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Spencer's Art Law Journal

Edited by Ronald D. Spencer

Editor's Note

This is Volume 6, Issue No. 1 of *Spencer's Art Law Journal*. This Winter issue contains two essays, which will become available on Artnet, January 2016.

The first essay: *(Blockage Discounts ...)* discusses problematic valuations of single artist collections which often result in substantially overvaluing the art.

The second essay: (*Protecting Expert Opinion ....)* examines legislation currently proposed to amend the New York Arts and Cultural Affairs Law, with the goal of protecting art experts and thereby encouraging these experts to express opinion about the authenticity of visual art.

Three times a year, this *Journal* addresses legal issues of practical significance for institutions, collectors, scholars, dealers, and the general art-minded public. – *RDS*

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BLOCKAGE DISCOUNTS VALUING ART COLLECTIONS: COURTS HAVE DRAMATICALLY OVERVALUED ESTATE ART INVENTORIES BY (IMPROBABLY) ATTEMPTING TO DETERMINE WHAT A RETAIL BUYER WOULD PAY FOR A SINGLE PIECE FROM THE ARTIST'S ESTATE.

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Ronald D. Spencer

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This essay addresses valuing art by a single artist for estate tax purposes. The difficulty is that the art will likely be sold years into the future because the market will not absorb the bulk of the art by only one artist anytime soon after the date-of-death valuation date. So the issue is to determine how much art could be sold, years and years (most likely) into the future, and at what price. Conceptually, the art would be sold by the estate to an investor or consortium of investors for investment and ultimate resale. Its value is the amount the buyer/investor would pay to the estate for his investment in the artist's art inventory. — RDS

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Blockage Discounts in the Courts

Valuations of art for estate and gift tax purposes (as well as for divorce and sale) present difficult issues when the art consists of many works by only one artist, chiefly because the art market can only absorb a limited number of works, yet the appraisal must decide value as of a certain date – in an estate, the owner's date of death. Consequently, this requires the valuation to determine the worth of a stream of income from art sales, sometimes in the rather distant future. Since it is quite clear that it would be imprudent to sell simultaneously and immediately a large number of works by the same artist, three United States Tax Court cases have accepted the concept of a "blockage discount".

Unhappily, these three Tax Court cases involving the art in the estates of David Smith, and Georgia O'Keeffe, and gifts of Alexander Calder art, while accepting the concept of "blockage" to discount the value of the art, have applied the concept in a way to greatly limit the discount and so produce art valuations (that is, a determination of what a buyer would pay) *much in excess* of real-world values.

Who Is the Hypothetical Buyer From the Estate: a Large Number Of Retail Buyers or a Single Bulk Purchaser?

In 1972, the Tax Court first took up the issue of a "blockage discount" for the value of art for estate tax purposes.[1] The artist, David Smith, died in an automobile accident, May 23, 1965, owning 425 pieces of metal sculpture created during various periods of his life beginning in 1937.

In valuing the art for estate tax purposes, the Smith executors first computed the price of each piece if sold individually at retail at the time of Smith's death, the total being $4,284,000. The executors then discounted this figure by 75% on the theory that these works could only be sold at the date of death to a bulk purchaser for resale, and then reduced this figure by one-third to cover the sales commissions which would be owed to Smith's gallery, Marlborough. The resulting figure of $714,000 was reported as the date of death value of the 425 sculptures.

The Smith estate argued that, if all 425 sculptures were offered for sale at the date of death, the purchaser could only be a person or syndicate acquiring the bulk of the sculptures for future resale, that such a person would be required to make a large cash investment which could be recouped with an acceptable profit only over a ten-year period of time; and that such a person would only pay 25 percent of the separate one-at-time value, which, after subtracting selling Marlborough commissions of one-third resulted in a value of $714,000.

The *Smith* court said that the 75 percent discount which the estate had applied to the one-at-time values was "too high". On the other hand,

> "We think that, at the very least, each willing buyer in the retail art market would take into account the price he would be willing to pay for any given item, the fact that 424 other items were being offered for sale at the same time. The impact of such simultaneous availability of an extremely large number of items of the same general category is a significant circumstance which should be taken into account."[2]

The Smith Estate argued that any value must be reduced by one-third to take account of commissions to which Marlborough Gallery was contractually entitled for its selling efforts. But the Tax Court said that the date of death value is what the estate would receive from a hypothetical sale, that is, "what a purchaser from the estate would pay." (The Court clearly is thinking only of a retail sale to the ultimate buyer.) Accordingly, the *Smith* court held that the fair market value at the date of death of the Smith sculpture was $2,700,000, equal to a 37% discount from the hypothetical single-piece total price of $4,284,000.

