



## Bankruptcy and Artwork Consignment in New Jersey

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“Art Hath An Enemy Call’d Ignorance”<sup>1</sup>

The story has become all too familiar. An art gallery in possession of hundreds of pieces of fine art on consignment files a voluntary bankruptcy petition under Chapter 11 of the United States Bankruptcy Code. With debts far exceeding any remaining assets, creditors seek to claim the artwork in the gallery’s possession

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<sup>1</sup> Benjamin Jonson, EVERY MAN OUT OF HIS HUMOUR, Act I, Scene 1 (1598).

in a last ditch effort to recoup amounts owed. Artists rush to the doors, only to learn that their precious work has been seized and is now in the custody of a court-appointed trustee. Months, or even years, later, a bankruptcy judge will decide whether the artist may regain possession of their own work. Whether the artist maintains a right to the work is a question that requires an understanding of the law governing the consignment of artwork in New Jersey.

## **The Law of Consignment**

In the United States, the legal relationship between an artist and gallery is most often governed by the laws of consignment. Consignment, in its most basic form, involves the delivery of a work of art to an art gallery with the understanding that the gallery will display the work for sale in exchange for a percentage commission of the final selling price. This symbiotic arrangement permits an artist to display his or her work to the public, and the gallery to fill its space, without either party expending large amounts of capital. In the absence of an agreement to the contrary, in most cases, title and ownership of the artwork remains with the artist until the piece is sold and delivered to the buyer. While

artwork is on display at the gallery, the gallery owner (usually an art dealer) acts as the artist's agent, a legal designation that imposes certain fiduciary duties of care and trust upon the owner and gallery staff.

Commercial transactions, including the consignment of artwork, are governed, in part, by a unified body of law called the Uniform Commercial Code ("UCC"). Article 9 of the UCC sets forth the basic requirements for qualification as consignment under the UCC:

"Consignment" means a transaction, regardless of its form, in which a person delivers goods to a merchant for the purpose of sale and:

(A) the merchant:

(i) deals in goods of that kind under a name other than the name of the person making the delivery;

(ii) is not an auctioneer;  
and

(iii) is not generally known by its creditors to be substantially engaged in selling the goods of others;

(B) with respect to each delivery, the aggregate value of the goods is \$1,000 or more at the time of delivery;

(C) the goods are not consumer goods immediately before delivery; and

(D) the transaction does not create a security interest that secures an obligation.<sup>2</sup>

Although arguments can be made in regard to whether artwork on consignment fits the UCC criteria, it appears evident that, in most cases, the standard gallery/artist arrangement is includable in this definition and therefore subject to the provisions of the UCC.

## **Bankruptcy and Consignment**

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<sup>2</sup> N.J.S.A. § 12A:9-102(20).

When a gallery files for bankruptcy protection, the Bankruptcy Code dictates the priority in which outstanding creditors will receive distributions, if any, from the gallery's remaining assets.<sup>3</sup> When the assets are exhausted, the opportunity for a low-priority creditor to recover may also be foreclosed. Although, as noted, ownership and title of artwork delivered to a gallery on consignment generally remains with the artist, if the artist has not taken affirmative steps to protect his or her interest in the consigned artwork, the artist will stand as a "general unsecured creditor" with an "unperfected" security interest in the bankruptcy case, a status that will place the artist among the last in line to receive any assets left in the gallery's bankrupt estate.<sup>4</sup> This priority designation not only greatly diminishes the likelihood that an artist will recover their work; it may preclude any recovery at all.

In regard to creditors' rights to artwork on consignment, the revised version of the UCC provides that "while the goods are in the possession of the consignee, the consignee is deemed to have rights and title to the goods

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<sup>3</sup> 11 U.S.C. §§ 506-507.

