

The Art Market Adjusts: Managing contractual obligations in uncertain times - US and UK

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Over the past several weeks, we have been asked to review a number of contracts and opine on their enforceability given the changing circumstances. In light of these conversations, we have noticed that new contracts coming our way have been tailored to address circumstances that none of us had previously imagined would be relevant. Therefore, now more than ever, it is important for the art industry, which we know would prefer to operate on a handshake basis, to pay attention to contractual terms. Failing to do so, has lately resulted in many surprises and monetary loss. So let's use this as an opportunity to develop better practices moving forward.

With that in mind, in this Q&A my colleagues, Dean Nicyper, Eleni Polycarpou, and Giulia Trojano address contract enforcement in the US and UK as the art market navigates COVID-19 and seeks additional protection for future transactions.

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Giulia: The impact of COVID-19 on the art market has resulted in auction houses having to postpone their sales, furlough employees and cut pay while concentrating their efforts on online sales, private sales, valuations and lending. How is this impacting those who have consigned artwork to auction houses for sale?

Eleni (UK): Sellers who had already consigned works to auction houses may find themselves in a difficult position. Sellers should review their consignment agreement closely and contact their auction house as soon as possible to discuss available options. They may want to take possession of the work in order to preserve its value long-term rather than prioritising a sale or, alternatively, consider private sales among interested collectors which the auction house could arrange.

Auction houses should also review their respective insurance policies and ensure that, despite the lockdown restrictions, works are preserved and stored safely. Just as museums have become targets for heists (see the van Gogh stolen in Amsterdam recently), storage facilities will need to tighten their security measures in circumstances where fewer members of staff will be authorised to guard premises and where transporting the work from the auction house back to the seller may not prove possible.

Dean (US): The same points Eleni raises for the UK are applicable in the US. This is a difficult time to make financial decisions. Collectors may prefer not to continue efforts to sell their works of art during the current economic downturn. For those who have a need to sell, the auction houses online sales and private sales may be an option. As Eleni points out, if the work is withdrawn, a decision must be made regarding where to store the work. Many art storage facilities are not fully functioning, as they are not "essential" businesses, and in most states in the US, non-essential businesses must place a hold on their activities pursuant to proclamations by many individual state's governors. It may, therefore, be necessary to keep unsold works at the auction houses, which, of course, may pose a liability risk for the auction house and a risk of loss for the consignor.

Giulia: Art businesses, as well as, sellers and buyers, for varying reasons, may find it difficult to perform certain obligations under their existing contracts. What are some of the important considerations regarding breach of contract and other business interruptions? In the current environment, would a contractual party be able to invoke a force majeure or impossibility clause?

Eleni (UK): It is important to note that for force majeure to be invoked successfully, the clause itself would have to expressly cover 'pandemics' or other directly relevant language, and that at the time the contract was entered, what happened was not foreseen by the parties. Furthermore, the

buyer would need to show direct causation and that no other reasonable steps could be taken to affect payment, meaning that the threshold will be very high. Buyers will also need to comply with all the necessary formalities (including giving notice) and should keep a record of their correspondence and the difficulties faced as a result of coronavirus which had an impact on their performance. If a force majeure clause can be successfully invoked, this will allow delayed payments with no penalty, rather than a cancellation of the contract.

Separately, if the force majeure provisions in the contract do not assist, there is a doctrine under English law called the doctrine of frustration. Again buyers would need to show that what has happened was not foreseen at the time the contract was entered into. If that is right, in a very narrow set of circumstances, in which buyers can show that the whole underlying basis for the contract no longer exists because of COVID-19 (rather than just showing it will now be uneconomical for them to do it), they may be able to say that their contract is frustrated. This would result in immediate cancellation of the contract with no obligation to make further payments and with a claim for repayment of what was paid already.

Dean (US): As in the UK, force majeure clauses are the first place to look in a contract in the US as well. These clauses are subject to different interpretations in the US depending upon which state's laws apply to the contract. In New York, for example, the law is similar to Eleni's description of UK law. In New York, courts generally construe force majeure clauses narrowly. A clause that lists a series of examples (such as acts of God, floods, fire, strikes, etc.) are strictly construed to include only the specific events listed, even where that list of events is preceded by the clause "including but not limited to." Therefore, in states like New York, the clause must specify "pandemics," or some equivalent, for force majeure to relieve the parties of their obligations.

