# THE VIRTUES OF COMMON LAW THEORIES AND DISCLOSURE REQUIREMENTS IN THE MARKET FOR FINE ART

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## INTRODUCTION

Purchasing fine art may in itself be an artistic endeavor full of risks and rewards. Auction houses present an opportunity to acquire artwork for lower rates as a consequence of the risk associated with consignment transactions.[1] Purchases from dealers, on the other hand, often involve a premium that corresponds to the lower risk of a direct transaction.[2] Additionally, works with greater assurances of authenticity sell at higher prices.[3] Legal analysis of transactions in fine art often centers on how best to appropriate this risk, particularly with respect to the

1. *See* Krahmer v. Christie's Inc., 903 A.2d 773, 781 (Del. Ch. 2006); Patty Gerstenblith, *Picture Imperfect: Attempted Regulation of the Art Market*, 29 WM. & MARY L. REV. 501, 555 (1988); Kai B. Singer, *"Sotheby's Sold Me A Fake!"—Holding Auction Houses Accountable for Authenticating and Attributing Works of Fine Art*, 23 COLUM.-VLA J.L. & ARTS 439, 452 (2000). Historically, an auction house would enter into a consignment relationship with a seller whereby its financial interest in the artwork would be limited to the commission earned on the sale and the purchaser would assume a greater risk regarding its authenticity. Gerstenblith *supra*, at 555; LEONARD D. DUBOFF & SALLY HOLT CAPLAN, 1 THE DESKBOOK OF ART LAW M-11 to -15 (2d ed. 2010); J. ALEXANDRA DARRABY, ART, ARTIFACT, ARCHITECTURE & MUSEUM LAW § 5:4, at 291 (2010). Since the 1980's, however, auction houses have increasingly expanded the types of their transactions, services, and clientele. *Id.*; Gerstenblith *supra*, at 555; DUBOFF & HOLT CAPLAN, *supra*, at M-10 to -11. For the purposes of this Article the term "auction house" generally connotes a transaction involving a consignment relationship between a seller and an auction house via a bidding process through which a purchaser is bound according to the Conditions of Sale. *See* DUBOFF & HOLT CAPLAN, *supra*, at M-11, M-15; Jonathon A. Olsoff, *Auction Law*, *in* ART LAW HANDBOOK § 11.03[A], at 920 (Roy S. Kaufman ed., 2000); *see also* RESTATEMENT (SECOND) OF CONTRACTS § 28(2) (1981). Auction houses comprise the largest secondary art market. DARRABY, *supra*, § 5:4, at 284. Two auction houses, Christie's and Sotheby's, control ninety percent of the worldwide market. *Id.*

2. *See* Gerstenblith, *supra* note 1, at 554–55. Dealers often purchase the artwork themselves prior to resale thereby becoming the seller with a comprehensive financial stake in the piece. *Id.* at 554. As such, they assume more financial risk in warranting the authenticity of a work. *See id.* at 555. Dealers do presently engage in a variety of different types of transactions, which may include consignment arrangements. DARRABY, *supra* note 1, § 2:12, at 46. For the purposes of this Article, the term "dealer" will connote transactions whereby a purchaser acquires a piece directly from an art merchant owner. *See* Gerstenblith, *supra* note 1, at 554–55.

3. *See* Steven Mark Levy, *Authentication and Appraisal of Artwork*, *in* ART LAW HANDBOOK, *supra* note 1, § 10.02[A], at 834 (authenticity and provenance are important factors in appraising the value of artwork); *see also* DARRABY, *supra* note 1, § 4:19, at 239 ("If on occasion authorship drops out of the bargain, a huge and palpable price differential would be apparent."); *id.* § 2:58, at 88 ("Certain prior owners or events may effectively enhance value by providing the artworks with a cachet."). This Article discusses misattribution and mistaken provenance as they relate to market valuation since other articles discuss similar issues relative to good title. *E.g.*, Bruce W. Burton, *In Search of John Constable's The White Horse: A Case Study in Tortured Provenance and Proposal for a Torrens-Like System of Title Registration for Artwork*, 59 FLA. L. REV. 531 (2007). Due to its focus on valuation, this Article also uses the term "authentication" to refer to both attribution and provenance. *But see* Levy, *supra*, § 10.02[A], at 834 (defining authentication to include attribution not provenance).