<sup>4</sup> 11 U.S.C. § 507.

identical to those the consignor had or had power to transfer.”<sup>5</sup> Actual title is therefore irrelevant when determining whether creditors have a right to artwork on consignment at the time a bankruptcy petition is filed. However, in an effort to safeguard the rights of the artist, the UCC provides that “[t]he security interest of a consignor in goods that are the subject of a consignment is a purchase-money security interest in inventory.”<sup>6</sup> A purchase-money security interest is a special type of security interest that affords the artist a “superpriority” over a conflicting security interest in the same property.<sup>7</sup> However, an artist will only acquire this “superpriority” if their interest is “perfected.”

While there are several ways to “perfect” a purchase-money security interest, the most common is to file a UCC-1 Financing Statement with the New Jersey Department of the Treasury. The purpose of the UCC-1 is to put the world on notice of the artist’s ownership of, and interest in, the work of art on consignment. The artist is then obligated to

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<sup>5</sup> N.J.S.A. § 12A:9-319.

<sup>6</sup> N.J.S.A. § 12A:9-103(d).

<sup>7</sup> N.J.S.A. § 12A:9-324(b).

send authenticated notification directly to any other interest holder within five years of the gallery obtaining possession of the artwork.<sup>8</sup> This notification should state that the artist “has or expects to acquire a purchase-money security interest in the inventory of the debtor” and include a detailed description of the artwork on consignment.<sup>9</sup> A UCC creditor search of the gallery will reveal the names and addresses of any other creditors who may have a perfected interest in the gallery inventory. As such, it is often prudent to run the UCC search before entering into a consignment agreement as there may exist creditors with conflicting interests in some or all of the gallery’s inventory, present and future.

## The New Jersey Artworks Consignment Act

New Jersey is one of several states that have enacted laws to protect consignment artists from creditors who seek to satisfy claims against bankrupt galleries under the provisions of the UCC.<sup>10</sup> Under the New Jersey

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<sup>8</sup> N.J.S.A. § 12A:9-324(b)(3).

<sup>9</sup> N.J.S.A. § 12A:9-324(b)(4).

<sup>10</sup> Over 30 states have enacted statutes protecting artists who place artwork on consignment with galleries. See, e.g., N.Y. Arts & Cult. Aff. Law § 12.01; Conn. Gen. Stat. Ann. § 42-116f; Fla. Stat. Ann. § 686.503; and Mass. Ann. Laws ch. 104a, §§ 1-6.

Artworks Consignment Act (the "ACA"), "works of fine art placed on consignment in compliance with the provisions of [the ACA] are not subject to the claims, liens or security interests of the creditors of the consignee or art dealer."<sup>11</sup> According to the ACA, consignment occurs when a work of "fine art" is "delivered into the possession and control of a person in whom title to the delivered object does not vest but who, by agreement with the [artist], is authorized to convey the [artist's] right, title and interest in the object to a third person."<sup>12</sup> The ACA defines "fine art" as "an original work of visual or graphic art created using any medium, including but not limited to, a painting, drawing or sculpture."<sup>13</sup> Although extremely broad in scope, the ACA has several simple, but mandatory, requirements that must be met to obtain protection under the law.

The ACA will only protect an artist's rights against a creditor's claim in bankruptcy if: 1) the artist or gallery places a sign on the artwork indicating that the work is on

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<sup>11</sup> N.J.S.A. § 12A:2-333.

<sup>12</sup> N.J.S.A. § 12A:2-330(8).

<sup>13</sup> N.J.S.A. § 12A:2-330(7).

consignment from the artist; 2) the artist can establish that the gallery is generally known by creditors to be substantially engaged in selling the goods of others; or 3) the artist “perfects” its security interest in the work by filing a UCC-1 Financing Statement.<sup>14</sup> While only one of these criteria must be met to secure protection under the ACA, it would be prudent for any artist consigning artwork to a gallery to satisfy all three. As is the case with many artists who seek post-bankruptcy relief under the ACA, failure to place a sign or “perfect” their interest leaves them attempting to establish that the gallery is “generally known” by creditors to be selling the artwork of others. This is an extremely subjective standard that will likely require testimony before a bankruptcy judge.