The *Smith* Court states, what is no doubt true, namely, that a willing buyer in the retail art market "would take into account the price he would be willing to pay for any given item, the fact that 424 other items were being offered for sale at the same time …". No doubt true, but *not at all helpful* in determining the price a bulk buyer would be willing to pay for all 425 sculptures. In effect, the *Smith* Court is arriving at a valuation of all the estate art by assuming a non-existent retail market, at the date of death, for each and every sculpture. The *real market* is a buyer or a syndicate of buyers who, in turn, would decide their purchase price from the estate by a calculation of their likely future sales (and cost of selling commissions and expenses) in both the dealer and the retail markets. Instead of trying to determine what each retail buyer would pay for given a sculpture, the *Smith* Court should have determined what a hypothetical estate buyer would have paid, since an estate bulk buyer would *necessarily* have made his own calculation for future retail (and wholesale) sales. The point becomes more clear, if one thinks of the sale by the Smith estate of the art inventory of David Smith's "art business". Accepted procedures for selling a business owned by an estate, clearly suggest that the estate executors would not seek to sell inventory into retail market. Rather, the executors would seek out a bulk inventory buyer interested in investment and future resale in retail and wholesale markets, who would also consider his selling expenses.

O'Keeffe (Wrongly) Decides That _Smith_ Was Correct. That Is, Value at Date of Death Is What the Retail Buyer Would Pay

Twenty years after *Smith*, in 1992, the Tax Court[3] again took up the issue of a blockage discount for the art of Georgia O'Keeffe in the following words:

> The O'Keeffe estate employed Eugene Victor Thaw (Thaw) to appraise O'Keeffe's works in the estate.
>
> It was Thaw's opinion that the appropriate blockage discount that should be allowed for O'Keeffe's works in the estate on the date of death is 75 percent. Thaw's opinion was based on the understanding and assumption that all of the works in the estate would be sold to a single buyer as a bulk purchase, which would require a syndicate of investors. The hypothetical buyer would have to hold the works for many years and, in determining the price to be paid, would take into account interest, selling costs, promotion, maintenance costs, and carrying charges. Thaw also based his opinion on the assumption that a buyer would consider "fluctuations from the very high market plateau for O'Keeffe's in 1986", although he would have advised a potential buyer that prices of works by O'Keeffe, on average, were unlikely to go down.[4]

The *O'Keeffe* Court noted, without elaboration, that Thaw would not have advised the O'Keeffe to sell at a 75% discount:

> Thaw would not, however, have advised a hypothetical seller of the works in the estate to sell the total of those works at a 75 percent discount. Thaw was under the impression that determination of blockage discount required him to assume a hypothetical buyer on the date of death who would have been required to purchase all of the works of the estate in bulk on that date. Although Thaw's written report categorized the works in the estate by medium and price, he did not differentiate among the works in determining the discount to be applied.
>
> In this case, the opinions of petitioner's experts that O'Keeffe's works in the estate, individually valued in excess of $72 million, could have been sold on the date of her death for $18 million, defies common sense. Our conclusion is based in substantial part on the particular content of the works. The individual values of 44 pieces totaled almost one-half of the agreed value of the whole group![5]

The *O'Keeffe* court continued:

> Thaw, for example, in effect assumed a forced sale in bulk of all of the works of the estate to a single buyer. Petitioner tries to justify that assumption by arguing that ascertainment of fair market value requires that property "must change hands" on the date of death. That argument is unsupported by authority or reason and ignores the concepts of willing buyers and willing sellers acting without compulsion – the defining actors in a fair market value transaction.
>
> Both Thaw and Rose [a second expert for the estate] conceded that they would not have recommended to a seller that the works in the estate be sold for the $18 million that they opined was the blocked value of the estate on the date of death.
>
> We are persuaded from Thaw's testimony and other evidence that the most valuable works would not necessarily be sold first and that some works of all types and values would be fed into the marketplace at a controlled pace. The most reliable consensus of the experts is that the better works could be sold within 7 years, and sale of the bulk of the estate would take more than 10 years. [6]

The *O'Keeffe* court then introduces the concept of different markets into which certain art could be sold, again taking issue with the Thaw approach of a single bulk buyer from the estate, who, in turn, would sell into specific markets:

> From the evidence, it is apparent to us that different works in the estate would be of interest to different segments of the art market. The parties have not reasonably quantified assumptions about the specific markets in which segments of the works in the estate would be salable. Petitioner has erroneously assumed that all of the art would initially be sold to a bulk purchaser, who would purchase for resale. Petitioner thus ignores the market of collectors who, while taking into account resale value, are not primarily interested in the rate of return on the investment.
>
> We conclude that the respective experts in this case each failed to consider the relevant market for particular works of O'Keeffe or groups of works in the estate . . . . The failure to consider the relevant market undermined the respective positions of the parties.
>
> We are persuaded that O'Keeffe's works in the estate on the date of her death should be segmented, not necessarily by value but by quality, uniqueness, and salability. There should be at least two categories, i.e., works that are salable within a relatively short period of time at approximately their individual values and works that can only be marketed over a long period of years with substantial effort. We believe that petitioner's experts' opinion is valid only as applied to the second category of works. Respondent's argument is meritorious with regard to

