ART ASSETS:
PRACTICAL ADVICE FOR TRUSTEES WHEN BUYING, HOLDING AND SELLING

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AUCTION HOUSES VERSUS PRIVATE SALES

AUCTION

– V –

PRIVATE SALES
THE ANATOMY OF THE ART MARKET

Sources
- Artists
- Private sellers
- Art dealers
- Auction houses
- Foundations
- Institutions

Facilitators
- Auction houses – online sales, live auctions, private treaty sales
- Art fairs
- Online auctions
- Art dealers - online, gallery space
- Art funds/investors
- Art finance
- Art leasing

Buyers
- Private collectors
- Art foundations
- Art dealers
- Corporations
- Museums
- Auction houses/subsidiaries
- Governments
- Art funds/investors

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DUE DILIGENCE

- Attribution
- Title/Ownership
- Condition
- Provenance
- Customs formalities/compliance
- Valuation
- Description of the work
- Tax Liability

Due Diligence
KNOW YOUR CLIENT: SELLER – AGENT – BUYER
THE 5TH ANTI-MONEY LAUNDERING DIRECTIVE
WHAT IS GOING TO CHANGE?

4th DIRECTIVE

"OBLIGED ENTITIES"

DUE DILIGENCE TO BE CARRIED OUT

HIGH RISK FACTORS

5th DIRECTIVE
IMPACT ON THE ART WORLD:

- Client confidentiality
- Damage to long-standing relationships
- Protection of commercial position
- Increased expense
- Delays
- Art fairs
The Responsible Art Market Initiative (RAM)’s mission:

To raise awareness amongst Art Businesses of risks faced by the art industry and provide practical guidance on establishing and implementing responsible practices to address those risks.
The Responsible Art Market Initiative (2/2)

- An initiative by the art market and for the art market
- An open working group of international art market players and experts
- Not for profit
- Under the auspices of the Geneva-based Art Law Foundation and the Art-Law Centre
The art transaction toolkit

Check lists
• Client
• Artwork
• Transaction

Red flags

Risk-based approach

Explanatory notes
Art transaction due diligence

**Client**
- Identity
- Role
- Authority

**Artwork**
- Ownership
- Provenance
- Authenticity
- Condition

**Transaction**
- Purpose
- Form
- Source of funds
When collecting

Divorce

Legacy

Death
Legal vehicles available to hold art in Switzerland

- **Direct ownership** structured through
  - Wedding contract
  - Will and contract of succession
- **Companies** ➤ Swiss and foreign
- **Foundations** ➤ Swiss and foreign
- **Trusts** ➤ foreign BUT recognized (Hague Trust Convention)
How to structure and pass art collection down through generations?

Holding art

- **Legal due diligence**
  - **Collecting**: ownership, authenticity, provenance, condition, export & import, tax, applicable law & forum, financial investment
  - **Structuring**: matrimonial & inheritance law, legal or financial vehicles, legal purpose, qualified operators, supervision, viability in time
  - **Transferring**: scope of the legal rights transferred, requirements, tax impact

- **Good governance & best practices**
  - **Operational structure**: supervision, checks & balance
  - **Financial viability**: sufficient financial resources to fulfil the donor’s will
  - **Clear objectives**: e.g. unity of the collection, peaceful enjoyment, public exhibition
Freeports
How sale channels secure the art for sale.

Step 1 – find the Art
Knowledge is Power... where is the art?

+ In a $68bn industry which is constantly scouring the world for works to sell, competition is fierce and nothing is left to chance.

+ Knowledge is Power, the sale channels must know:
  + Where is the art?
  + Who owns it?
  + Who are the influencers?
  + What is the likelihood that works will come for sale?

+ The art industry nearly always knows the answers through:
  + Purchase history
  + “Free” valuations
  + Paid valuations
  + Market/social intelligence

A well known auction house uses 40+ intelligence analysts to track this information.
How sale channels secure the art for sale.