Similar to Eleni's description of the doctrine of frustration under English law, the laws in many states also include a frustration of purpose defense. In addition, many US courts also allow impossibility of performance as a ground to relieve a party of its obligations. Courts construe both doctrines narrowly (for example, the event that created the impossibility must not have been reasonably foreseeable), but one or both of these legal theories may be applicable depending upon the specific contract terms and circumstances. One additional legal theory to consider is impracticability of performance under the Uniform Commercial Code's sales of goods provisions. In most instances, the UCC's sale of goods provisions apply to sales of art. For a seller to be relieved of its obligations as a result of impracticability, the contract must contain a contingency, the impracticability must have arisen out of that contingency, and the non-occurrence of the contingency must have been an assumption of the contract.

Giulia: If a buyer is likely to miss a scheduled payment date as a result of COVID-19, what alternative or steps should they explore to avoid default?

Eleni (UK): Buyers who are likely to miss their scheduled payment terms as a result of coronavirus will need to explore what alternatives are available including contacting the seller or seller's agent directly and pro-actively coming to an agreement for smaller payment instalments or asking for a moratorium or a contractual variation. However, sellers and parties entitled to receive a commission on the sale will be looking closely at their finances and seeking to recover where possible. Defaulting buyers from earlier auctions especially will fall under tighter scrutiny. While auction houses and galleries will want to strike a balance between recouping their costs and maintaining long-term relationships with buyers, buyers who were in default or will be in default in the near future will need to look at the force majeure clauses in their purchase agreement or payment terms in detail.

On a related note, art businesses may also have rental payments to consider. In London, by way of example, Christie's sublets some of its spaces to art dealers. Auction houses will also want to strike the right balance between collecting rent to meet their own obligations (and minimise losses) while also ensuring they do not lose long-term tenants. While Christie's would not want to lose valuable tenants and may opt for a moratorium, it will need to enter into discussions with its own landlord (The Crown Estate) to negotiate any rental waivers and deferrals.

Dean (US): If buyers have financial constraints that truly impair their ability to pay, they should immediately contact the seller or seller's agent to negotiate a payment arrangement. Dealers or auction houses, of course, have corresponding obligations to their consignors. Therefore any payment terms might also need the consignor's approval.

Giulia: How should museums and cultural institutions handle their contractual agreements during a time when their doors are closed to the public and exhibitions have been postponed, rescheduled or cancelled?

Eleni (UK): Museums and cultural institutions with items on loan for the purposes of international exhibitions will also need to assess their contractual arrangements. Lenders (whether private or institutional) will need to decide whether to extend their loan or seek the return of their works notwithstanding possible logistical difficulties. In circumstances where a loan was tailored to a specific exhibition, even without force majeure clauses, parties to the loan agreement may seek frustration of the contract as the purpose for which it was entered into can no longer be performed. This may cause further difficulties where a museum already holds the work in its storage facility and will need to front any additional insurance and maintenance costs until the work can be safely returned to its owner.

Dean (US): The most immediate consideration is storage and safekeeping. With their galleries empty, and in light of the recent museum thefts (as Eleni mentioned), museums have to confirm their insurance and increase their security measures to safeguard their art.

Giulia: What potential issues should art market participants and consignors be mindful of when entering into new agreements?

Eleni (UK): New buyers will most likely not be able to inspect the works on sale, meaning that purchase agreements should be drafted with detailed sets of warranties and representations to protect both parties, along with recent condition reports. As transport to the buyer's preferred location may not be viable, auction houses may store the work on-site, with the buyer covering expenses incurred in so doing. We may see more closely tailored purchase agreements, particularly with regards to payment obligations, as buyers may be asked to front larger portions of payment or pay in full – protecting both agents receiving commissions and ensuring the seller receives prompt compensation.

Dean (US): One significant unknown is the date commerce will return, or even begin to return, to normal. It is therefore difficult at this time to sign an agreement for a public, in-person auction to take place on any specific date. If online or private sales are intended, as Eleni notes, all activities requiring in-person interaction will be curtailed, and the parties need to construct alternative processes and specify them in their contracts.

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