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## Consignment Catastrophes: Lessons from New York's Art Gallery Fraud

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CONSIGNMENT CATASTROPHES: LESSONS FROM  
NEW YORK'S ART GALLERY FRAUD

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ABSTRACT

*The 2007 collapse of Salander O'Reilly Gallery in New York City caught the attention of New York's state lawmakers after artists and their heirs lost nearly \$120 million in gallery owner Lawrence Salander's schemes. This scandal ultimately led lawmakers to enact major changes in the state's art consignment statute. The changes bolstered existing protections while adding additional safeguards for artists who choose to consign their works through galleries rather than selling them wholesale.*

*This Article will examine the relationship between consignors and consignees, highlighting major vulnerabilities that current consignment statutes create for artist consignors. In Section I, this Article will examine the benefits of consignment to both artists and dealers. In Section II, this Article will discuss the most common provisions in art consignment statutes that tend to leave artists unprotected in consignment deals. In Section III, this Article will examine New York's amended consignment statute, which alleviates all major concerns for artists, and will argue that New York has provided a model statute that all states should implement in order to provide a fairer balance in the relationship between artists and art dealers.*

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*Finally, Section IV will briefly examine the potential benefits the statute can provide for artists asserting claims to protect their consigned works.*

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INTRODUCTION

In 2010, the art world watched as Lawrence Salander, the owner of the former Salander O’Reilly Gallery in New York City, was sentenced to six to eighteen years in prison after pleading guilty to 29 counts of grand larceny.<sup>1</sup> In 2007, a judge ordered the gallery closed.<sup>2</sup> That order was preceded by several lawsuits from Salander’s investors and artists claiming, among other things, that Salander fraudulently sold multiple works of art and failed to pay back a number of loans.<sup>3</sup> All told, Salander’s scheme had racked

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<sup>1</sup> Helen O’Neill, *The art world’s Bernie Madoff, and his deceptions*, THE STAMFORD ADVOCATE (Oct. 24, 2010, 10:59 PM), <http://www.stamfordadvocate.com/local/article/The-art-world-s-Bernie-Madoff-and-his-deceptions-721757.php>.

<sup>2</sup> James Barron, *Manhattan Art Gallery Is Shut as Lawsuits Multiply*, THE NEW YORK TIMES (Oct. 19, 2007), [http://www.nytimes.com/2007/10/19/nyregion/19gallery.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2007/10/19/nyregion/19gallery.html?pagewanted=all&_r=0).

<sup>3</sup> *Id.*

up nearly \$120 million in damages.<sup>4</sup>

While many of Salander's investors suffered their fair share of monetary losses, perhaps most affected were many of the artists Salander had worked with.<sup>5</sup> When the gallery's finances became imperiled, Salander began selling a number of paintings given to him on consignment without permission from the artists.<sup>6</sup> He often sold these pieces at prices that were well below what the pieces were actually worth in order to satisfy his other debts. A number of artists and their families also alleged that Salander had sold multiple pieces that were given to him for storage purposes only, leaving the original owners without their works of art or compensation for any of them. Those parties claimed that they never authorized Salander to sell the pieces. They only accepted Salander's offer to hold the artwork in his gallery for safekeeping.

News of the gallery's collapse caught the attention of New York lawmakers, who quickly worked to amend the state's art consignment statute to prevent such harm to other artists in the future.<sup>7</sup> The amendments passed in 2012 provided a number of protections to artists selling their works on consignment against dealers using techniques like Salander's.<sup>8</sup>

## I. WHY CONSIGN?

Consignment has become more prevalent in the art world after the recent global economic crisis. Galleries with little cash on hand often prefer to obtain works on consignment because purchasing

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<sup>4</sup> John Eligon, *Art Dealer Is Sentenced for \$120 Million Scheme*, THE NEW YORK TIMES (Aug. 3, 2010), <http://www.nytimes.com/2010/08/04/nyregion/04salander.html>.

<sup>5</sup> Eileen Kinsella, *Untangling the Salander Mess*, ART NEWS (July 1, 2010), <http://www.artnews.com/2010/07/01/untangling-the-salander-mess/>.