customer who has yet to sharpen his "artistic" eye.[4]

Early English case law historically provided protection for purchasers of art through either breach of an express warranty of authenticity or common law fraud.[5] Contemporary American law broadens protection to include the potential for indefinite merchant liability, which raises questions regarding the best way to govern authentication given the unique nature of artwork.[6] Scholars typically propose one of three theories of liability to adjust buyer protection.[7] The application of securities laws to the art market is another potential solution.[8]

Yet the scholarly proposals will provide limited benefit and will disproportionately upset the art market.[9] To the extent securities laws are even applicable to art transactions, they too will marginally supplement protection and unduly interfere with market principles.[10] The better approach is to implement flexible disclosure requirements uniquely tailored to the authentication of artwork in order to promote more efficient pricing.[11]

## I. EARLY ENGLISH COMMON LAW PROTECTED BUYERS FROM MISTAKEN AUTHENTICITY

Early English case law provides a benchmark for handling mistaken authentication. Claims for breach of warranty were available at common law and did not have an intent requirement, but were subject to a limited filing period.[12] Alternatively, the buyer could file a common law fraud action that included the "discovery rule," but required proof of

4. *See, e.g.*, Gerstenblith, *supra* note 1, at 519; Singer, *supra* note 1, at 440; Raul Jauregui, *Rembrandt Portraits: Economic Negligence in Art Attribution*, 44 UCLA L. REV. 1947, 2023–28 (1997). Indeed, art can be an analogy for much of anything done in life, including the theoretical analysis of pricing legal claims. *See* Robert J. Rhee, *A Price Theory of Legal Bargaining: An Inquiry into the Selection of Settlement and Litigation Under Uncertainty*, 56 EMORY L.J. 619, 625 (2006) ("[L]ike a brushstroke of an impressionistic painting, each theory adds to the mosaic.").

5. *See infra* Part I.

6. *See infra* Part II.

7. *See infra* Part III.

8. *See infra* Part IV.

9. *See infra* Part V.

10. *See infra* Part VI.

11. *See infra* Part VII.

12. *See infra* Part I.A.

specific intent.[13] While both actions had their strengths and weaknesses, the dispositive issue in the case law was whether or not there was in fact a mistake in authentication.[14]

### *A. Breach of Express Warranty at Common Law*

At early English common law, a purchaser could hold a seller liable pursuant to a breach of an express warranty of authenticity.[15] A seller could create a warranty by using the word "warrant"[16] and by making a representation of authenticity that was an affirmation of fact, not an opinion.[17] The case of *Jendwine v. Slade* suggested that antiquities did not meet this requirement because seller representations of authenticity for very old works could only constitute opinions.[18] The buyer must also have relied on the seller's representation, which could be apparent as a consequence of the price of the piece[19] or the relative knowledge of the parties.[20] While a buyer that incurred damages for a breach on resale had an action against the original seller,[21] filing periods limited claims for breach of warranty generally.[22]

### *B. Action for Fraud at Common Law*

Common law fraud provided an alternative pleading to a claim for a breach of warranty in matters dealing with

13. *See infra* Part I.B.

14. *See infra* Part I.C.

15. *See generally* Power v. Barham, (1836) 111 Eng. Rep. 865; Pennell v. Woodburn, (1835) 173 Eng. Rep. 52; De Sewhanberg v. Buchanan, (1832) 172 Eng. Rep. 1004; Lomi v. Tucker, (1829) 172 Eng. Rep. 586; Jendwine v. Slade, (1797) 170 Eng. Rep. 459.

16. *See De Sewhanberg*, 172 Eng. Rep. at 1004 (trial testimony that seller expressly used the word "warrant" in stating that the painting was an authentic Rembrandt).

17. *See, e.g.*, *Jendwine*, 170 Eng. Rep. at 460.

18. *See id.* The rationale in *Jendwine* was that a representation regarding the authenticity of an antiquity was inherently speculative on account of the age of the work and therefore could not constitute an affirmation of fact. *Id.* *But see* case analysis in Part I.C., *infra*.

19. *Lomi*, 172 Eng. Rep. at 587.

20. *De Sewhanberg*, 172 Eng. Rep. at 1005.

