Art law – recent developments

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Welcome to the latest issue of our "Art law - recent developments" newsletter in which we discuss legal issues currently affecting the global art community.

In this issue we look at:

- De-regulation of New York auction houses – a riskier climate for prospective buyers?
- "Flipping" artwork
- "Beautiful tropical, jungle painting (with pink snot)"

De-regulation of New York auction houses - a riskier climate for prospective buyers?

Introduction

New York City has recently abolished the rules which regulate its auction industry. The changes, part of a suite of measures impacting a range of businesses from cafés to laundrettes, were ostensibly implemented to remove red tape and improve trading conditions in the wake of the COVID-19 pandemic (and have the no doubt welcome side effect of decreasing the workload of an already over-stretched Consumer Affairs Department).

However, concerns have been raised as to whether this wholesale reversal of thirty-year old measures, which apply equally to both smaller public salerooms and international auction houses such as Sotheby's, Christie's and Phillips, will erode the trust of art market consumers in what is already perceived to be an opaque market.

We take a look at the New York changes below before turning to the legislation and regulations which apply to auction houses in the UK, specifically those which protect purchasers of art and other fine objects at auction.

New York changes

From 15 June 2022, New York auction houses no longer need to be licensed. Changes enacted in April 2022 also abolished requirements regarding the conduct of sales. In particular, auction houses are no longer required to:

- enter into written consignment agreements with consignors (i) setting out all fees, commissions and charges to be paid by the consignor to the auction house and (ii) containing a warranty from the consignor that they will pass good title in the lot (the benefit of which is then usually passed on to the buyer);
- publish truthful statements in catalogues and other sale materials;
- disclose to prospective buyers where (i) a lot is being sold subject to a reserve or minimum price; (ii) the auction house has a direct or indirect

financial interest in a lot (this includes where the lot is being sold subject to a guarantee i.e. an agreement between the consignor and the auction house in which the latter promises that it or a third party will purchase the lot if the item does not sell for a minimum pre-agreed sum at auction); or (iii) a consignor will be bidding on their own lot;

- ensure that "*chandelier bidding*" (a controversial practice whereby an auctioneer creates the appearance of demand when bidding opens by pretending to spot and accept fictitious bids in the room[1]) does not rise above the consignor's minimum price or reserve;
- keep a written record of all details of each sale of a period of six years from the date of the auction.

In reality, good business practice and the risk of liability arising for other reasons will likely ensure that many of the requirements will continue to be followed. However, if New York auction houses took advantage of the legislative changes, particularly around the disclosure requirements, it could significantly undermine consumer confidence in the auction process as a forum in which to establish a reliable open market value for what are often extremely high-value items.

Regulation of auction houses in the UK

The UK does not have a single, dedicated set of rules which regulate auction house activity. Rather, auction houses must take heed of a host of more general consumer and trading regulations when offering works for sale. We consider some of these below.

It is worth bearing in mind, firstly, that the sale contract is ultimately between the seller and the buyer, with the auction house acting as an intermediary and secondly, that the auction house acts as agent for the seller (not the buyer). Given the absence of a contract between the buyer and the auction house, many of the usual consumer protections do not apply to this relationship (although they may apply to the consignment agreement between the auction house and a seller). That said, there are still circumstances in which the auction house may incur legal liability to the buyer.

The terms on which a buyer purchases a lot are ordinarily governed by the auction house's standard conditions of sale (the "**Conditions**"), often included at the back of an auction catalogue, which seek to limit any potential legal liability the auction house might incur to a buyer. However, certain legislation may still come to the buyer's rescue. Examples are:

- The Sale of Goods Act 1979 (the "**SGA**")

  The SGA implies certain terms into the Conditions including that:

  - the seller has the right to sell the work (section 12(1));
  - the work is free of charges and encumbrances not disclosed to the buyer and the buyer will enjoy quiet possession of the work (section 12(2));
  - the work corresponds with the description on the sale catalogue (section 13(1)).

