until 1926. The tablet arrived in Germany in 1926 and was put on display in the Vorderasiatisches Museum in Berlin from 1934 until the outbreak of World War II in 1939, when it was placed in storage. It was found to be missing from the Museum's inventory sometime around 1945.

Around the same time, a man named Riven Flamenbaum was freed from Auschwitz. At some point thereafter, by means unknown to the court or the parties to the law suit, Mr. Flamenbaum came into possession of the gold tablet. He emigrated to the United States four years later with the tablet in hand. Mr. Flamenbaum died in 2003, and during an accounting of his estate the museum became aware, for the first time, of his possession of the tablet. The museum then sued for the tablet's return.

The surrogate's court in Nassau County that originally heard the museum's claim found that the museum had superior legal title to the tablet – after all, it was, by some means, stolen from the museum. The Nassau County court found, however, that the museum could not recover the tablet from the Flamenbaum estate due to an equitable defense called "laches." Under the doctrine of laches, a party who seeks to recover a piece of lost or stolen property will not be able to do so if they have not exercised reasonable diligence in attempting to locate the property, and their failure to do so results in prejudice to the current possessor of the property when the original owner finally learns of its whereabouts.

The museum appealed that result, and an appellate court in Brooklyn reversed the trial court's ruling on laches. The appellate court found that the Museum had not failed to exercise reasonable diligence in searching for the tablet, even though it had neither reported the stolen tablet to law enforcement nor listed the tablet on an international stolen art registry. The judge was persuaded that these failures did not prejudice Flamenbaum's estate and had not caused it to change its position. Moreover, the court noted that laches is an equitable doctrine – in other words, a doctrine of fairness – and that the equities in the case favored the museum.

In a New York Times article that described the Flamenbaum decision, the lawyer for the Museum, who has also represented Holocaust survivors, was quoted as saying that the "principle that property taken unlawfully should be returned is consistent with the rights of Holocaust victims…. This precedent will help those seeking return of stolen works that are museums not only in the U.S. but throughout Europe."

The Flamenbaum estate reportedly intends to appeal the decision.

For more information on this topic, contact Jo Laird at 212.336.7614 or jblaird@pbwt.com.
The assistance of summer associate Michael Fresco is gratefully acknowledged.

On The Cover

The cover art for this issue is a current work by Alice Aycock, *Devil Whirlwinds on the Clouds for 2 Players: From the Gameboard Series #6*. Noted art historian Robert Hobbs has called Ms. Aycock one of the "most important post-modern artists working today." Her work is included in the collections of, among others, the Museum of Modern Art, New York; the Metropolitan Museum of Art; the Whitney Museum of American Art; the Brooklyn Museum; the Louis Vuitton Foundation; the Los Angeles County Museum of Art; the National Gallery of Art, Washington, D.C; the Kunstmuseum in Basel, Switzerland; and the Staatsgalerie in Stuttgard, Germany. The new Parrish Art Museum in Southampton, New York, and the Grey Art Gallery in New York City (New York University), will host a retrospective of her drawings in 2013. Her public sculpture includes installations at four major American airports, including *Star Sifter* at Terminal One at JFK (1998) in New York, and *Game of Flyers, Part II*, International Arrivals, Dulles Airport (2012). In the spring of 2014, a series of Ms. Aycock's sculptures will be installed on the Park Avenue Malls in New York City, entitled *Park Avenue Paper Chase*.

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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