

# ADVISORY

## SULLIVAN & WORCESTER LLP ART & MUSEUM LAW ADVISORY

### Important Changes and Interpretation of New York Consignment Law

A new law that takes effect on November 6, 2012 and a fresh interpretation of the General Obligations Law that governs auction and consignment sales in New York have altered consignment law significantly. Consignment sellers in New York are put to a higher duty than ever before to safeguard objects, as well as the sale proceeds of any of those objects. In addition, auctioneers will now be required to disclose the name of the consignment seller if the auction house wants to have an agreement that can be enforced against the high bidder. This advisory addresses both developments.

#### NEW LAW GUARDS AGAINST SALANDER O'REILLY SCENARIO

Consignment as a general principle, whether of art, clothing, or other property, merely means that the consignor (the owner) entrusts the property (e.g., art) to the consignee (e.g., a gallery or auction house) for sale under agreed-upon conditions, first and foremost the distribution of any resulting revenue. New York recently passed an amendment to its Arts & Cultural Affairs Law, N.Y. Arts & Cult. Aff. Law §12.01(2012) that affects the consignment relationship and creates critical new duties—and liabilities, for the dealer on consignment. Most importantly, it makes using any form of agreement drafted under the old law risky, particularly for the gallery or consignee. The law takes effect November 6, 2012.

The background to the law has been widely reported in the art and legal world. Specifically, one of the more notable art world scandals in recent memory was the collapse of the Salander O'Reilly Gallery. Among the many causes were the sale of works not actually owned by the gallery, the sale of the same work to multiple buyers, as well as the use of consignment sale proceeds to pay off unrelated debts.

The new law attempts to address this risk head-on by amending the provisions that deal with consignment. First, the amended statute broadens the scope of the law itself, defining "successor in interest" of the artist considerably, to include categories like personal representative, testamentary beneficiary, trustee of a trust, heirs, and the like. The upshot is that the class of persons who can enforce the rights under the statute has broadened.

Second, and most critically, it clarifies that under no circumstances can the artwork or proceeds that are held in trust be reached by the consignee's (*i.e.*, a gallery's) creditors. That is to say, even if an artist's work is sold

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for \$10,000,000, the gallery has no assets, and the creditors swoop in the very next day before the artist is paid her share, the creditors cannot touch that amount. That cannot prevent outright fraud, but once a gallery/consignee is going underwater, it can protect the artists/consignors who have not yet settled up.

Lastly, even though the previous version of the law used language of "trust" to describe the property held by the consignee, the new law makes clear that any failure to obey the statute's directives is not merely a breach of the contractual relationship between the parties, it is a breach of fiduciary duty, misconduct that generally entitles a plaintiff to a greater scope of damages, and which bars the defendant/consignee from raising certain kinds of defenses when self-dealing may be involved. Moreover, a prevailing artist/consignor will recover her attorneys' fees, a substantial risk and the exception to the traditional "American Rule" that all parties bear their own attorneys' fees in civil cases, regardless of who wins.

As before, the protections of the statute cannot be waived prospectively, but that safeguard has been bolstered now to bar any waiver absent "words which 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. . . ." Clearly, the consignee/gallery party has a heightened duty and far greater risk in the event of a failure to adhere to the new provisions. Artists and their successors now have additional tools to vindicate their rights. And, most importantly, almost any standard contract form being used (not actual contracts already in existence, which are not affected) will be obsolete on November 6, 2012, when the law goes into effect. Whatever protections galleries in particular thought they had about waiver and liability may no longer be effective. Anyone involved in these kinds of transactions should review and consider their rights carefully with an attorney.

#### **APPELLATE COURT CLARIFIES WHAT IS REQUIRED TO FORM A BINDING AUCTION CONTRACT**

The Appellate Division of the Supreme Court ruled recently that an auctioneer must disclose the name of any owner who has consigned the work for sale, or a sale against a successful bidder cannot be enforced.

Typically at auction, after a buyer goes to cash out with the auction clerk, the buyer gets an invoice. That invoice will ordinarily include details like the date, the bidder's name/number, and the winning bid. If the work was sold on consignment, sometimes the owner's name will be included too—but not always, and that left an opening in the recent case.

A few years ago, the William J. Jenack auction house in Chester, New York, auctioned for sale (for an unnamed owner) an object described as "Fine Russian Silver/Enamel Covered Box with Gilt Interior, Signed I.P. Khlebnikov, 19th Century. Height 1½"; Top 2½" x 3 5/8", which apparently came to be seen as the work of renowned silversmith Ivan Petrovich Khlebnikov. The high bidder was a man named Albert Rabizadeh, but after the sale Rabizadeh did not pay. Jenack sued Rabizadeh, presumably on the argument that he breached the contract to buy the object. Jenack won, and after some procedural wrangling over the damages to be paid relative to the subsequent resale, the case was appealed again.

Rabizadeh's invoice stated only that the consignor was "consignor #428," however. The Appellate Division focused on New York General Obligations law § 5-701, the New York version of what is known as the Statute of Frauds. Dating to medieval England, the Statute of Frauds is in fact the statute designed to *prevent* fraud, codifying what kinds of agreements have to be in writing to be enforceable. Until enacted in American states, it was not even a statute, but a doctrine of English common law. The most common (in other states as well) kinds of agreements that require a writing "signed by the party to be charged" (that is, the party later denying the existence of an agreement) are the sale of land, or agreements that cannot be performed within a year. New York, as elsewhere, has added certain other kinds of agreements the legislature determined are better enforced only in writing, ostensibly because it reduces confusion over what the agreement was.

Here, § 5-701(a)(6) is at issue, governing agreements for "goods sold at public auction." The statute requires that where the auctioneer makes a record at the time of the sale with "the name of the purchaser, and the name of the person on whose account the sale was made, such memorandum is equivalent in effect to a note of the contract or sale,

subscribed by the party to be charged therewith." In other words, an auction record that contains the name of the seller and the name of the buyer is a contract that can be enforced consistent with the Statute of Frauds.

The Appellate Division considered the implications of this, and ruled that by extension, an auction record that does *not* contain the name of the seller (the consignor) is not a contract consistent with § 5-701(a)(6). Whether or not it is "common practice" to name the auctioneer rather than the consignor, the auction house is not the "party to be charged"—the owner/consignor is. Without applying the rule both ways, a consignment seller could simply refuse to sell the item for the auction price if it were unhappy, pointing out that it had no binding agreement requiring it to do so.

The case may be appealed to the state's highest court, the Court of Appeals, but any further review is entirely discretionary. Unless and until there is a reversal of this decision, which the odds are always against as with any appeal, the Appellate Division's widely-reported opinion will affect auction contracts broadly. Until further notice, for a winning bidder to be compelled to pay for and buy an object, the seller has to be bound, too. For that to be the case, both sides have to comply with the Statute of Frauds.

Clearly, anyone selling art (or other objects) on consignment should review their policies and practices and, if concerned by the result, consider legal advice on how to move ahead.

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