

## Special Rules Govern Consignments of Art in New York

Artists have long relied on art galleries to sell their works, and artists and galleries frequently use the legal construct of a “consignment” to facilitate the display and sale of art. In a consignment, the gallery does not acquire title to a work. Instead, the artist (the “consignor”) entrusts the work to the consignee—in most cases a gallery or auction house—for the consignee to sell. If and when an artwork is sold, the gallery pays the artist out of the proceeds of the sale. The consignment system enables galleries to introduce the work of new artists to the art-buying public without the gallery having to expend funds to buy works of artists for whom there is no active market. The consignment system is one of the principal ways that new artists gain exposure to the art community. Through consignment arrangements, art galleries expect to develop long-term relationships with new artists whose works they display. For over 50 years, the New York State legislature has attempted to address what some perceive to be shortcomings in consignment relationships between living artists and art galleries.<sup>1</sup>

### The 1960s: Initial Legislative Efforts to Protect Artists

In 1966, the New York State legislature passed an amendment to the General Business Law as its initial effort to protect artists from having their works improperly taken by art galleries.<sup>2</sup> The legislation provided that any artwork delivered by an artist to a gallery would (unless

the gallery had actually purchased the painting from the artist) be deemed to be a consignment of the work and that an agency relationship would exist between the artist (as principal) and the art gallery (as agent). Any such agent would be guilty of a larceny if it misappropriated the work.<sup>3</sup> The original 1966 legislation was specifically limited to works of art themselves and did not apply to proceeds of sales of artworks. An amendment to the law in 1969 broadened its scope by providing that (a) the law covered proceeds of a sale of consigned art and (b) consigned artwork, and proceeds of a sale of consigned artwork, were held in trust by the art gallery. The 1969 amendments provoked considerable controversy—with the Committee on Art of the Association of the Bar of the City of New York, the New York State Attorney General and the New York Artists Equity Association supporting the legislation, and the Art Dealers Association of America objecting to the burdens imposed on galleries by the law.

### 1975: Subordination of Claims of Creditors of a Gallery

The Uniform Commercial Code (the “UCC”) treats a consignment as a grant of a security interest by the consignee (in this case, the art gallery) to the consignor (the artist). If the consignor does not perfect his or her security interest in the artwork, then the consignee is deemed to have “... rights and title to the [artwork] identical to those the consignor had ...”<sup>4</sup> In 1975, the General Business Law was

amended to change this UCC rule insofar as it applied to consignments of the works of living artists. The amendments provided that claims of a secured creditor of an art gallery with respect to an artwork held by a gallery on consignment were subordinated to the claims of the artist of the work: “... no such trust property [*i.e.*, an artwork] or trust funds [*i.e.*, proceeds of a sale of artwork] shall be or become subject or subordinate to any claims, liens or security interests of any kind or nature whatsoever, of the consignee’s creditors, anything in uniform commercial code section 2-326 or any provision of the uniform commercial code to the contrary notwithstanding.”<sup>5</sup> The 1975 amendments increased the law’s protection of artists but created a new diligence burden for secured creditors of art galleries who could no longer rely on the consignment provisions of the UCC to give them a senior lien on consigned art in the possession of a gallery.

## 2012: Response to the Salander-O’Reilly Bankruptcy

The 2007 bankruptcy of Salander-O’Reilly Galleries gave rise to many of the problems that these various statutory provisions were enacted to address.<sup>6</sup> When the gallery went bankrupt, Lawrence Salander, the gallery owner, disclosed fraudulent failures to pay artists for sales of their works and the sale of paintings he had no right to sell.<sup>7</sup> In 2012, partly in response to the bankruptcy, the legislation<sup>8</sup> was again amended in an effort to increase the likelihood that art galleries would comply with the law and to address other shortcomings.<sup>9</sup> The 2012 amendments addressed the following issues:

- **Persons Entitled to Rely on the Law.** The amendments made clear that the statute benefits not only a living artist and his or her heirs but also his or her legatees and heirs who acquire a work from another heir (rather than directly from the artist).<sup>10</sup>
- **Treatment in Bankruptcy.** The revisions to the law expressly provided that a consigned artwork is held in a statutory trust, and the artwork and the proceeds of its sale are not property of the gallery and not subject or subordinate to liens in favor of the gallery’s creditors.<sup>11</sup> These revisions to the law were intended to make clear that consigned artwork is not property of the gallery’s bankruptcy estate.
- **Segregation of Funds.** The amendments prohibited art galleries from comingling funds, required that the trust property be segregated from the other funds of the gallery, imposed fiduciary obligations on galleries and provided that a breach of those fiduciary obligations constituted a misdemeanor.<sup>12</sup>
- **Private Cause of Action.** The 2012 amendments also granted a private cause of action for those injured by the law, with provisions for injunctive relief and the payment of actual damages and attorneys’ fees.<sup>13</sup>

## Implications of the Legislation

All of the legislation dealing with consignments by living artists—the trust provisions, the subordination of claims of creditors of art galleries and the private cause of action—are now included in Section 12 of the New York Arts and Cultural Affairs Law. The provisions of the law have implications for art galleries, creditors of art galleries and artists.