Galleries are also under certain obligations to the artist when entering into a consignment arrangement. The ACA requires that the gallery provide a written statement of rights afforded to the artist under the ACA.<sup>15</sup> Any gallery that fails to provide such a statement may be subject to criminal penalties.<sup>16</sup> Prior to

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<sup>14</sup> N.J.S.A. § 12A:2-332(1).

<sup>15</sup> N.J.S.A. § 12A:2-332(2).

<sup>16</sup> Id.

delivery of the work, the gallery must also provide the artist with a written receipt that describes the work of art and the terms of the consignment agreement.<sup>17</sup> Although an artist may waive his or her rights to protection under the ACA, such a waiver must be “clear, conspicuous and in writing.”<sup>18</sup> Although inapplicable to the present discussion, the ACA also requires gallery owners to protect artwork on consignment from damage and/or loss.<sup>19</sup> Failure to protect the work on consignment will subject the gallery and its management to civil liability.<sup>20</sup>

## Consignment Checklist

In an economic climate where galleries are filing bankruptcy petitions at a unprecedented rate, it is more critical than ever for artists to take proper precautions when entering into consignment arrangements. The following checklist should act as a preliminary guide for artists seeking to procure the various protections available under the law. Artists who remain unsure regarding the various risks

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<sup>17</sup> N.J.S.A. § 12A:2-334.

<sup>18</sup> N.J.S.A. § 12A:2-336.

<sup>19</sup> N.J.S.A. § 12A:2-335.

<sup>20</sup> Id.

of consignment should consult their attorney prior to, and in conjunction with, entering into a consignment agreement with a gallery.

**1.UCC Creditor Search:** Run a UCC search on the gallery with the New Jersey Department of the Treasury. This search will provide the names and addresses of any creditors of record that may have an interest in the assets of the gallery. Both certified and non-certified searches may be run at:

<http://www.nj.gov/treasury/revenue/searchucc.shtml>.

**2.UCC-1 Financing Statement:** File a UCC-1 Financing Statement with the New Jersey Department of the Treasury to “perfect” the artist’s interest in the artwork on consignment. For more information, and to file a Financing Statement, visit: <http://www.nj.gov/treasury/revenue/fileucc.shtml>.

**3.Notice to Creditors:** Within five (5) years of delivery of a work of art, send authenticated notification to all creditors listed in the UCC creditor search. This notification should include a detailed description of the artwork and contain a

statement informing the creditor of the artist's "perfected" purchase-money security interest in the artwork. An updated UCC search will be necessary if time has passed since the pre-filing search.

**4. The Consignment Agreement:** The artist must be extremely cautious when entering into a consignment agreement without the aid of counsel. Of particular note, the artist must be acutely aware of provisions relating to: 1) the rights of the parties during the consignment term; 2) the precise term (duration) of the agreement; 3) the percentage commission afforded to the gallery; 4) the name and description of the works on consignment (avoid generalities); 5) the approximate value of the works on consignment; 6) whether the agreement is binding on the heirs, executors and beneficiaries of the artists estate; 7) the existence of an agency relationship between the artist and gallery; 8) crating and shipping costs; 9) insurance; 10) framing, lighting, gallery placement, temperature and other aesthetic issues; 11) liability for payment of taxes and tariffs upon sale; 12) rights of reproduction (including promotion of the gallery in paper form and on the gallery

website); 13) waivers of liability and indemnification; and 14) rights to terminate the agreement. This list, while not exhaustive, should act as a starting point for artists entering into consignment agreements with galleries.

**5. Signage:** Make arrangements (perhaps in the consignment agreement) for a sign to be placed on the artwork indicating that the work is on consignment from the artist.

**6. Delivery of Artwork:** When delivering the artwork, or immediately prior to delivery, the gallery must provide a written statement of rights afforded to the artist under the ACA. The gallery must also provide a written receipt that describes, in detail, the work of art on consignment and the terms of the consignment agreement.

**7. Repetition and Diligence:** The above steps must be taken each time a new work is placed on consignment with a gallery. General agreements, although common, will not protect an artist from all potential creditor claims.

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