  In reality, the above terms are usually included as express terms in the major auction house's Conditions in any event.

- The Unfair Contract Terms Act 1977 ("**UCTA**")

  Where a buyer is a consumer and deals on an auction house's written standard terms of business i.e. the Conditions, the auction house can only rely on the following terms to the extent they satisfy the UCTA "*reasonableness*" test:

  - terms which purport to exclude or restrict liability for breach of contract, or which claim to entitle the auction house (i) to render a contractual performance substantially different from that which was reasonably expected of it;

[1] Whilst criticised by some, the practice of "*chandelier bidding*" has been defended by others on the grounds that fictious bids below the reserve price do not unfairly prejudice buyers as it would not be possible to purchase a lot below the reserve price in any event. If such fictious bidding was permitted above the reserve price it could effectively drive up the price payable by an ultimate buyer in the absence of any true, competitive demand for the lot in question.

or (ii) in respect of the whole or any part of its obligation, to render no performance at all (section 3); and

- terms which purport to exclude or restrict liability for misrepresentation or the remedies available to the buyer in the event of a misrepresentation (section 8).

It was confirmed in *Avrora v Christie Manson & Wood Limited*[2] that UCTA applies to the Conditions where they restrict liability for negligence or misrepresentation. However, in that case, which concerned an authenticity dispute, it was held that the relevant term in Christie's Conditions was "*reasonable*". Underpinning the decision was the fact that the Conditions provided an alternative remedy where it came to light after the sale that the work was a forgery (namely an authenticity warranty allowing the buyer to cancel the purchase).

- The Unfair Trading Regulations 2008 (the "**UTR**")

The UTR contain a general prohibition on unfair commercial practices (section 3(1)). A commercial practice is unfair if it (inter alia):

- contravenes the requirements of professional diligence and it materially distorts (or is likely to materially distort) the economic behaviour of the average consumer (section 3(3));
- is a misleading auction (section 4(a) and regulation 5);
- is a misleading omission (section 4(b) and regulation 6); or
- is aggressive (section 4(c) and regulation 7)).

It has been deemed that where a seller bids on his own lot to drive up the price of a lot, this is unfair pursuant to the UTR (this practice is known as "*shill bidding*", not to be confused with "*chandelier bidding*", which is when an auctioneer accepts fictitious bids up to the reserve price).

On the matter of pre-sale disclosures in an auction catalogue, the Advertising Standards Agency ("**ASA**") issued a ruling in 2018 stating that the way in which Christie's published estimates in its sales catalogue was misleading. In particular, the ASA considered that the information as to additional fees and taxes, such as buyer's premium and VAT, was insufficiently clear. The ASA ruling provided that each individual catalogue entry should include (inter alia): the likely percentage of buyer's premium to be charged, the rate of VAT which would likely apply and detail as to any other applicable fees (such as artist's resale royalty). In light of the ruling, auction houses have taken steps in their sale catalogues to address the ASA's requirements.

Comment

Whilst the rules in New York and the UK may differ, the likes of Sotheby's, Christie's and Phillips are still international businesses attracting (very often sophisticated) international buyers. As such, they arguably have a vested interest in ensuring that the practices they adopt across their global salerooms are consistent. For example, many of the practices which previously governed New York auction houses made their way to London as a matter of good practice, and it is difficult to envisage a wholesale and international reversal of operations prompted by the recent changes. It is therefore perhaps unsurprising that all three major auction houses have issued statements to the effect that, notwithstanding the relaxation of the New York rules, they will continue to "*operate fairly*" (Sotheby's), "*continue to operate as [they] have been*" (Christie's) and conduct auctions "*fairly, transparently, and in the best interest of [their] clients*" (Phillips).