> the first category. For want of a more reliable breakdown, we conclude that one-half of the value of O'Keeffe's works in the estate would be appropriately subject to petitioner's experts' analysis and should be discounted 75 percent. Using our best judgment on the entire record, we conclude that the other half of the total value of O'Keeffe's works should be discounted 25 percent. After considering the entire record, we conclude that the fair market value of O'Keeffe's works in the estate at the date of death was $36,400,000.[7]

Thus, the *O'Keeffe* court decided that the O'Keeffe estate "erroneously assumed that all of the art would initially be sold to a bulk purchaser, who would purchase for resale", and, instead, the art "should be segmented, . . . by quality, uniqueness and salability."

But, is not this "segmentation" into various retail markets, *exactly* the analysis a bulk estate buyer would make in deciding on a bulk purchase price? *O'Keeffe* decided that the estate experts on valuation "failed to consider the relevant market for particular works of O'Keeffe or groups of works . . . " But, how else could the estate bulk buyer decide what to pay except by an analysis of the dealer and retail market for particular works, based on the qualities of each of the works?

Thus, *Smith* and *O'Keeffe* agree that in arriving at date of death value the court should *not* determine what a bulk buyer would pay for the art! Instead, both courts sought to determine (a problematic task!) the amount a single retail buyer would pay for a single piece knowing that many other pieces would be sold at the same moment. Indeed, the assumption of a retail sale is why *Smith* would not subtract the cost of sale commissions. But that determination should be for the bulk buyer in calculating his purchase offer to the estate. (Of course, it is fair for the court to decide that the hypothetical bulk buyer did not properly calculate his resale opportunities, but that is very different from trying to figure out, in a bulk sale circumstance, what a hypothetical *retail* buyer would offer).

The *Calder* Court Approaches Blockage as a Simple Determination of the Time Value of Money

In 1985, the Tax Court[8] decided the value for gift tax purposes of 1,226 gouaches created by Alexander Calder, who had died November 11, 1976. Calder's widow, Louisa Calder stipulated with the IRS that the average retail value of each gouache was $2,375, and reported on her gift tax return, the total value of the gifts to be $949,750.

The *Calder* court noted the IRS "annuity" approach:

> Under this approach, realization of the value of the art works can be compared to the right to receive an annuity of the stated amount over the given period, and the present worth of such annuity can be determined from the appropriate valuation tables, . . . The appropriate valuation factor reflects a discount for the amount of time the various installments of the annuity are deferred. As applied in the instant case, the effect is to grant a blockage discount in a somewhat more sophisticated manner than the usual method of applying a single percentage discount to the retail value of the items at the date of the gift. We are not prepared to say that respondent's theory is unreasonable, but its accuracy obviously depends upon the validity of respondent's assumptions regarding the number of gouaches that can be liquidated each year and, thus, the length of time such liquidation will require.[9]

The *Calder* court went on to say that it did not have to rely on assumptions to decide how fast the market could absorb the art:

> The actual sales experience in the period is the best evidence we have of the true absorption rate of the gouaches in the marketplace, and should be preferred to determine the estimated liquidation period for the purposes of determining the appropriate amount of blockage through an annuity approach. [10]

Calder determined that it would take as much as 22 years to sell all the gifted art at the stipulated average price of $2,375 per gouache. Hence, the date of death value, of the right to receive $2,375 per Calder gouache, up to 22 years in the future was, in total, $1,200,000.

Calder took an annuity approach to valuation. That is, it calculated the present value of money to be received up to 22 years in the future, $2,375 per gouache. It then simply calculated the time value of money and discounted the $2,375 based upon an assumed prevailing interest rate. However, treating the value of art as an annuity payable as much as 22 years in the future, is, of course, not in accord with the inherent uncertainty of the art market generally — all the more so for art created by one artist, even one with the reputation of Alexander Calder. Nevertheless, the principles underlying the time value of money are well understood and accepted by the courts. The question then becomes what amount of money is to be received in the future. *Calder* assumed that amount of money would be the stipulated retail price, $2,375 for each gouache.

The Time Value of Money

A sale of a large amount of art by the estate of one artist requires that the art be sold gradually over a considerable period of time. For the proper estate valuation of art created by a single artist at the artist's date of death, the assumption should be that the art will be sold in a manner that results in the as large a net value as current and future market circumstances permit. That is, the date of death value of the estate art is the maximum amount the art would be worth to a buyer acquiring the art with the intention of reselling in a way resulting in the largest possible financial return to the estate's buyer. The price to this hypothetical buyer is the discounted present (date of death) value of a stream of revenue expected from future art sales.

