IKON

PRIVATE VIEWING

Vivian Haines and **Georgina Hepburne Scott** consider if the traditionally confidential art market can resist pressure for greater regulation and transparency

KEY POINTS

What is the issue? Clients who want to protect their confidentiality when buying and selling art may find themselves having to disclose more information about their art holding structures as a result of more regulation.

What does it mean for me? Professional advisors advising on art sales and purchases should conduct adequate due diligence when acting on transactions.

What can I take away? Know your client; make sure you understand fully any holding structure in which art is bought and sold; and prepare for the possibility of additional disclosure obligations under new regulations.

Major changes in the art market and wider trends in society are challenging the tradition of confidentiality observed by many art professionals and collectors. In particular, the transparency and due diligence requirements for major transactions make it increasingly difficult to meet collectors' expectation of confidentiality. Other factors include:

- **There are now so many more artists, collectors and agents that transacting business on trust is far more difficult, as it is hard to know all the key players.**
- **The huge value placed on artworks, including those by artists who were relatively unknown a decade ago, demands more rigorous due diligence by a purchaser seeking to validate the title and provenance of a work. In recent years, there have been several high-profile cases that have highlighted the ability of certain individuals to abuse client confidentiality to perpetrate serious frauds.**
- **Further developments in anti-money laundering legislation and international tax laws, including the introduction of the OECD's Common Reporting Standard and continued use of tax information exchange agreements, may force additional disclosure about the beneficial ownership of artworks. With regulation increasing in all industries, the art market may soon receive growing attention from regulatory authorities if incidents of artworks being used for money laundering or tax evasion purposes continue to occur.**

The response of the art world in anticipating and responding to new regulatory challenges will help determine whether the industry continues to self-regulate or whether governments will impose regulation, with all the attendant bureaucracy and cost. It should be stressed that the art market is already, in a sense, regulated by the laws of contract and tort but does not have a regulator to oversee day-to-day conduct between participants.

THE GROWTH OF THE ART MARKET

The art market has historically been a community where relationships of trust, tradition and etiquette have played a vital part in the flow of business. The need for a member of the community to be known and trusted has been one of the strongest incentives to follow accepted practices.

The market's recent growth has brought such a high volume of new entrants into the industry that it is difficult to keep pace with the number of artists, let alone new agents and collectors. It is no longer a sector

where everyone knows each other. Practices in the art world will have to change to reflect this fact, something that is likely to lead to greater formalisation and regulation.

Some new regulation may even be desirable. The risk is that excessive and indiscriminate regulation will be imposed that fails to take account of the judgments that have to be made, without materially reducing risk or preventing crime. Arguably, regulation sometimes increases risk, as administrators become more concerned with jumping through hoops than applying their own judgment and experience to a particular situation.

LEGAL CASES

In recent years there have been a number of cases concerning the repercussions of breaching confidentiality in the art world. Two are of particular interest.

In *Lumerman* v *Tucknick et al*,[1] the court ruled that confidentiality agreements do not always guarantee 'bulletproof' protection and will rarely be absolute. The courts have to weigh up the equitable interests of the parties who have been prejudiced against the contractual protection afforded by the confidentiality agreement.

In this case, Willem de Kooning's first wife and three daughters petitioned the New York Surrogate's Court to force Christie's and Sotheby's to reveal the identities of the buyers of around 200 paintings by De Kooning that had been consigned for sale by other family members. The court permitted disclosure, despite confidentiality agreements with the buyers, and the auction houses claiming that the disclosure would damage their reputation. Families that wish to avoid litigation may, on occasion, have to be involved in intrusive and uncomfortable questioning of a family member's authority to consign artworks for sale. On the other hand, a buyer wanting to rely on a confidentiality agreement should take advice on the dangers of a court overturning an agreement to protect equitable interests.

