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REPORT ON LEGISLATION BY THE ART LAW COMMITTEE

A.8604-B M. of A. Rosenthal S.4988-B Sen. Little

AN ACT to amend the arts and cultural affairs law, in relation to consignments of works of art to art merchants by artists, their heirs and personal representatives.

THIS BILL IS APPROVED

This report is respectfully submitted by the Art Law Committee of the New York City Bar Association in support of A.8604-B/S.4988-B (the "Bill"). The Association is an organization of over 23,000 lawyers and judges dedicated to improving the administration of justice. The members of the Art Law Committee address legal issues relating to works of art.

The Committee supports the Bill because it addresses certain deficiencies in provisions of the New York Arts and Cultural Affairs Law ("NYACAL") that are applicable to consignments of works of art to art merchants by artists, their heirs and their personal representatives. Specifically, the Bill will strengthen the existing trust property and trust fund provisions of Articles 11 and 12 of NYACAL. The Committee has evaluated similar laws from other states and related New York laws. (Attached is a list of other laws in the United States that address issues similar to those addressed in Article 12 of NYACAL.) The Committee's support is also informed by the facts and developments in the various lawsuits and bankruptcy proceedings concerning Salander O'Reilly Galleries LLC, which is discussed in further detail below.

Background

Artists rely on sales of their work to earn a living. Art galleries are an important outlet for such sales. Galleries are compensated for selling artists' works usually by taking a percentage of the sales proceeds as a commission. Commissions usually range from 10% to 50% and it is not uncommon for galleries to receive 40% to 50% for works consigned by artists. Compensation may instead be in the form of a fixed fee or any amount the gallery receives for a work of art above a specified price agreed to by the artist and the gallery for the sale of a particular work of art.

Many galleries do not segregate the portion of the sales proceeds that belong to the artist from the portion of the sales proceeds that is owed to the gallery. Instead, many galleries place

¹ This report has been reviewed and approved by the Association's Committee on Trusts, Estates and Surrogate's Courts.

the total sales proceeds in a single account that is also used to pay for the gallery's regular operating expenses.

When galleries that comingle funds encounter financial difficulties, they at times are unable to pay artists the sales proceeds they are owed because the galleries used those proceeds to pay the gallery's operating expenses. As a matter of law, the sales proceeds are property of the artist and galleries do not have discretion to use those proceeds for their own purposes. The existing provisions of Article 12 of NYACAL recognize this principle by providing that sales proceeds "are trust funds in the hands of the consignee for the benefit of the consignor." The existing NYACAL provisions, however, do not include any measures to enforce the trust funds principle and do not include penalties for galleries' failure to treat sales proceeds as trust funds. The lack of such measures and penalties enables galleries to continue using consignors' sales proceeds to pay the galleries' own operating expenses. When these galleries fail financially, the artists lose the money to which they alone are entitled.

The collapse of the Salander O'Reilly Galleries ("SOG") illustrates this problem. Prior to filing for bankruptcy protection in 2007, SOG operated as a gallery for more than 20 years. By 2005, it was a high profile gallery located in a five-floor townhouse off 5th Avenue on 71st Street, often exhibiting four separate shows on each of its four exhibition floors. The gallery had relationships with many artists, artists' heirs and artists' estates. It comingled the sales proceeds that belonged to the artists, artists' heirs and artists' estates with the gallery's own funds. In 2005, SOG had difficulty paying consignors the portion of sales proceeds owed to them, and by late 2007, SOG ceased paying its consignors entirely. In October, an involuntary bankruptcy petition was filed, and within a few weeks the gallery converted it to a voluntary bankruptcy petition under chapter 11 of the U.S. Bankruptcy Laws. SOG's principal, Lawrence Salander was indicted and plead guilty on March 18, 2010, to numerous fraud charges. The Gallery Director, Leigh Morse, was convicted on April 6, 2011 of defrauding artist estates. However, no charges were brought in either case for comingling funds or SOG's misuse of funds belonging to artists, their heirs, or estates.