21. *See* Pennell v. Woodburn, (1835) 173 Eng. Rep. 52, 52 (jury instructions indicating plaintiff buyer entitled to recover for damages from warranty breach on resale if initial transaction was in fact a bona fide sale).

22. *See Jendwine*, 170 Eng. Rep. at 459–60 (defense of breach of warranty to seller suit for non-payment could be time-barred absent the "discovery rule" in fraud claim).

mistaken authentication of artwork.[23] An action for fraud at common law required a showing of specific intent to deceive and not merely the creation and breach of a warranty.[24] Fraud claims also benefitted from an extended filing period based on the "discovery rule," which tolled the accrual of the statute of limitations.[25] Early English fraud claims balanced the heightened requirement of specific intent with the lenient filing period of the "discovery rule."[26]

### *C. The Dispositive Issue of Mistaken Authenticity*

While *Jendwine v. Slade* suggested that a seller could not warrant authenticity for antiquities, a careful reading of early English case law reveals that the dispositive issue was whether there was a mistake in the authentication.[27] The *Jendwine* court pointed to the ages of the works to assert that the affirmations were opinions, but the artists in question each died a little over 100 years before the case and the trial involved conflicting testimony from "several of the most eminent art experts."[28] Yet in *De Sewhanberg v. Buchanan* the court submitted the question of warranty to the jury, notwithstanding the seller's reliance on the *Jendwine* decision, when expert testimony unequivocally stated that the painting was not a Rembrandt and Rembrandt died 163 years before the trial.[29] Therefore, the dispositive issue in breach of

23. *See id.*; *see also* Power v. Barham, (1836) 111 Eng. Rep. 865; *Lomi*, 172 Eng. Rep. at 587.

24. *See Power*, 111 Eng. Rep. at 866 (arguing pre-sale catalogue attributing paintings in *Jendwine*, 170 Eng. Rep. at 459, constituted stronger evidence of a "positive undertaking" of fraud then the bills of parcels in the case at bar).

25. *Jendwine*, 170 Eng. Rep. at 460 (no time bar when party "comes recently after the discovery of the deception").

26. *See Power*, 111 Eng. Rep. at 866; *Jendwine*, 170 Eng. Rep. at 460.

27. *See* De Sewhanberg v. Buchanan, (1832) 172 Eng. Rep. 1004, 1004–05; *Jendwine*, 170 Eng. Rep. at 460; *see also Lomi*, 172 Eng. Rep. at 587.

28. *See Jendwine*, 170 Eng. Rep. at 459. Lorraine died in 1682, which translates to 115 years before the case. *See* Art Biography of Claude Lorraine (French, 1604–1682), *Heilbrunn Timeline of Art History*, METRO. MUSEUM OF ART, http://www.metmuseum.org/toah/hi/hi_locl.htm (last visited Apr. 14, 2011). Teniers died in 1690 or 107 years before the case. *See* Art Biography of David Teniers the Younger (Flemish, 1610–1690), *Heilbrunn Timeline of Art History*, METRO. MUSEUM OF ART, http://www.metmuseum.org/toah/hi/hi_tenyoungdav.htm (last visited Apr. 14, 2011).

29. *See* 172 Eng. Rep. at 1004–05; Biography of Rembrandt van Rijn (Dutch, 1606–1669), *Heilbrunn Timeline of Art History*, METRO. MUSEUM OF ART, http://www.metmuseum.org/toah/hi/hi_remb.htm (last visited Apr. 14, 2011). *See also Lomi*, 172 Eng. Rep. at 587 (warranty of Poussin authenticity submitted to jury when artist

warranty cases was likely expert testimony speaking to the issue of a mistake in the authentication.[30]

