

The Art Market Adjusts: Protecting your assets from international creditors - UK and Hong Kong

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CATEGORY:
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Following our publication of the Q&A, [Protecting consigned artworks from creditors](#), between Dean Nicyper and Kim Almazan last week, we have received several questions about art collectors' recourse against creditors in other countries. The art market transcends borders and art market participants must be cognizant of the varying laws that may govern their ownership and security interests in their works of art. As Kim and Dean discussed, a European or Asian collector who consigns a work of art to a gallery located in New York must be mindful of the security interest and creditor protection laws governed by the Uniform Commercial Code (UCC). Similarly, U.S. collectors and businesses must be mindful of the laws enforced by other countries in which they purchase, consign and sell works of art. These considerations are of particular importance during the global health pandemic, as transactional logistics are hampered and delayed by business closures and government shutdowns. Rest assured, however, that collectors and dealers need not fear entering into consignment and purchase agreements with galleries during this period, as long as they are armed with the necessary knowledge (and legal counsel) to safeguard their interests in the work of art.

In this conversation, my colleagues Xanthe Lok, Soo Khim Keoy and Kenley Stark discuss the security interest laws buyers and consignors should be aware of when transacting with galleries in the United Kingdom and Hong Kong.

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Kenley: In the United States, if an owner of a work of art consigns the work to a gallery, the consignor must put third parties on notice of its ownership interest to protect its interest from creditors of the gallery. Xanthe and Soo Khim, how does the law differ in England and Wales and Hong Kong? For example, imagine that an owner has consigned a work of art to a gallery for sale. If the gallery becomes insolvent while holding the consignor's work, what recourse does the consignor have to get its work back?

Xanthe: The general rule under the common law in England and Wales is that the owner of a work of art (ie holds title to that work) held by a gallery generally has priority over the gallery's creditors. One exception would be if there were any sums due in connection with the work. For example, a creditor of the gallery that might want to make a claim on the owner's work of art would be a service provider who was engaged by the gallery to do some restoration or cleaning services on that work. If the gallery fails to pay the service provider, the provider could make a claim against the work of art for recovery of the unpaid service fees.

Soo Khim: The position in Hong Kong is akin to that in England and Wales, as we also follow the common law. Hence, the owner of a work of art will usually have priority over the gallery's creditors. For a consignor, the position will be slightly more complicated if the work of art has been sold but the gallery has not yet transferred the net sale proceeds from the buyer to the consignor. In this case, it will depend on when title will pass to the buyer pursuant to the terms of the consignment agreement. If title to the work of art passes only when the consignor receives the sale proceeds, even though the buyer may have paid the gallery in full, the consignor will have priority over other creditors of the gallery. The consignor should put the gallery or its storage facility on notice to stop delivery of the work to the buyer, pending clearance of payment by the gallery with the consignor (as the final step to effect transfer of title to the buyer). If, however, title has already passed to the buyer who has made full payment, the consignor will simply stand as a creditor of the gallery but will not have recourse to the work of art in question.

Xanthe: Soo Khim's observations about the position in Hong Kong where the work of art has been sold will also apply in England and Wales.

Kenley: If the gallery is storing the work at a fine art storage facility under the gallery's account, what additional steps should a consignor take to protect its interests?

Soo Khim: As with warehouse management of other forms of commodities, the gallery should enter into a custody agreement with the storage facility. Under this agreement, the storage facility should agree not to release or remove the work of art unless the consignor authorizes the gallery to request a release or relocation of the work. The agreement should also provide that the storage facility acknowledges and recognizes that the work of art stored is owned by a third party owner and not the gallery. This should prevent the storage facility from exercising a lien or set-off over the work of art for debts due by the gallery to the storage facility, such as unpaid storage fees. Lastly, the storage facility should have a system in place to segregate works of art stored by a gallery that are owned by different title holders.

Kenley: If a gallery in Hong Kong becomes insolvent while holding the consignor's work of art, what recourse does the consignor have to get its work back?

Soo Khim: If the gallery has sold the consignor's work of art but not yet paid the consignor, the consignor will be a creditor of the gallery and may file a claim of debt for the net sale proceeds due to the consignor in connection with the sale of the work. If the consignment agreement provides that the consignor retains title to the work until the consignor receives payment, or if the gallery was required to and did place the sale proceeds in a segregated account, the consignor may be able to trace the sales proceeds or argue that it ought to be treated as a secured creditor and therefore has priority over other creditors. Otherwise, the consignor will simply stand as an unsecured creditor.

Kenley: It is so important to be cognizant of how the timing of title transfer can affect one's interests. Now let's imagine that a buyer purchases a work of art from a gallery located in London or Hong Kong, and the gallery is unable to ship the work to the buyer for an unknown period of time. Against whom should the buyer protect its interests in the work?

Xanthe: First, the buyer should protect its interests in the work of art vis-à-vis the gallery. The buyer and the gallery should enter into a custody agreement, which will formally document the arrangements and basis on which the work is being held by the gallery. The buyer should also request from the gallery a certificate of insurance for the work that names the buyer as an additional insured and loss payee.

Second, the buyer should protect its interests in the work of art vis-à-vis any potential creditors of the gallery. As previously mentioned, a service provider or, if the gallery becomes insolvent, a bankruptcy trustee or liquidator, could make a claim against the buyer's work of art if there are any unpaid sums due to the gallery in connection with the work. Such unpaid sums might include, for example, any outstanding payments by the buyer for purchasing the work, cleaning or restoration service fees, or security fees.

Kenley: What if the buyer is paying for the work of art in instalments? How would this affect the owner's security interest in the work over creditors of the gallery?

Xanthe: If a buyer is paying for a work of art in instalments and title will not pass to the buyer until payment has been made in full, the creditors of the gallery will have recourse to the work of art to the extent that any of the instalments remain outstanding. The buyer should request written confirmation from the gallery of each instalment made and received. When all instalments have been made, the gallery should provide the buyer with a written acknowledgment that the work is legally owned by the buyer and the work should have some form of notice affixed to it or placed in close proximity to alert others that the work belongs to the buyer.

In practice, this rule means that if the buyer has paid one out of five installments for the work, the creditors might have recourse to the remaining four instalments. Note, however, that if a creditor of the gallery were to take possession of the buyer's work and sell it, it would be a breach of contract and the creditor would need to reimburse the buyer for the installment portion the buyer has already paid. If the creditor does not repay the buyer, then the buyer becomes a creditor of the gallery with respect to the installment payment it has made for the work, since the buyer has not received anything in return. In such a case, if the gallery became insolvent, the buyer would be able to make a claim against the bankruptcy trustee or liquidator for the amount of the installment portion already paid.

Soo Khim: Ideally, the sale and purchase agreement between the gallery and the buyer should stipulate clearly that title to the work of art has passed to the buyer notwithstanding that the payment would be made in installments. All owners of works of art, including artists, consignors and purchasers, should do the following to protect their security interests: obtain documents evidencing title ownership; affix to the work of art a written notice of ownership; include in any custody or consignment agreement a proper retention of title clause when parting with possession; require the gallery to segregate sales proceeds for a work of art; and obtain from the gallery written confirmations of payments. These steps are important particularly in the insolvency or bankruptcy setting, where the liquidator has the duty to identify assets belonging to the gallery that can be sold off for distribution of sale proceeds amongst its creditors, and segregate works of art that belong to different title owners which will need to be returned upon the gallery's insolvency or bankruptcy.

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