All three Tax Court decisions properly took into account the time value of money in arriving at the present value of a stream of revenue to be received in the future.

The Tax Court has long recognized the common sense principle that a sum of money due to be received in the future is worth less than the same amount immediately available. How much less depends upon the prevailing general interest rates, because the time value of money is amount that could have been earned but for the delay in future sales. Thus, for example, with a 5% prevailing interest rate, $1,000 receivable in 14 years has a present value of $500, with $500 representing the discounted present value of $1,000 receivable in 14 years. That is to say, if the estate's art could not be sold for 14 years, the date of death value must be reduced by 50% by reason of the time-value-of-money factor, alone.

How the Tax Court in *Smith, O'Keeffe* and *Calder* Should Have Analyzed Blockage Valuation

None of the three Tax Court decisions seem to have taken into account the *single greatest risk* a hypothetical buyer from the estate must have considered in deciding what to pay for the estate art, namely the risk that the art might depreciate very substantially in value over the period of time during which the art was to be sold – the so-called *risk premium.*

Risk and Uncertainty in Art Sales

Art to be sold in the future is, of course, subject to the usual risks of damage or destruction by fire, natural catastrophe, theft, accident and deterioration.

But art created by a single artist (especially) is subject to another kind of risk, namely the art can decline (or increase) in value relative to any general trend in art prices. Art purchased cheaply may become very valuable ten years later or may collapse in market value over the same period. The result of this depreciation or appreciation – the possibility of bi-directional uncertainly is not a "wash".

The distinguished economist, Professor William J. Baumol, gives several arresting examples of this concept:[11]

> Just consider a government that promises to pay the holder $1,000 later today, and a lottery ticket that will pay the holder after the drawing this afternoon either $1,500 or $500 with a 50-50 chance of either outcome.
>
> Clearly the treasury bond will be worth approximately $1,000 because it is virtually cash in hand and will actually be so in a few hours. The lottery ticket . . . brings with it the possibility that anyone who purchases it for $1,000 will be $500 poorer that evening. Consequently, the

> market will normally deduct what is described as a risk premium for the price of the lottery ticket. Normally, moreover, the magnitude of this risk premium will be greater the greater the range of uncertainty entailed in the investment. Thus, consider a second lottery ticket that offers either a $2,000 payoff or one equal to zero . . . the lure of the investment brings the possibility of doubling one's money if one pays $1,000 for the ticket. But, now, the danger is that one's investment will be lost altogether . . . The second lottery ticket, because it entails the greater gamble, can be expected to entail the larger risk premium . . . [12]

Professor Baumol continues:

> The very fact that there patently is a range of possibilities . . . means that the . . . future value of those art works must be reduced by a substantial risk premium to obtain a correct current [date of death] valuation.
>
> . . . the big risk, is the risk that the price of the work will drop unexpectedly and disastrously in the future.
>
> . . . it has happened to Titian and Sargent, among many others.
>
> . . . the very great risk of investment in art is confirmed by every statistical investigation of which I am aware.
>
> . . . The starving artist who goes unrecognized during his lifetime but whose works are later sought after avidly by museums and wealthy collectors is the stuff of romantic story-telling. We all know of van Gogh who never was able to sell a picture while he lived (except for one sale to his brother), of Gauguin and Cèzanne, whose paintings commanded no high prices and whose works have since undergone price explosions. There is, however, an abundance of cases in which histories are reversed . . . [13]

Historical Winners and Losers

The economists, Bruno S. Frey and Werner Pommerehne,[14] wrote in 1988 about their important historical study of art prices and investment return:

> "Man in Black" by Frans Hals sold at Christie's in 1885 for five pounds sterling and in 1913 for 9,000 pounds at Sotheby's, and artists like Manet, Matisse have shown enormous price increases. But John Singer Sargent's oil sketch 'San Virgilio' sold for 7,350 pounds in 1925 but in 1952 sold for only 105 pounds at Christie's. Other well known artists such as Sir Edwin Landseer and Sir Joshua Reynolds had works sell at real financial loss.

The Unpredictability of Fashions: Resulting in Unanticipated Price Movements.

Frey and Pommerehne continue:

> A careful analysis of the long-term evolution of the price of paintings suggests that the changes in price can be understood as a random process. The long-run rate of return on investments in paintings cannot be attributed to a systematic identifiable factors. . . The price movements that in retrospect are termed "fashions" are not predictable even by art experts, and therefore cannot be anticipated or and exploited systematically.
>
> . . . There are many examples that support these findings: Vermeer was held in low regard for a long time, and his paintings accordingly fetched low prices; today his paintings are among the world's most expensive. The same can be said of El Greco. Turner's paintings at first sold at very high prices; then prices fell sharply. Today his prices fetch record prices . . . . Conversely, there are many artists who were previously highly esteemed, but nowadays are little known . . . Alma-Tadema also comes to mind; his works were initially highly priced, but by the time of his death in 1913, the prices of his paintings had been falling for a decade. . .

one of his most famous paintings could not find a buyer at 5% percent of the price paid in 1904.[15]

Additional Risks and Uncertainties: Tending to Depress the Value of Art

If the art valuation is, as it often is, in the context of estate values, of course the deceased artist will not be adding to the market supply with the sale of newly created works. But it is important to bear in mind that, in calculating rate at which the market can absorb art from the estate, owners, other than the artist's estate will be selling into the public and private markets, possibly at a greater rate than when the artist was alive.