<sup>6</sup> *Id.*

<sup>7</sup> Dennis O. Cohen & Lindsey A. Shoshany, *The Art of the Deal*, MEDIA LAW BYTES & PIECES (Oct. 24, 2012), [www.lexology.com/library/document.ashx?g=abbd4b65-cac5-46d7-ae58-659a7d526994](http://www.lexology.com/library/document.ashx?g=abbd4b65-cac5-46d7-ae58-659a7d526994).

<sup>8</sup> Nicholas O'Donnell, *Change to New York Art Consignment Statute Adds Protections, Risks*, THE ART LAW REPORT (Sept. 27, 2012), <http://www.artlawreport.com/2012/09/27/change-to-new-york-art-consignment-statute-adds-protections-risks/>.

pieces to sell can be prohibitively expensive. Consignment allows galleries to save their cash reserves and pay the artist only after their works sell.

Consignment is often an attractive option for artists as well. Many artists who cannot or simply do not want to spend their time selling their works will often turn pieces over to galleries for consignment. These agreements give artists the opportunity to have their pieces sold by professional sellers, thus giving the artist more time to create rather than run a business. In addition, artists are often able to obtain favorable fee splits with galleries that ultimately net the artists more money than they would have made selling their works wholesale to dealers.

However, consignment agreements can also leave artists quite vulnerable in many ways. Notably, as will be discussed in more detail below, many states do not afford sufficient protections to artists who consign their works. Thus, artists without access to legal counsel often do not know what to look for or what questions to ask when entering such agreements. This lack of knowledge ultimately places artists on unequal footing when contracting with savvy dealers and galleries.

## II. VULNERABILITIES IN CONSIGNMENT STATUTES

To date, 33 states have art consignment statutes.<sup>9</sup> Though the statutes vary widely, many address the same key issues. In addition, such statutes frequently create the same vulnerabilities for artists. Three significant weaknesses are often present in such statutes: little to no regulation of how dealers are to place works and profits in trust for the artist; a lack of attorney's fees for prevailing plaintiffs; and no requirement for written consignment agreements. These issues can create significant problems for artists when consigning their works.

### *A. Property Held in Trust*

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<sup>9</sup> Erin McGowan, *Artist-Gallery Consignment Statutes*, ST. LOUIS VOLUNTEER LAWYERS AND ACCOUNTANTS FOR THE ARTS (2013), <http://www.vlaa.org/?view=Artist-Gallery-Consignment-Statutes>.

One common provision in many states' consignment statutes is a requirement that galleries hold the artist's works and any profits from their sale in trust for the artist, thus creating a fiduciary duty to the artist.<sup>10</sup> However, most statutes are silent on how the consignee is to handle the property they hold in trust.<sup>11</sup> In most states, galleries are able to commingle their business funds with consignment profits without being subject to penalties.

Though some states do specify that the consignment proceeds must be protected from the gallery's creditors,<sup>12</sup> most statutes do not include this provision. Without this protection, artists' profits in those states are vulnerable to seizure by third parties if the gallery goes bankrupt. While there certainly are remedies for breach of fiduciary duties, the high cost of legal counsel can often limit many artists' ability to seek help, especially in such disputes where their expected profits from completed sales are being held from them. Even if artists are able to afford legal counsel, they are often limited to seeking restitution from a failing gallery or through impending bankruptcy proceedings. This makes it extremely unlikely that the artist will recover much, if anything, for their previously sold or lost works.

### *B. Attorney's Fees*

Of the states that have art consignment statutes, most do not address the issue of attorney's fees.<sup>13</sup> While the traditional American rule, where each party pays their own legal costs and fees, is generally the default when statutes are silent on the issue,<sup>14</sup> this requirement can create a significant burden for artists seeking to enforce prior agreements or protect their works in a dispute. Many artists choosing to consign their works are not highly paid;

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<sup>10</sup> *Id.*; *see, e.g.*, ALASKA STAT. § 45.65.200 (2012); WASH. REV. CODE § 18.110.010 (2012).

<sup>11</sup> McGowan, *supra* note 9.