However, the big auction houses are becoming increasingly more competitive and inventive in how they go about securing high-value, high-profile consignments from prospective sellers ahead of their rival houses. With that in mind, it is not beyond the realms of possibility that a savvy seller might invite an auction house to take advantage of the de-regulation if they thought it might ultimately stand to benefit them e.g. asking the auction house to omit disclosure of the existence of a third-party guarantee in the auction catalogue if the seller considered it

[2] *[2012] EWHC 2198 (Ch)*

would likely result in a higher hammer price. However, it seems unlikely that the auction houses would wish to move away from the present relative transparency to secure a competitive advantage in this way.

In any event, it is noteworthy that, in circumstances where the London art market is becoming increasingly more regulated (see, for example, our recent article *HMRC issues AML risk assessment for Art Market in the July 2021 issue of our Art newsletter* on the Money Laundering Regulations), the US art market (particularly in New York) appeared to be rowing in the opposite direction[3]. However, that trend may be about to change. In recent weeks a new bill, known as the Enablers Act, moved one step closer to introducing anti-money laundering regulations on art market participants in the US[4]. It will be interesting to see if the Enablers Act is passed once it is considered by a conference committee later in the year.

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[3] By way of further example, the Financial Crimes Enforcement Network (an agency within the US Department of the Treasury) recently released its "*Study of the Facilitation of Money Laundering and the Financing of Terrorism through the Trade in Works of Art*", ultimately concluding that further regulation of the art market is not needed at present - U.S. Study Finds Further Regulation of the Art Market Not Needed Now - The New York Times (nytimes.com).

[4] An Anti-Money Laundering Bill That Could Have Profound Effects on the Art Market Just Took a Big Step Forward | Artnet News

"Flipping" artwork

"Flipping" of artwork hit the headlines a few months ago in the case involving the prominent Chinese collector, Michael Xufu Huang, and Federico Castro Debernadi, an Argentinian collector.

The practice of "flipping" is not a new phenomenon and can sometimes be the exception rather than the rule in the art market. It involves buying and swiftly selling an artwork for a quick profit. Artists make money from the proceeds of sale of their artwork, which is often sold through a dealer/gallery (on the primary market). If buyers "flip" the work by selling at auction (on the secondary market) for a quick profit, artists do not benefit from these sales, except in jurisdictions where the artist benefits from a resale royalty which itself can be a relatively modest amount. Further, art dealers and galleries concerned with primary sales are often closely involved in nurturing an artist's career, and emerging artists' reputations can be affected if a buyer purchases a work from a dealer and then "flips" it publicly (i.e. sells it by way of auction) for a quick profit as it inflates the artist's market and the wider market too. Such inflation in an artist's work, particularly those emerging artists, may not be sustainable in the long term.

The art market is increasingly alive to "flipping" and has sought ways of preventing such practices (by including resale restrictions in agreements, as discussed further below). However, such restrictions may be seen as hindering competition.

Huang v Debernardi

This case hit the art market headlines in January 2022.

The two collectors, Mr Huang and Mr Debernardi entered into an agreement whereby Mr Huang, whose access to artists and galleries was greater than Mr Debernadi's, would purchase works and sell them to Mr Debernadi for a 10% commission.

The two fell out over Mr Huang's purchase of a work, *Faeriefeller*, by Cecily Brown from the Paula Cooper gallery in New York for US$700,000. Mr Huang sold this onto Mr Debernadi for US$770,000, thus making a 10% commission. Shortly after Mr Debernadi had acquired the work, he sold it through the Lévy Gorvy gallery.

Mr Huang's problem was that the Paula Cooper gallery had included a resale restriction in the agreement which prevented him from selling the work for 3 years other than by instructing the gallery to act as agent. Failure to comply with this restriction meant Mr Huang would be liable to the gallery for the difference between: (i) what similar works "in perfect condition" of the artist had sold for at the last public auctions; and (ii) the original purchase price.