Also, art created by the artist remaining in the estate at the artist's death is, by definition, art that was not sold during the artist's lifetime, most likely because it is less saleable than that which the artist sold during life. (Clyfford Still may be the exception, proving the rule).

Conversely, if the valuation is for purposes of divorce or sale where the artist remains alive and creating art, this market supply *overhang* would tend to reduce the rate at which the market would be able to absorb the artist's existing inventory.

The net result of the above-noted risk and uncertainties affecting the value of art, and, most importantly, the *risk premium*, suggests that many single-artist estates are very much *overvalued* by both appraisers and courts.

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NOTES

[1] *Estate of David Smith v. Commissioner*, 57 T.C. 650 (1972), *aff'd,* 510 F.2d 479 (2d Cir. 1975).

[2] *Smith* at 658.

[3] *Estate of Georgia T. O'Keeffe*, 63 T.C.M. (CCH) 1992-210 (1992).

[4] *Id.*

[5] *Id.*

[6] *Id.*

[7] *Id.*

[8] *Calder v. C.I.R.*, 85 T.C. 713 (1985).

[9] *Calder*, at 724.

[10] *Calder*, at 725.

[11] Affidavit of William J. Baumol, *In the Matter of the Estate of Andy Warhol*, Index No. 1987-0824 (Surr. Ct. N.Y. County).

[12] *Id.*

[13] *Id.*

[14] Bruno S. Frey and Werner W. Pommerehne, *Is Art Such a Good Investment?*, The Public Interest, Spring 1988, at 79.

[15] *Id.*

PROTECTING EXPERT OPINION ABOUT VISUAL ART: PROPOSED LEGISLATION IN THE NEW YORK LEGISLATURE WILL PROBABLY NOT ACHIEVE ITS INTENDED RESULT. AND, AS A SIDE-EFFECT, EXISTING STATUTORY WARRANTY PROTECTION FOR ART BUYERS COULD BE REDUCED

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Judith Wallace

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This essay addresses efforts to protect expert opinion about the authenticity of visual arts, thereby encouraging these opinions. In the past few years, there have been several proposals to amend New York law to provide protection for legal claims against experts for their opinions. Currently, another proposal to amend the law is being considered. It attempts to protect expert opinion by stating that the opinion is not a warranty of authenticity upon which the expert could be subject to liability. This proposed legislative approach may not fully protect the expert and could have the nasty side-effect of reducing existing statutory warranty protection for the art buyer – RDS

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Opinions About Art –Why Are They in the Public Interest?

Recently there has been a renewed effort to promote a New York state law protecting art experts from lawsuits. But why it is more important to single out art experts – among all professionals – for protection? Why are their opinions more deserving of protection than those of bond rating agencies, restaurant reviewers or doctors?

Expert opinions about art are essential to the business of buying and selling art, which is a substantial contributor to the New York economy. Scholarship about art, expressed in articles, lectures and exhibits, is also of great interest to many members of the public. But art experts are uniquely vulnerable to lawsuits because they are asked to provide yes or no opinions – not that the piece is "probably" by Picasso. There is also a First Amendment value at stake – the U.S. Supreme Court has recognized that opinions and other ideas are entitled to constitutional protection.[1]

Opinions about art arise in two ways. Experts may be asked for opinions when a work being offered for sale, especially if the work does not have an extensive history of public exhibition. In this situation, experts can demand a "no-sue" agreement as a condition of providing an opinion. But the same scholars also write books and articles, or volunteer their unsolicited views, and in those situations the expert cannot obtain a "no-sue" agreement in advance from either art owners or future readers.

Legal exposure for the expert can arise whether the expert's opinion about the art is positive or negative. If the expert's opinion is positive, and relied on by a buyer, but later turns out to be incorrect, the disgruntled buyer may seek to hold the expert accountable for the initial, positive opinion. If the expert's opinion is negative, the current owner may claim that the expert has improperly disparaged the property or interfered with a prospective sale. Most professionals need to be concerned principally with malpractice liability, which makes them responsible to their clients and requires them observe reasonable standards of due diligence, but art experts have faced claims from upstream or downstream owners who have wanted the experts to be required to prove that their opinions are correct, and not merely that they followed standard industry practices in their evaluation of the artwork.