<sup>12</sup> *See, e.g.*, D.C. CODE § 28:9-114 (2012).

<sup>13</sup> McGowan, *supra* note 9.

<sup>14</sup> *See, e.g.*, Baykam v. Martin/Molinary Art & Design Galleries, Ltd., No. 86 CIV. 1010 (JEL), 1987 WL 12375 (S.D.N.Y. 1987); Koeniges v. Woodward, 702 N.Y.S.2d 781 (N.Y. Civ. Ct. 2000).

they create art as a hobby or side project. Thus, when faced with the choice between paying costly legal fees or simply dropping the matter, many artists may think twice about using the courts to settle their disputes.

### C. *Written Agreements*

Though some states, such as Georgia,<sup>15</sup> require that all or portions of consignment agreements be reduced to writing, most do not have this requirement.<sup>16</sup> Informal verbal agreements that take the place of written agreements put both parties to an agreement at risk. However, artists in particular, especially those without experience selling their own works, can be taken advantage of in this context. Like most of the general population, inexperienced artists are not always aware of what their rights are in a contract negotiation. A savvy gallery owner or dealer who is more familiar with consignment practices and transactions could easily take advantage of a consignor in the absence of a written document spelling out the consignor's rights.

### III. NEW YORK'S STATUTE

In 2012, New York lawmakers set out to prevent a future Salander O'Reilly-like disaster by protecting those artists most likely to suffer when consignment transactions go wrong.<sup>17</sup> Lawmakers amended the relevant statute, section 12.01 of the New York Arts and Cultural Affairs Law, later that year by putting a number of artist protections<sup>18</sup> that addressed the shortcomings discussed above, all of which were present in the former New York statute.<sup>19</sup> The amendments went even further by allowing courts to

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<sup>15</sup> GA. CODE ANN., § 10-1-523 (2012).

<sup>16</sup> McGowan, *supra* note 9.

<sup>17</sup> NEW YORK CITY BAR ART LAW COMMITTEE, REPORT BY THE ART LAW COMMITTEE RECOMMENDING AMENDMENTS TO ARTICLES 11 AND 12 OF NEW YORK ARTS AND CULTURAL AFFAIRS LAW 2 (2010), *available at* [http://www.nycbar.org/pdf/report/uploads/3\\_20071866-CommentsonArticles11and12ofNYArtandCulturalAffLaw.pdf](http://www.nycbar.org/pdf/report/uploads/3_20071866-CommentsonArticles11and12ofNYArtandCulturalAffLaw.pdf).

<sup>18</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01 (McKinney 2012).

<sup>19</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01 (McKinney 1999).

impose additional discretionary penalties on dealers who breach their agreements with artists.<sup>20</sup> The resulting statute is unprecedented as a whole. No other state provides such extensive protections for works held in trust, allowance of attorney's fees, or a requirement for written artist-dealer agreements.<sup>21</sup>

### A. Property Held in Trust

Though New York's consignment statute has always required that consignors hold an artist's property in trust for the benefit of the artist, prior versions of the statute did not specify what this meant.<sup>22</sup> Prior to 2012, it was not uncommon for consignors to commingle their own funds with the sales proceeds from works they obtained on consignment.<sup>23</sup> Not only did this commingling create issues when separating the funds, but in some cases it also allowed a consignor's creditors to reach the funds being held for the artists. Creditors could reach the funds because it was not always possible to discern the source of the consignor's account deposits.<sup>24</sup> As in the Salander O'Reilly case, a dealer or gallery's bankruptcy could leave artists with unfulfilled consignment agreements and nothing else. That is, their works had been sold long before and the proceeds from that sale were intertwined with other property, which in turn was subject to seizure in bankruptcy proceedings.

Under the new amendments however, New York's consignment statute now specifies that the consignor-consignee relationship creates a fiduciary duty for the consignor,<sup>25</sup> and they must uphold this duty in accordance with existing New York state law.<sup>26</sup> Under section 11-1.6(a) of the New York Estates, Powers and Trusts Law, New York's state law governing fiduciaries and

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<sup>20</sup> O'Donnell, *supra* note 8.