## II. EXPANSION OF PROTECTION AT CONTEMPORARY AMERICAN LAW DEVELOPS POLICY CONCERNS

Contemporary American law has expanded protection for purchasers of artwork with a mistake in authentication.[31] The codification of warranty claims pursuant to the Uniform Commercial Code (UCC) has expanded buyer protection and common law fraud claims remain available as an additional remedy.[32] The two theories enjoy a symbiotic relationship such that evidence of fraudulent concealment can toll the UCC statute of limitations and at least one jurisdiction has held that this tolling may occur even in the absence of fraud.[33] Given its potential for indefinite liability in the absence of fraud, this holding raises serious policy questions regarding the most appropriate way to protect purchasers in light of the unique nature of artwork.[34]

died 170 years before the case and opinion defense not raised); Art Biography of Nicolas Poussin (French, 1594–1665), *Heilbrunn Timeline of Art History*, METRO. MUSEUM OF ART, http://www.metmuseum.org/toah/hi/hi_pous.htm (last visited Apr. 14, 2011); *Power*, 111 Eng. Rep. at 866 (no opinion defense for authentication of Canaletto who died seventy years before the case); Art Biography of Canaletto (Canal, Giovanni Antonio) (Italian, 1697–1798), *Heilbrunn Timeline of Art History*, METRO. MUSEUM OF ART, http://www.metmuseum.org/toah/hi/hi_canal.htm (last visited Apr. 14, 2011).

30. *See De Sewhanberg*, 172 Eng. Rep. at 1004–05; *Jendwine*, 170 Eng. Rep. at 459; *Lomi*, 172 Eng. Rep. at 587.

31. For a discussion of buyer remedies presently available in addition to breach of warranty and common law fraud see Levy *supra* note 3, §§ 10.02[B][2], [4], 10.04[B][6], [7] (state consumer statutes and statutes governing dealer representations, as well as claims for negligent misrepresentation in appropriate circumstances); DARRABY, *supra* note 1, § 5:67–70 (discussing Racketeer Influenced and Corrupt Organizations Act (RICO) claims in art transactions); *see also* Balog v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556, 1567–68 (D. Haw. 1990) (art fraud action brought under RICO).

32. *See infra* Part II.A.

33. *See infra* Part II.B.

34. *See infra* Part II.C.

### *A. UCC Warranty and Common Law Fraud*

Breach of warranty and fraud claims remain[35] and have strengthened or broadened in many instances.[36] The UCC broadens buyer protection by eliminating any requirement that the seller expressly use the word "warrant"[37] and by allowing an opinion to constitute a "fact" if it forms the "basis of the bargain."[38] The UCC also now expressly presumes

35. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-85 to -92 (discussing breach of warranty claims in art transactions); Levy, *supra* note 3, §§ 10.02[B][1], [3], 10.04[B][5] (discussing claims for breach of warranty and fraud governing art sales). At times, this Article refers to both the UCC and the case law as the "common law" because the UCC often incorporates pre-code common law. *See* ROBERT A. HILLMAN ET AL., COMMON LAW AND EQUITY UNDER THE UNIFORM COMMERCIAL CODE ¶ 1.03, at 1–4 (1985) (UCC often restates common law rules, employs common law terms, and selects the best rule from conflicting common law opinions).

36. Legal recourse for buyers in contract or in tort based on allegations of auction house misrepresentations requires the additional step of establishing that the auction house as consignee constitutes an agent for the seller. *See* RESTATEMENT (THIRD) OF AGENCY § 6.11(2)–(3) (statements of agent incident to a contract are attributable to principal); *id.* § 6.11 cmt. e (statements incidental to contract include warranties); *id.* §§ 7.01, 7.04, 7.08 (agent liable for own tortious conduct and principal liable for tortious conduct of agent). While the case law is sparing, establishing an agency relationship between an auction house and a consignor should not be too difficult since key jurisdictions have unequivocally found such a relationship in other contexts. *See, e.g.*, Cristallina S.A. v. Christie, Manson & Woods, Int'l, Inc., 117 A.D. 284, 292 (N.Y. App. Div. 1986) ("The Auctioneer is the agent of the consignor."). It is also commonly understood that the auction house is an agent of the consignor. Olsoff, *supra* note 1, § 11.02[A], at 904 ("[T]he relationship between an auction house and a consignor is governed by basic principles of agency law."). Moreover, the auction house has actual authority with respect to appraisal services in most cases. *See* Olsoff, *supra* note 1, § 11.02[B], at 913–14 (typical consignment agreement leaves consultation of experts and research to the "sole discretion" of the auction house).

37. U.C.C. § 2-313(3) (2004) ("It is not necessary to the creation of an express warranty that the seller use formal words such as 'warrant' or 'guarantee' or that he have a specific intention to make a warranty . . . .").