**Galleries.** Due to the increased protections provided by the law, galleries must create segregated accounts for sale proceeds of art consigned by living artists and maintain adequate records to ensure compliance with the law. Galleries should document consignment transactions to mitigate the risk of disputes with artists about the application of sale proceeds.

**Creditors of Galleries.** Because the UCC treatment of consignments does not apply to artwork, creditors of art galleries should conduct

due diligence to determine what artwork the gallery owns and what artwork is on consignment to the gallery. Credit arrangements based on a borrowing base of inventory should address the treatment of inventory that is not owned by the gallery.

**Artists.** Artists should ensure that each art gallery to which they consign their works complies with its obligation to maintain a segregated account for sale proceeds. Artists should insist on adequate documentation for consignments, specifying the amount of proceeds payable to the artist. Artists should keep in mind that the protections that exist for them in New York may not exist with respect to artworks consigned to galleries outside of the state of New York.

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## Endnotes

<sup>1</sup> One of the problems with consignment relationships (wholly separate from any shortcomings in the legal regime that governs them) is that consignments by artists to galleries are made with meager documentation or without any documentation at all.

<sup>2</sup> N.Y. Gen. Bus. Law §§ 219, 220 (McKinney 2015) (Repealed 1983).

<sup>3</sup> N.Y. Gen. Bus. Law § 220-2 (McKinney 2015) (Repealed 1983). The New York State Law Department took the position, in support of the legislation, that district attorneys in New York were reluctant to prosecute dealers

for misappropriation because “the exact relationship between artist and dealer has never been spelled out explicitly.”

<sup>4</sup> N.Y. U.C.C. § 9-319(a) (McKinney 2016).

<sup>5</sup> N.Y. Gen. Bus. Law § 219-a-1-c (McKinney 2015) (Repealed 1983); N.Y. Arts & Cult. Aff. § 12.01 (1)(a)(v) currently provides: “... and no such trust property or trust funds shall become the property of the consignee or be subject or subordinate to any claims, liens or security interest of any kind or nature whatsoever of the consignee's creditors.”

<sup>6</sup> In addition to the issues addressed herein, *See also In re Salander-O'Reilly Galleries, LLC*, No. 14 CV 3544(VB), 2014 WL 7389901 (S.D.N.Y. Nov. 25, 2014) (describing the legislators' attempt to protect artists in their relationship with art galleries) and *In re Salander-O'Reilly Galleries, LLC*, 475 B.R. 9 (S.D.N.Y. 2012).

<sup>7</sup> “His modus operandi was to sell works from the estates he managed without telling those owed money from the sale, or to sell works that weren't consigned or marked for sale, or to sell shares in paintings that added up to more than 100 percent.” *See Dan Duray, Raging Bulls of the Renaissance Scam: Larry Salander's Dupes Clash in Court*, OBSERVER, (Mar. 23, 2011), <http://observer.com/2011/03/raging-bulls-of-the-renaissance-scam-larry-salanders-dupes-clash-in-court/#ixzz3g5dm1e28>.

<sup>8</sup> In 1983, various provisions of New York law relating to arts and cultural affairs were consolidated into a single chapter, now known as the Arts and Cultural Affairs Law.

<sup>9</sup> As evidence of the inadequacy of the existing legislation, the Art Law Committee of the New York City Bar, in its May 2012 report on the proposed amendments, noted that in the Salander-O'Reilly case “... no charges were brought ... for commingling funds or [the gallery's] misuse of funds belonging to artists, their heirs, or estates.”

<sup>10</sup> N.Y. Arts & Cult. Aff. § 11.01. Creditors of galleries sometimes claimed that a child of an artist was not entitled to the benefit of the statute if the artist's surviving spouse acquired the work upon the artist's death and the child acquired the work upon the spouse's death.

<sup>11</sup> N.Y. Arts & Cult. Aff. § 12.01(1)(a)(v).

<sup>12</sup> N.Y. Arts & Cult. Aff. § 12.01(2). The statute imposes on art galleries the requirements of fiduciaries in the New York Estates, Powers and Trust Law. N.Y. Est. Powers & Trusts Law § 11-1.6 (McKinney 2011). Before the enactment of the 2012 amendments, it was not clear what consequences a gallery faced if it failed to comply with the segregation obligations. The penalties for breach of the fiduciary requirements of the New York Estates, Powers and Trusts Law are at Section 11-1.6.

<sup>13</sup> N.Y. Arts & Cult. Aff. § 12.01(3). Commentators have noted that the provision for attorneys' fees is of particular importance to a frequently impecunious class of plaintiffs.

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