Back to the Future

There is a perception that the reluctance of experts to voice negative opinions is a new problem created by an increase in art values, art fraud or litigious owners. This misimpression may be due to a few high-profile announcements by experts that they would cease giving opinions to avoid the possible expense of legal fees.

Yet the same need for legal reform was identified in 1966 by New York State Attorney General Louis J. Lefkowitz, who advocated a state law granting qualified immunity to "accredited" art experts who judge art works to be false, unless the disgruntled seller proved bad faith by the art expert. Fifty years ago, there was the same perception that art fraud was on the rise, and that a law was needed to encourage experts to freely express negative opinions, because "[u]nder present conditions, many art experts are reluctant to give opinions."[2] Ironically, the Art Dealers Association of America opposed that proposal because it excluded dealers from the proposed accreditation and immunity.[3] Artists including Jacques Lipchitz testified in support of the Attorney General's proposal.[4] But the proposal failed, and the statute that is now the Arts and Cultural Affairs Law was enacted in 1966 without immunity for experts.

Unfortunately, as discussed below, the legislation now being proposed offers experts more limited protection than the 1966 proposal, and potentially undercuts fundamental protections for art buyers.[5]

Key Features of the New York Arts and Cultural Affairs Law

The "express warranty" provision is the key protection for non-dealer art buyers contained in the New York Arts and Cultural Affairs Law ("non-merchants," in the terminology of the statute). It provides that certificates of authenticity "or any similar written instrument" are deemed to be *express warranties* upon which buyers may rely as guarantees of authenticity (at least within the four-year statute of limitations). This protection was initially enacted by the legislature in 1966, and augmented in 1981 and 1990 with even more stringent warranties for multiples. The purpose was to address dealers who claimed that representations about art were mere "opinions" and not warranties, and to require sellers to be more explicit about disclaimers. As the legislative history explained,"[t]here is no doubt that the price paid is usually based upon the buyer's assumption that … words of description are intended as a representation or warranty. This bill would remove any doubt in this regard by putting the burden on the seller to make his intention clear."[6]

This express warranty applies only in sales from dealers to non-dealer collectors for unique works (for multiples, it applies to all sales). Dealer-to-dealer sales are governed by the generally applicable warranty in the Uniform Commercial Code for all sales of goods, which does not specifically address the role of certificates of authenticity for fine art.

Courts have recognized the practical reality that attributions are subject to change, and held that, at least for unique works of art (as opposed to multiples), a dealer that had a "reasonable basis in fact" at the time of sale is not liable under the New York Arts and Cultural Affairs Law for the warranty, even if the work is later shown to be inauthentic.[7] Some dealers also explicitly inform buyers at the time of sale that a change in expert opinion will not be grounds for a refund. But where there is no such disclaimer, buyers can often rely on expert opinions and still have warranty claims if the work is proven not to be as it was represented to be in all material respects.

Proposed Legislative Amendments (Purportedly to Protect Experts) Actually Undercut Key Protections for Art Buyers

Unfortunately, the proposed amendments to protect experts may destroy this valuable protection for art buyers.

The proposed legislative amendments to the warranty standard address situations where the expert provides a positive opinion or otherwise makes a statement of fact that turns out to be inaccurate. The proposed amendments state that certain warranty provisions in the Arts and Cultural Affairs Law "shall not apply to an authenticator's opinion or information concerning a visual art multiple or work of fine art."[8] In other words, statements made in these authenticators' expert opinions could not serve as the basis for a warranty claim.

That is a change that shields *dealers* as well as authenticating experts. The amendments do not merely create an exemption from the warranty for claims *against authenticating experts*, who are defined in the proposed

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amendment as recognized experts with no financial interest in the work of art at issue.[9] A simpler amendment proposed by the Art Law Committee of the New York City Bar Association in 2013 explicitly stated that it only raised the bar for claims against authenticating experts.

Instead, the proposed amendments state that expert opinions do not give rise to a warranty — period. Thus, if a dealer sells a work, attributing it to a particular artist, based upon an expert's opinion, and three years later the work is discovered to be a fake, the purchaser will demand a refund from the dealer. But the proposed amendments seem to say (perhaps inadvertently) that the buyer would not have a warranty claim — against anyone — because the parties relied on an expert opinion. If that is not the intention of the proposed amendments, the proposal should be revised, and if it is the purpose, it needs to be disclosed and debated, because it is a significant change in the law. Under existing law, a disclaimer of warranties would need to be explicitly stated in sales documents.