The Paula Cooper gallery caught wind of the onward sale to Lévy Gorvy and confronted Mr Huang. The gallery threatened to sue Mr Huang for between US$500,000 and US$1 million. The restriction included in the agreement between Paula Cooper and Mr Huang was not tested in the US courts as the case settled for an amount which Mr Huang says was "way over the 10% I made" from the commission.

Subsequently, Mr Huang filed a claim against Mr Debernadi in March 2021 for allegedly breaching their agreement, which included provisions preventing Mr Debernardi from selling the *Faeriefeller* without Mr Huang's approval and that

neither party would acknowledge that Mr Debernadi owned the work. These terms were presumably a way for Mr Huang to seek to ensure that he would not fall foul of the restriction in the agreement made with the Paula Cooper gallery. Mr Huang sought US$1.3 million in reputational damages. The case settled in January 2022.

Resale restrictions

Resale restrictions can take on a number of forms but usually they will seek to prevent the buyer from reselling, or otherwise disposing of, the work (by way of auction and/or resale through a third party) for a certain period of time.

These restrictions can also provide the dealer with a right of first refusal, meaning that if the buyer intends to sell the work, or an offer has already been made by a third party, the buyer is obliged to offer the dealer an opportunity to purchase the work.

If the buyer is a consumer

The enforceability of such restrictions under English law is questionable, particularly if a dealer is contracting with a buyer who is a "consumer," and the restrictions have not yet been tested by the English courts in an art context. The English law cases dealing with resale restrictions that do exist are mostly in the context of real property or share sales.

Under the Consumer Rights Act 2015, a "consumer" is an individual who is acting outside his/her "trade, business, craft or profession."

Any restriction needs to be carefully drafted so as to comply with the provisions of the Consumer Rights Act, and even then it is not clear at present whether the English courts would uphold it. However, if worded in the correct way, a resale restriction may act as a deterrent to buyers who potentially intend to "flip" the artwork for a much higher price within a short period of time.

It is important that restrictions are drafted and negotiated on a case-by-case basis – they are very unlikely to be enforceable if they are "hidden" away in a dealer or gallery's standard terms and conditions. They have to be negotiated with and freely accepted by the buyer so as to comply with the requirement of fairness under the Consumer Rights Act.

Issues such as the period of the right of first refusal need to be considered. The longer the period, the more likely the restriction would be held to be unenforceable. The price at which the dealer has the opportunity to re-purchase the work is also a factor to be considered – the agreement could provide that the dealer purchases the work at the original purchase price but this may be detrimental to the buyer if the value of the work has increased substantially since the original sale. The parties could agree on a mechanism by which the price of the work is determined to resolve this issue.

If the buyer is not a consumer

If the buyer is not a consumer, but acting for purposes relating to that person's trade, business, craft or profession (for example another gallery), then dealers still need to be mindful of including resale restrictions in their agreements without the buyer having freely negotiated them.

Clauses which seek to prohibit or restrain the right of businesses or traders to trade as they wish (restraint of trade clauses) may be held to be unlawful by the English courts unless they: (i) are designed to protect a legitimate business interest; (ii) are no wider than reasonably necessary to protect that interest and (iii) are not contrary to the public interest.

If the resale restriction has been negotiated freely between the dealer/gallery and the buyer and each is of equal bargaining power, then the English courts may be more likely to uphold it and find it enforceable. Similar issues, such as those referred to above in relation to the period of the right of first refusal and the price, would still need to be considered even if the buyer is a trader/non-consumer.

What happens if a buyer has breached the resale restriction?

If a buyer has breached a resale restriction, the dealer may simply refuse to conduct business with that buyer in the future. A dealer may hope that the inclusion of a resale restriction in the agreement would act as a deterrent to the buyer from "flipping" the work in the first place.

The dealer may consider issuing proceedings against the buyer for breach of contract. However a claim in contract could not be brought against the auction house or dealer/gallery in charge of the resale as they would not have been a party to the original contractual agreement between the dealer and buyer. In some circumstances a claim might be available in tort for interference in the contract.