Millions of dollars belonging to consignors, including artists, artists' heirs and artists' estates were never paid by SOG to those artists, artists' heirs and artists' estates. The sales proceeds that SOG was required to keep as "trust funds . . . for the benefit of the consignor" under the existing NYACAL provisions were gone, having been spent by SOG for its own operating expenses. In addition, the gallery had possession or control of hundreds of works of art consigned by artists, their heirs and their estates. However, because SOG's debts far exceeded its minimal remaining assets, creditors attempted to claim the consigned works of art in the gallery's possession or control as assets of the estate. With greater financial resources to fund the positions they took in the legal proceedings, creditors such as SOG's principal bank relied on creative legal arguments to tie up works consigned by artists' heirs. A common argument was to challenge whether the children of artists qualified as heirs under NYACAL. The contention was that, if an artist died and left works of art to his or her spouse, the children of the artist and spouse would not qualify as "heirs" because they did not receive the works of art directly from the artist. Section 2-1.1 of New York's Estates, Powers and Trusts Law ("EPTL"), however, provides that whenever the term "heirs" is used in a statute or instrument, it means the distributees, as defined in Section 1-2.5. EPTL Section 1-2.5 provides: "A distributee is a person entitled to take or share in the property of a decedent under the statutes governing descent and distribution." Thus, under EPTL Section 1-2.5, the issue of an artist will qualify as a distributee of the artist (and therefore an heir of the artist) regardless of whether the artist first leaves works of art to his or her spouse. Unable to pay legal fees to challenge such creative legal arguments, however, the artists' sons and daughters in many cases had to pay the estate to buy back their art.

The Bill's amendments to Articles 11 and 12 of NYACAL are designed to add teeth to the existing law and clarify certain provisions to prevent unintended interpretations from interfering with the purpose of these Articles.

Summary of Proposed Bill

Article 11 of NYACAL

To update and clarify who has standing to qualify for the protections of Article 12 of the NYACAL governing consignments, and in order to protect children of an artist in circumstances like those present in the Salander O'Reilly Gallery case, the Bill would amend Article 11 ("Definitions") to include a definition of "successor in interest" that includes heirs, personal representatives, testamentary beneficiaries, and trustees or beneficiaries of lifetime trusts, while cross-referencing the applicable definitions in the EPTL. The bill also makes it clear that the heir can acquire the subject work directly from the artist or craftsperson or from another heir or beneficiary of the artist or craftsperson. By clearly defining who has standing under the law, and by cross-referencing EPTL definitions, the bill will help avoid confusion and needless, costly litigation, while protecting consignors who may otherwise forego their rights.

Article 12 of NYACAL

The Bill specifies, in subsection (v) of Article 12.01.1(a), that trust property and trust funds, which are referenced in Section 12.01.1(a)(ii) and (iii), shall be considered property held in statutory trust. This provision follows an amendment made to a similar law in Massachusetts² to make explicit that works of art consigned by artists, craftspeople, their heirs and personal representatives to art merchants are not, and shall not become, the property of the art merchant, or the art merchant's bankruptcy estate.

The Bill also adds a clause specifying that the trust property and trust funds referred to in Section 12.01.1(a)(ii) and (iii) shall not be subordinate to any claims, liens or security interests "of the consignee's creditors." This last clause clarifies the terms immediately preceding it (i.e., "claims, liens or security interests").

As currently written, the statute allows a consignor to waive the provisions of Section 12.01(a)(iii) so long as the waiver is clear, conspicuous, in writing and signed by the consignor, with certain exceptions. This permits waiver of the provision establishing that sales proceeds constitute trusts funds. The Bill makes it clear that any such waiver must clearly and specifically apprise the consignor that the consignor is waiving rights under this section with respect to proceeds from the sale of the consignor's work. Continuing to permit a waiver of the trust fund provisions without specifically including such cautionary language would enable galleries to

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² Section 1 of Chapter 104A of the Massachusetts General Law.

obtain the waiver without the consignor necessarily knowing that he or she is waiving the right to proceeds, thereby undermining the purpose of the trust fund law and the Bill's amendments.