<sup>21</sup> McGowan, *supra* note 9.

<sup>22</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01 (McKinney 1999).

<sup>23</sup> Amelia K. Brankov, *New York Strengthens Law Governing Consignments from Artists to Galleries*, FRANKFURT KURNIT KLEIN + SELZ, PC (Dec. 21, 2012), <http://fkks.com/news/new-york-strengthens-law-governing-consignments-from-artists-to-galleries>.

<sup>24</sup> *Id.*

<sup>25</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01(1)(a)(iv) (McKinney 2012).

<sup>26</sup> *See id.* § 12.01(1)-(2).



their duties, fiduciaries must not commingle any of their individual property with the property they receive in their fiduciary capacity.<sup>27</sup> This existing statute also specifies that the beneficiary's separately held property must not be in an account under the fiduciary's own name,<sup>28</sup> making it less likely that the fiduciary's creditors can reach that property. Violations of this duty can lead to misdemeanor charges for consignee dealers or galleries.<sup>29</sup>

These changes give galleries a bigger incentive to properly handle works that have been entrusted to them in consignment deals. In addition to litigation costs, which are discussed below, galleries who mismanage sale proceeds or physical works of art now risk higher damages as well as criminal charges.<sup>30</sup> This can give artists greater peace of mind when signing consignment agreements.

### *B. Attorney's Fees*

Another significant change to New York's consignment statute is the allowance of attorney's fees for plaintiffs who successfully sought to enforce their rights in court. The statute states, in relevant portion, that:

Any person who has been injured by reason of a violation of this article may bring an action in his or her own name to enjoin such unlawful act, to recover his or her actual damages, or both. The court may award reasonable attorneys' fees, costs and expenses to a prevailing plaintiff in any such action.<sup>31</sup>

Allowing prevailing plaintiffs to receive attorney's fees has an obvious benefit for artists: those whose interests have been harmed through art consignment no longer need to fear the high cost of

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<sup>27</sup> N.Y. EST. POWERS & TRUSTS LAW §11-1.6(a) (McKinney 2011).

<sup>28</sup> *Id.*

<sup>29</sup> *Id.*

<sup>30</sup> See generally N.Y. ARTS & CULT. AFF. LAW § 12.01(2) (McKinney 2012).

<sup>31</sup> *Id.* § 12.01(3).

litigation when seeking to protect their rights. Furthermore, the wording of the statute significantly balances fairness concerns in the artist–dealer relationship. Notably, the statute only authorizes the award of attorney’s fees for prevailing *plaintiffs*, giving artists greater ability to litigate these disputes when other resolution attempts have failed. Now prevailing plaintiffs do not have to fear responsibility for prohibitively expensive costs and fees at the end of litigation.

Though it seems at first glance that dealers and galleries could also be the prevailing plaintiffs, the thrust of the statute aims to prevent abuses directed at artists by delineating galleries’ and dealers’ responsibilities as consignees.<sup>32</sup> In fact, none of the provisions of section 12.01 mention any responsibility that the artist has in a consignment agreement, presumably in recognition of the artist’s vulnerability in such agreements. Thus, “injured parties” will nearly always be artists who have offered their works for consignment.

### C. Written Agreements

New York’s statute also now provides protections for artists by requiring that certain portions of consignment agreements be explicitly detailed in writing.<sup>33</sup> The statute makes it clear that, with one very limited exception,<sup>34</sup> artists may not waive any of the protections spelled out in the statute, even with informed consent.<sup>35</sup> Any such waiver not complying with the strict demands of the statute’s exception is automatically deemed void.<sup>36</sup> The one exception to this, however, is that artists may waive their right to have all of the proceeds from the sale of their works held by the consignor solely for the artist’s benefit.<sup>37</sup> This exception gives

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<sup>32</sup> O’Donnell, *supra* note 8 (“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.”).

<sup>33</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01(1)(b) (McKinney 2012).