Even if a claim has been brought or even intimated by the dealer, this would not prevent it from seeking an out-of-court settlement with the buyer (as was seen in the Huang/Paula Cooper case referred to above).

In conclusion, resale restrictions in an art context have yet to be tested by the English courts and so their enforceability is questionable. They are more likely, but not guaranteed, to be enforceable if they are fair, freely negotiated on a case-by-case basis with the buyer and not hidden among a dealer/gallery's standard terms and conditions. Often, they may act as a deterrent to any buyer who is seeking to speculate, rather than appreciating and looking after the artwork for a long period of time.

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Beautiful tropical, jungle painting (with pink snot)[5]

Litigation in the Art Market is common; be it about ownership and title, authenticity and provenance, misattribution, restitution, fraud, copyright and intellectual property, auction house negligence, breaches of contract, the list goes on.

Yet despite the frequency and variety of disputes, very few cases ever make it all the way through the Courts to a judgment. Often that is because those in the Art Market are commercially minded and solutions or compromises to most disagreements can be found. And, in a generally speaking private world where confidentiality is prized, disputes are usually resolved out of the public eye.

The recent case of *Hilden Development Limited v Phillips and Robert Tibbles* bucks this trend because at its heart it was not about the money, rather it was the result of a family feud which the Court colourfully described as "litigation warfare".

In summary, Robert Tibbles, an early follower of the 'Young British Artists' and art collector, purchased the Damien Hirst spin painting with its eye-catching name for £68,000 in 1998. In February 2020, he sold the painting for £350,000 through Phillips Auction House as part of a collection of 40 works.

Shortly thereafter, two of Robert's family, standing behind a BVI Company (Hilden Development Limited ("**HDL**")), issued a claim against Phillips (for whom Stephenson Harwood acted) and Robert for conversion alleging that HDL owned the painting because of the source of funds used to originally purchase the painting. The key issue of the case therefore was who owned the painting.

Caught in the Middle – CPR 86 Applications

Phillips found itself in the unenviable (but not uncommon for an auction house) position of being caught in the middle of a bitter ownership dispute. Fortunately for Phillips, it still had possession of the Painting having cancelled the sale following receipt of the competing claims. But what do to with the Painting? What to do in response to the claim?

When an auction house or dealer is caught between two parties claiming title they can protect themselves by making a stakeholder application (otherwise known as an interpleader application). This is a procedure where a person under a prospective liability to two or more parties can apply to court under CPR 86 for directions as to which party to pay or give the contested goods or assets to. Helpfully, the scope of such an application and the protection it can afford extends to cases where:

- formal court proceedings have not been issued;
- proceedings have been issued but in a foreign court or via arbitration (*ST Shipping and Transport Pte Ltd and ors v Space Shipping Ltd and ors*); and
- the prospective "competing" claimant is known to the stakeholder but has not yet asserted a claim because it has not yet learned of the full facts, analysed them or taken legal advice (*Global Currency Exchange Network Ltd v Osage 1 Ltd*) – this may be useful in circumstances where, in conducting due diligence, the auction house or dealer discovers that somebody other than the consignor may have a claim to ownership of the consigned item.

In Phillips' case, however, the matter was more straightforward, as HDL had issued a claim in the English courts and made Phillips a defendant.

Should a stakeholder be caught in such a position, as practical advice and to minimise costs, we would recommend in the first instance seeking to agree with the warring parties that the artwork, money or chattel be held pending the outcome of the dispute. Only if no agreement is forthcoming should the stakeholder then proceed with seeking the court's protection via a stakeholder application.

To make such an application it is necessary to prepare a sworn statement to the Court (which is served on the other parties) stating that the stakeholder:

[5] An image of the painting can be found here: https://www.phillips.com/detail/damien-hirst/UK010120/20

- claims no interest in the subject matter in dispute other than for charges or costs
- does not collude with any of the claimants to that subject matter; and
- is willing to pay or transfer that subject matter into court or to dispose of it as the court may direct.