The Bill adds a new section 2 to Section 12.01. It provides that if the consignee fails to treat the trust funds and trust property identified in Section 1 in accordance with the requirements of fiduciaries in Section 11-1.6 of the EPTL, then such failure shall constitute a violation of NYACAL Article 12 and Section 11-1.6 of the EPTL. This amendment makes explicit the fiduciary obligations of the consignee with respect to trust property and trust funds in the consignee's possession and control. Among other things, the cross-referenced EPTL section specifies that property received as a fiduciary must be kept separate from the fiduciary's own property. It also illustrates that the fiduciary generally cannot treat the trust property or trust funds as if it were the fiduciary's own property or funds.

In addition, the existing statute does not specify the consequences in the event the fiduciary breaches his obligations. The lawsuits and claims arising out of events related to the Salander O'Reilly Gallery demonstrate a need for making such consequences explicit. The Bill cross-references EPTL Section 11-1.6 and thereby makes clear that a breach of such obligations include the penalties for committing a misdemeanor, as is already specified in EPTL Section 11-1.6.

Finally, the Bill creates a new Section 3 that further specifies consequences for breach of the fiduciary duties created by Article 12's statutory trust provisions. The Bill makes explicit a private right of action under the Article and specifies that a consignor may seek injunctive relief, recover actual damages and recover reasonable attorneys' fees if and to the extent such consignor is successful in such action. As one Court has noted, that absence of an attorneys' fee provision "appears to be a gap in the protections afforded to artists under section 12.01." In Koeniges v. Woodward, 183 Misc.2d 347, 358, 702 N.Y.S.2d 781,789 (NY Civ Ct. 2000), the Court explained:

While the court has denied plaintiff's claims for attorneys' fees and punitive damages, the court is sympathetic to plaintiff's argument that a violation of section 12.01 occurred, and the return of the photographs after institution of a lawsuit and almost two years later does not fully remedy the wrong. While not necessarily implicated here, there appears to be a gap in the protections afforded to artists under section 12.01. Perhaps, should the Legislature choose to amend the Arts and Cultural Affairs Law, the Legislature may deem it appropriate to address this issue. <u>Id.</u>

Conclusion

The Bill will add teeth to the existing trust property and trust fund provisions of Articles 11 and 12 of NYACAL. In addition, the Bill will provide clarity to prevent unintended interpretations of certain provisions from interfering with the intended application of these provisions. For these reasons, the Committee supports the Bill and urges its enactment into law.

APPENDIX

ART CONSIGNMENT STATUTES THROUGHOUT THE UNITED STATES

Alaska § 45.02.326

Arizona § 44-1772; § 44-1773

Arkansas § 4-73-207

California Cal. Civ. Code § 1738.6

Colorado § 6-15-102

Connecticut § *42-1161*

Florida § 686.503

Georgia § 10-1-520 through §10-1-529. Shorthand Name: Georgia Consignment of Art Act

Idaho § 28-11-102

Illinois § 815 ILCS 320/2

Iowa *I.C.A.* § 556D.2

Kentucky §365.855 through §365.860

Louisiana § 51:2151 through § 51:2156. Shorthand Name: Artists' Authorship Rights Act

Maryland § 11-8A-01 through § 11-8A-04

Massachusetts 104a §1-6

Michigan § 442.311 through § 442.315

Minnesota § 324.01 through § 324.10

Missouri § 407.900 through § 407.910

Montana § 22-2-501 through § 22-2-503

New Hampshire § *352:3 through* §*352:12*

New Jersey § 12A:2-329 through § 12A:2-336. Shorthand Name: Artworks Consignment Act

New Mexico § 56-11-1 through § 56-11-03. Shorthand Name: Artists' Consignment Act

New York Arts and Cultural Affairs Law, Article 12

North Carolina § 25C-1 through § 25C-4, 25C-12

Ohio § 1339.71 through § 1339.78 *NOTE: Statute Repealed*

Oregon §359.200 through § 359.255

Pennsylvania 73 § 2121 through 73 § 2130. Shorthand Name: Artworks Consignment Act

Tennessee § 47-25-1001 through § 47-25-1006. Shorthand Name: Tennessee Consignment of Art Act

Texas § 2101.001 through § 2101.003. Shorthand Name: Artists' Consignment Act

Washington § 18.110.010 through § 18.110.030

Wisconsin § 129.01 through § 129.08