The second case, *Marguerite Hoffman* v *L&M Arts*,[2] shows the potential difficulty caused by confidentiality provisions that are insufficiently precise and fail to anticipate the practicalities of subsequent sales.

In this case, Marguerite Hoffman sold a Mark Rothko painting ('Untitled', 1961) via a dealer under a confidentiality agreement that required the dealer and buyer to 'make maximum efforts to keep all aspects of this transaction confidential'. The painting was included three years later in a Sotheby's auction in New York, revealing that Ms Hoffman once owned the painting. She sued the agent of her buyer for breach of confidentiality and won the case (but not for the sums sought). While the judge held that the confidentiality undertaking did not prevent the buyer of the painting from reselling or displaying the painting, it was arguable that the act of selling was itself a breach of the confidentiality undertaking.

A confidentiality agreement should set out clearly the limits of the undertaking and what rights the buyer has to resell a work to avoid future issues.

TITLE AND PROVENANCE

In 1977, Judge J Shorter of the New York State Supreme Court wrote of provenance in the art community: 'In an industry whose transactions cry out for verification of both title to and authenticity of subject matter, it is deemed poor practice to probe into either.'[3]

"Provided that confidentiality is used for the right reasons, clients have a legitimate right to request that their affairs are kept private"

For some, asking too many questions about title or provenance can seem intrusive, and buyers are often expected to accept a seller's word as gospel. This should be resisted, as the rule of *caveat emptor* still largely applies in the art market. While many dealers do conduct adequate checks, there are a few individuals who take exception to this trend.

To avoid issues of false verification, buyers should look to purchase primarily from credible sources. The checks needed to verify the provenance of an artwork are conducted by all major auction houses, which consult the Art Loss Register prior to every sale to establish whether an item is listed on its database of lost or stolen art. However, auction houses remain commercial enterprises, and there is a limit to how much due diligence can be conducted on each purchase. If a buyer is still concerned about the authenticity and provenance of a work, they can take out appropriate title insurance and, as a last resort, claim against the insurer or the seller for breach of warranty.

ADEQUATE DISCLOSURE

A buyer and their agent should take extra care when buying from an individual not associated with an auction house or recognised dealership. In not knowing a seller, a buyer puts themselves at risk of being unable to recover their loss if a transaction goes wrong. Without checks being undertaken, the seller may prove to be an empty shell or have insufficient assets, making any warranty or indemnity given by the seller very difficult to enforce. In these circumstances, a purchaser should seek further protection in the form of greater transparency of a seller's assets and who the ultimate beneficial owner of the work is. If a buyer is dissatisfied with the amount of information provided, they should not be prepared to transact.

Also, an agent for a buyer should know their client, and ensure they have the ability to pay the purchase price. An agent for a buyer who is unable to pay for the artworks they bid on at auction faces huge legal complications and loss of credibility. In these circumstances, industry regulation is likely to be an appropriate and encompassing method to prevent fraudulent transactions.

CONCLUSION

Provided that confidentiality is used for the right reasons, clients have a legitimate right to request that their affairs are kept private. However, silence over the questionable provenance of a work, silence for fear of being sued or the artwork possibly being fake, and silence for fear of loss of profit only support the argument for increased regulation of the industry.

If the art world is to adapt successfully to an environment of increasing regulation, it must take steps towards more transparency in transactions. There should be more detailed inquiries into counterparties (if not already in place) and the industry must ensure regular due diligence checks on title and provenance. Moreover, every effort should be made to prevent the use of confidentiality to mask misdemeanours. Often, there may still be good reasons to keep aspects of a transaction confidential, but only if it does not prevent the parties involved in the transaction from having adequate transparency of counterparty risk.

1 No.0489/05, 2008 WL 920666 (Surr Co, Westchester Co, 14 March 2008)
2 3:10-CV-0953-D, ND Tex (filed 4 September 2014)
3 *Porter* v *Wertz*, 56 AD2d 570, 392 NYS2d 10 (1st Dep't 1977)

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