It is fair to amend the law to make it clear that an opinion by an expert with no financial interest in the artwork is not a warranty backed up by the expert's bank account. Experts who not receive any portion of the purchase price cannot be expected to provide a refund of the purchase price for the art if they turn out to be mistaken. No scholar could afford to create a catalogue raisonné if doing so constituted a warranty of authenticity for every work included. This clarification in the law of warranties would be especially helpful to artist-established or estate-established foundations and authentication boards, who are often attractive, but inappropriate, targets of lawsuits by disgruntled purchasers, especially if the seller who received the purchase price is overseas, out of business, or, years later, having paid taxes and business expenses, no longer has the sale proceeds.

If the proposed legislative changes are enacted, they will likely be cited by a seller in response to a claim, arguing that the parties relied on the expert opinion, and therefore there is no warranty. And when courts review the revised statutory language, they might not be aware of the legislative history, might not interpret the legislative history as establishing that the change is limited to claims against experts, or might not view the legislative history as appropriate for consideration at all if the statute appears clear on its face. A clarification that explicitly limits the proposed amendments to claims against expert authenticators with no financial interest in the sale needs to be restored to the proposed legislation.

It has been reported that the reason the simpler and more limited 2013 proposal did not pass is because it was opposed by the trial lawyers' lobby, which, it is said, opposes any obstacle to lawsuits. It would be ironic if the 2015 version passed instead.

Even with the issue of its unintended effects, the proposed amendments are still an imperfect shield for experts if their opinions turn out to be wrong. The amendment does not prohibit non-warranty claims such as negligence that might be made based on a positive but incorrect negligent opinion. It does not apply to warranty claims by dealers under the Uniform Commercial Code.

Nor is it even an unambiguous protection from warranty claims. The current version of the proposed amendments is a muddled string of cross-references shoehorned into in the section of the Arts and Cultural Affairs Law applicable to multiples, though it mentions and seems to disclaim the warranty for unique works of art as well.

If the proposed amendment does apply to the warranty for unique works, it disproportionately harms private collectors (as opposed to dealers). The proposed amendment cuts back on warranties in the New York Arts and Cultural Affairs Law. But, as noted above, the Arts and Cultural Affairs Law warranty for unique works applies only to *non-dealers* buying from dealers. The warranty provision of the UCC, applicable to purchases by dealers, is not amended. The result will be that warranty claims over authenticity issues will likely devolve into factual disputes about who the actual buyer is, which can be difficult to determine if a sale involves nearly simultaneous back-to-back transactions, or if it is unclear whether parties are buying and selling on their own behalf or as agents.

Thus, the principal effect of the proposed amendments will likely be to complicate – rather than eliminate – warranty claims. And, since the protection envisaged by the proposed amendments may turn on future events unknown to the expert, such as who the buyer will be (dealer or collector) or how the deal will be structured, it might not do much to encourage experts to speak freely.

Failure to Immunize Negative Opinions

Nor do the proposed amendments provide a meaningful fix for *negative* statements about art.

The proposed amendments do not increase the burden of proof for plaintiffs, or add any new defenses for experts and scholars. Rather, the proposed changes merely require plaintiffs to make more detailed allegations in a complaint and state "specify with particularity" the "facts sufficient to support each element of the claim or claims asserted."[10] That might not be much of an obstacle for owners who can articulate exactly what they object to in the expert's opinion, and allege enough facts to survive a motion to dismiss.

Obviously, the "qualified immunity" for experts proposed in 1966 would be ideal. There are also potential models in other areas of New York law. Uncompensated not-for-profit directors and officers generally enjoy qualified immunity unless they are grossly negligent or intentionally caused harm.[11] And in certain claims involving architects and engineers, a plaintiff must show a "substantial basis in law" for a claim that negligence of the professional caused an injury to survive a motion to dismiss.[12]

Qualified immunity is also consistent with some federal case law on the First Amendment, recently considered in the case of bond-rating agencies, holding that pure opinion statements about a matter of public concern, made publicly, are not actionable unless made with actual malice. Qualified immunity of the type proposed in 1966 would codify that art expert opinions are statements in the public interest, and are statements of pure opinion, entitled to the most deferential level of constitutional analysis (even if some underlying "facts" play a role in forming that opinion), and could provide that the same standard applies to all opinions, whether in academic publications or advice in connection with sale transactions.[13]

Possibility of Recovering Legal Fees

Since it is extremely rare for an expert to be found liable and ordered to pay damages for a good-faith opinion, the main risk to the authenticator is the legal fees incurred in responding to a claim.

The general rule in U.S. litigation is that parties bear their own legal fees. A party can only recover legal fees if a statute or contract explicitly authorize it. The proposed amendments allow an expert to potentially recover fees, but it is not an automatic entitlement. The expert must both prevail in the lawsuit and convince the court that there is good and just cause it to be reimbursed for its fees.[14] That is not always necessary – some statutes, such as the federal racketeering law, require payment of fees to a prevailing party. The 2013 version of the proposed amendments to the Arts and Cultural Affairs Law did so as well.