Step 2 - become (or pay) the “Trusted Adviser”
“Trusted Adviser”: Sale Channels (Auction House, Brokers, Dealers)

Once the sale channels know where the art is. An army of extremely charismatic sales people (known in the trade as “Business Getters”) are deployed to develop relationships (for decades if necessary). A well known auction house employs over 300. The salesforce is expanded further through heavy use of introductory commission.

The Alchemy: There is a very strong natural tendency for amateur clients to confuse art expertise and “friendship” with independent advice. And so the sale channel becomes the “Trusted Adviser”.

The trusted “advice” from sale channels is always the same:
+ Trust me
+ Sell everything (especially the masterpiece)
+ Sell now
+ Don’t call anyone else
“Trusted Advisers”: the Notactually-
“Independent” art advisers

There is considerable industry-wide “confusion” about the meaning of the word “Independent”. Some definitions to help focus the mind:

“free from outside control, not subject to another’s authority”
“not influenced or controlled by others in matters of opinion, conduct, etc”
“not depending on another for livelihood or subsistence”

Useful questions to ask art advisers who claim to be “independent”:

+ **Have you ever received introductory commission?** ("independent art advisers" essentially act as an extended sales force for the auction houses and dealers). **Introductory commission is indirectly paid for by the seller!**
+ Do you broker private sales?
+ Might you acquired works directly or indirectly from our client?
+ Will we contract directly with the sale channel?

While we’re here:
+ Do you ever take physical control of the art?
+ Do you ever handle client funds?
+ Do you have Professional Indemnity insurance?
Agents & Consultants

In order to secure consignments of property and identify private sale and auction sale opportunities, Christie’s sometimes consults or seeks assistance from other art market professionals or third parties. We may also enter into partnerships or risk sharing arrangements with, or pay Introductory Commission to, third parties. In such cases, Christie’s imposes a legal requirement on the third party to disclose their financial interest or relationship to anyone they are acting as agent or adviser to. If you are represented or advised in any transaction you should always ask your representative or adviser to confirm whether or not they have a financial interest in the transaction. If you are in doubt please contact us.

OUTCOME: “Friendship” works.

Lawyers, Family Offices and Trustees are usually presented with a “done deal” in which the owner/beneficiary has complete confidence. Until they are confronted with evidence showing they will make less money. Uncompetitive business is twice as profitable.
“My client knows everyone in the art world. They know exactly what they are doing.”

“It’s a passion thing. We just leave it to the family as it’s not a subject we know anything about.”

Here is why conflicts really matter...
WHY CONFLICTS MATTER

+ Despite perceptions created by headlines, the art market is generally thin: At auction most works either don’t sell or sell to only one bidder. Most market sectors are going down or sideways.

+ Failure to sell is extremely costly: 20-45% probability works offered FAIL at auction, average loss is -31%.

+ Conversely, value comes from competition: A single additional bid at auction is worth +10%, upside potential 100%+

+ Auction Houses look the same: Performance can vary significantly (and measurably) at a sector level. Which is why IC is a serious issue.

+ Conclusion: In a thin market where channel performance varies significantly Understanding Marketing Reach is critical. This is done through proper Sale Channel due diligence.

+ Professionals always conduct detailed due diligence when selling.

  + Conflicts of interests ensure that Sale Channel Due Diligence doesn’t happen.
Sale Channels Options

POTENTIAL SALE CHANNELS

“TRADERS”

Dealers
- Quick Cash
- 200-300%+ Margins
- Low Price

Brokers
- 10-20% Claimed Margin
- Small businesses / limited reach
- No data / impossible to assess
- Prone to "burn" property
- Layered transactions
- Unregulated / Unmanageable

GLOBAL AUCTION HOUSES

Private Sales
- “Special” works only
- High prices possible
- 10-20% Fixed margin
- Large teams / global reach
- Can assess (quant/qual)
- Can tightly manage

Public Auction
- Performance key
- Guarantees / Risk Mgt
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