In other words, the stakeholder must be entirely neutral in the dispute (albeit it is still entitled to seek its costs in relation to the stakeholder application itself).

In this case, Phillips made the necessary application, agreed it would hold the Painting pending further order and the claim against it was stayed. It was agreed that the loser of the ownership dispute would pick up Phillips' legal costs. Phillips moved out of the picture so to speak.

Caught Overseas – Giving Evidence Abroad

In determining how the painting was purchased in 1998 the Court required detailed examination of the factual witnesses. Two of HDL's witnesses were based overseas. Robert's father, Nigel Tibbles, aged 91, lives in France. Robert's twin, Sebastian Tibbles, lives in Singapore. With an eye to costs and convenience, the parties agreed that the three-day trial should be conducted remotely which the Court, as required, then approved.

No doubt this is something that we will see more of as a result of the users of the English Court (and the Court itself) having had remote hearings forced upon them by Covid and it has been established that a) remote hearings can work (albeit it is less ideal for the Court when a witness is examined) and b) it can be considerably more convenient for parties and lead to costs savings[6].

The case is a useful reminder of the Court's attitude to and requirements for allowing witness evidence via video link. Pre-trial, the judge directed that (i) HDL's legal representatives obtain confirmation that no permissions were required from the French or Singaporean authorities for video evidence to be given[7]; and (ii) the parties provide a protocol, to be approved by the court, setting out the arrangements for giving remote evidence. Such a protocol includes agreeing:

- where will each party and their representatives be while attending on the Court
- carrying out a test run using the relevant platform in advance of the hearing;
- ensuring that the witnesses have access to only unmarked hearing bundles in either hard copy or electronic form and that they must not consult any notes or other documents during the hearing, other than the trial bundles; and
- ensuring that the witnesses understand that there should not be anyone in the room with them when they are participating in the hearing. To this end in Hilden the parties agreed (and the Court approved) the following: "*Each witness will confirm to the Court at the start of their evidence and after each break that they are unaccompanied. Should the Court or any party wish to seek confirmation of the same, the witness will show the Court the room in which they are sitting by turning their camera to illustrate the same*".

Court's verdict

The case highlights the importance of witness evidence, particularly the credibility of the witnesses, in circumstances where there was a paucity of contemporary records in relation to the original purchase that took place 23 years earlier and the parties all put forward contrary statements with regard to (i) who entered into the agreement to purchase the Painting; (ii) who paid the deposit; and (iii) who paid the completion monies.

The Court formed the view that those witnesses for HDL had tried to "*reconstruct events from a selection of documents*" and that their evidence was "*heavily*

[6] Indeed, as an aside, a recent trial of this author would have been cancelled as a result of the train strikes in June but it was able to proceed as all the parties agreed to do so on the basis of a remote hearing.

[7] In accordance with the Practice Note of the Chancellor of the High Court dated 11 May 2021 and Practice Direction 32, Annex 3, paragraph 4

influenced by the wider "family feud" and loss of trust and confidence in Robert Tibbles".

In contrast, Robert Tibbles was "*candid about his lack of recollection of the details of the payment arrangements put in place in respect of this particular acquisition*" and the Court formed the view that "*he was giving evidence honestly and was doing his best to assist the Court*".

Given the importance of the witness evidence and given the Court's opinion of the witnesses themselves, it is unsurprising that the Court found in favour of Robert holding that White Cube had sold the painting to him and legal title had subsequently been transferred to him.

With the Court concluding that Robert was the rightful owner of the painting, he is free to try and sell it again (after 2.5 years of litigation). And, at the high cost of defending the claim (such costs exceeding the value of the painting), he has obtained judicial confirmation of his title, an unusual benefit to be able to pass to a buyer. However. should the price of the painting not exceed £280,000 (being the original hammer price), he will have suffered a loss as a consequence of HDL's actions and will crystallise his counter-claim against HDL for the difference.

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