Experts who are asked to volunteer opinions but who are deterred by the potential cost of litigation (or even the cost of consulting an attorney and responding to demand letters from owners) will not be comforted by the possibility that if they are sued and win, they will have a chance to recover their fees. Mounting a First Amendment defense or attempting to prove that the expert was correct involves substantial legal work. Without a change that substantially shifts burden of proof, such as the creation of a qualified immunity for good-faith and reasonably diligent opinions, and a guarantee that experts will obtain an award for their legal defense fees if they defeat a lawsuit, the proposed amendments will not encourage experts to more freely express their opinions.

Even so, qualified immunity is not a perfect fix. A careful plaintiff will be able to allege the disputed facts needed to prevent the case from being dismissed at an early stage – whether it is bad faith, gross negligence, or lack of recognition as an art expert. While the case is proceeding, the expert would still need to fund a defense. Werner Spies recently obtained a reversal on appeal of the French ruling ordering him to reimburse a collector who relied on a statement by Spies that he planned to include the work in his catalogue raisonné of Max Ernst, but most experts would not be able to (or want to) fund a defense through a trial and appeal. In contrast, professional liability insurance, with coverage for the cost of defending against a claim, is an option that can cover the expert's legal fees as they are being incurred.[15]

Are Flawed Amendments Better than Nothing?

A change in the law, by statute or by judicial decisions, could increase protections for experts and encourage them to issue unambiguous on-the-record opinions. "No-sue" agreements can help scholars when they are advising on art transactions, but not when they are volunteering opinions in lectures and scholarly work. Insurance can cover the cost of a defense, but some experts may not be willing or able to comply with the formalized business procedures an insurer will require.

Unfortunately, the proposed amendments do more harm than good. For warranty claims, the change muddles and undercuts a key art buyer protection under the Arts and Cultural Affairs Law, and still might not provide a defense to experts in warranty disputes between dealers that are governed by the UCC. The remaining protections offered by the amendments to protect experts from objections to negative statements about art are exceedingly modest. As a practical matter, they are unlikely to inhibit lawsuits against art experts. On balance, these amendments would not accomplish much and will certainly squander the chance for comprehensive and effective state-level legislative reform protecting art experts.

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NOTES

[1] *See Milkovich v. Lorain Journal*, 497 U.S. 1 (1990); *Gertz v. Robert Welch, Inc.*, 418 U.S. 323 (1974).

[2] Milton Esterow, *Lefkowitz Urges Art Fraud Curbs*, New York Times, November 19, 1965,.

[3] *Spokesman for Dealers Scores Lefkowitz's Art Fraud Proposal,* New York Times, March 16, 1966 (reporting that Ralph F. Colin, administrative vice president of the Art Dealers Association of America, resigned from the Attorney General's advisory committee in protest, and stated that it "will receive no further assistance or cooperation" from the association" because the exclusion of art dealers from qualified immunity.)

[4] Richard V. Shepard, *Artist or the Public: Who Needs the Protection?*, New York Times, December 29, 1965.

[5] Assembly Bill A1018A; Senate Bill S1129A.

[6] Legislative Annual 1966.

[7] *Dawson v. G. Malina, Inc.*, 463 F. Supp. 461, 467 (S.D.N.Y 1978); *Christie's Inc. v. SWCA, Inc.,* 11 Misc. 3d 380 (Sup. Ct. N.Y. County 2008) (in which the author, with Gary D. Sesser and Ronald D. Spencer, represented the defendant that prevailed on this issue).

[8] The proposed amendments would add to the express warranty in Section 15.11 text providing that "This section shall not apply to an authenticator's opinion or information concerning a visual art multiple or work of fine art, as set forth in subdivision 23 of Section 11.01 of this Chapter, Section 15.12 of this Article, and Subdivision 4 of Section 15.15 of this Article."

[9] Section 2, amending 15.11. The 2013 version of the proposed amendment was limited to claims against authenticators who did not have a financial interest in the work being sold.

[10] Section 3, adding 15.12

[11] New York Not-for-Profit Corp. Law Section 720-a.

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[12] CPLR 3211(11)(h).

[13] *See* Judith Wallace, *Museums and Museum Curators: Caught in the Cross-Hairs of Authenticity Disputes*, *in* The Legal Guide for Museum Professionals (Julia Courtney, ed. 2015), at http://www.clm.com/docs/7612511_1.PDF; Ronald D. Spencer, Protection from Legal Claims for Opinions about the Authenticity of Art, Spencer's Art Law Journal, February 13, 2013, at http://www.clm.com/docs/7154982_1.pdf.

[14] Section 4, amending Section 15.15.

[15] Judith Wallace, *Liability of Art Experts: Is Insurance a Solution and Will Opinions Be Less Dangerous Things to Give?*, *Spencer's Art Law Journal*, March 12, 2015, at http://www.clm.com/docs/7591563_4.pdf.

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