<sup>34</sup> *Id.*

<sup>35</sup> *Id.*

<sup>36</sup> *Id.*

<sup>37</sup> *Id.*

artists the opportunity to explicitly split proceeds from their sales with any other party that they may choose. However, the recent amendments to this statute make it clear that this waiver must be in writing and it must be in words that “clearly and specifically apprise the consignor that the consignor is waiving rights under this section . . . .”<sup>38</sup> This strengthened informed consent provision indicates that consignors are no longer able to slip a vague profit-splitting agreement into a contract without the artist’s knowledge. This protection can be immensely helpful for artists who are unable to seek legal counsel before signing consignment agreements.

#### *D. Other Notable Provisions*

In addition to the above protections, the amended New York statute contains a number of other protections for artists, some of which are completely unique to New York. One notable provision that is absent from any other state’s statutes is the addition of criminal charges for dealers who fail to properly handle any property they hold in trust for an artist.<sup>39</sup> Previously, consignees were only subject to civil suits when breaching their fiduciary duty to consignor artists.<sup>40</sup> Now consignees who fail to properly protect an artist’s property in their care may face misdemeanor charges.

In addition to allowing for criminal charges, the consignment statute’s amendments also make it easier for the children of deceased artists to pursue claims under the statute with regard to their parents’ works.<sup>41</sup> In its prior iteration, New York’s statute only stated that an artist’s “heirs” or “personal representatives” could pursue claims against consignors.<sup>42</sup> Under the amendments, however, any of the artist’s “successors in interest” may consign an artist’s work and may enforce that artist’s rights under any

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<sup>38</sup> *Id.*

<sup>39</sup> *Id.* § 12.01(2).

<sup>40</sup> *See* N.Y. ARTS & CULT. AFF. LAW § 12.01 (McKinney 1999).

<sup>41</sup> *See* N.Y. ARTS & CULT. AFF. LAW § 12.01(1)(a) (McKinney 2012); Brankov, *supra* note 23.

<sup>42</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01(1)(a) (McKinney 1999).

agreement.<sup>43</sup> This change directly addresses challenges pursued by consignors prior to the amendments, in which the consignors claimed that the child of a deceased artist with a surviving spouse could not properly be considered an “heir” because the child had inherited the works in question from the surviving spouse, not the artist herself.<sup>44</sup> New York legislators disagreed, however, and the new amendments make it clear that any rightful owner of an artist’s work may consign and enforce his or her rights whether he or she obtained the works directly from the artists or from any other of the artist’s beneficiaries.

#### IV. FUTURE EFFECTS

Though there has not been much recent litigation since New York’s amendments went into effect in November 2012, cases heard prior to the statute’s effective date provide illustrative examples of the benefits the statute will give to artists. For example, in *Koeniges v. Woodward*,<sup>45</sup> the judge noted that while he believed the prevailing artist plaintiff should be awarded fees and costs, the existing statute’s silence on the issue precluded him from doing so.<sup>46</sup> The judge in *Baykam v. Martin/Molinary Art & Design Galleries, Ltd.*<sup>47</sup> expressed similar concerns when denying the plaintiff’s request for attorney’s fees.<sup>48</sup> The plaintiffs in these cases ultimately received some relief for their efforts, but in both cases their awarded damages were likely far less than the cost of the litigation.

#### CONCLUSION

Overall, New York’s art consignment legislation is an unprecedented step in creating protections for artists who rely on

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<sup>43</sup> N.Y. ARTS & CULT. AFF. LAW § 12.01(1)(a) (McKinney 2012).

<sup>44</sup> Brankov, *supra* note 23.

<sup>45</sup> *Koeniges v. Woodward*, 702 N.Y.S.2d 781 (N.Y. Civ. Ct. 2000).

<sup>46</sup> *Id.* at 789.

<sup>47</sup> *Baykam v. Martin/Molinary Art & Design Galleries, Ltd.*, No. 86 CIV. 1010 (JEL), 1987 WL 12375 (S.D.N.Y. 1987).

<sup>48</sup> *Id.* at \*6.

selling their works to earn a living. However, in light of the above examples, it is also illustrative of a minimum standard that all states should implement in order to provide a sufficient fairness balance in the relationship between artists and art dealers. Despite the mutual benefits for all parties in consignment deals, without proper protections, artists should be careful when entering into such agreements.