38. § 2-313(2)(a) (2004); *see also* § 2-313 cmt. 10 (an opinion is something that cannot be fairly viewed as entering into the bargain). When dealing with attribution of artwork, the distinction between fact and opinion often becomes plainly apparent based on the price of the piece. *See* Levy, *supra* note 3, § 10.02[A], at 834 (authenticity and provenance affect appraisal); DARRABY, *supra* note 1, § 4:19, at 239 ("If on occasion authorship drops out of the bargain, a huge and palpable price differential would be apparent."); *id.* § 2:58, at 88 ("Certain prior owners or events may effectively enhance value by providing the artworks with a cachet."). This distinction was also plainly apparent centuries ago at early English common law where it reflected the creation of a warranty and buyer reliance. *See* Lomi v. Tucker, (1829) 172 Eng. Rep. 586, 587 (jury rejects argument that price reflects sale of copies). The benefit of the codification of this principle through state adoption of the UCC becomes particularly apparent in states that would otherwise statutorily mandate caveat emptor. *See* Weisz v. Parke-Bernet Galleries, Inc., 325 N.Y.S.2d 576, 583 (Civ. Ct. 1971), *rev'd* 351 N.Y.S.2d 911, 912 (N.Y.

buyer reliance on the statements of the seller if such statements were made "during the bargain."[39] While disclaimers exist to protect sellers from unlimited liability, they must be construed reasonably in light of any warranties.[40] Fraud theories remain intact and continue to extend the limitations period pursuant to the "discovery rule."[41] Misattribution determined by expert testimony, however, remains the dispositive factor in the case.[42]

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App. Term 1974) (per curiam); *infra* note 145.

39. § 2-313 cmts. 5 & 8 (2004). This presumption of reliance was also available prior to the 2003 amendments. U.C.C. § 2-313, cmt. 3 (1995). The presumption of reliance is embedded in the concept of the opinion-fact distinction because if a seller's opinion "forms the basis of the bargain" thereby becoming a "fact," then the buyer relied on it. § 2-313(2)–(3) (2004). For this reason any knowledge asymmetry of the parties may be a factor in the analysis as it was at early English common law. *See* Balog v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556, 1565 (D. Haw. 1990) (court points to superior expertise of art seller in determining buyer reliance); De Sewhanberg v. Buchanan, (1832) 172 Eng. Rep. 1004, 1005 (court considers relative knowledge of parties); *see also* Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 821 (E.D. Pa. 1987) (noting plaintiffs were art dealers before barring claim via UCC statute of limitations).

40. *See* U.C.C. § 2-316(1) (2004). The two major U.S. auction houses typically warrant authenticity for five years with Sotheby's excluding only authorship for pre-1870 works unless they are found to be counterfeit. *See* FORM 11-1, *Conditions of Sale and Limited Warranty—Christie's*, *reprinted in* Olsoff, *supra* note 1, at 935–37 [hereinafter *Christie's Conditions of Sale*]; FORM 11-2, *Conditions of Sale and Terms of Guarantee—Sotheby's*, *reprinted in* Olsoff, *supra* note 1, at 941–42 [hereinafter *Sotheby's Conditions of Sale*]. *But see* Krahmer v. Christie's Inc., 903 A.2d 773, 783 (Del. Ch. 2006) (involving a six-year warranty in Christie's auction sale). As at early English common law, *see supra* notes 21–22 and accompanying text, an intermediary can sue the original seller when necessary, *see generally* Mickle v. Christie's, 207 F. Supp. 2d 237 (S.D.N.Y. 2002) (Christie's sues seller for damages incurred after granting buyer rescission for mistaken authentication), and warranty actions are limited by a filing period. *E.g.*, N.Y. U.C.C. § 2-725(2) (McKinney 2011) (four years accruing upon tender of delivery).

41. *See, e.g.*, Rosen v. Spanierman, 894 F.2d 28, 35 n.2 (2d Cir. 1990). The elements of fraud are typically: 1) a false representation of 2) a material 3) fact 4) where the defendant knew of the falsity and 5) made the statement for the purpose of inducing the plaintiff to rely on it and 6) the plaintiff did in fact justifiably rely on the statement 7) causing damages. RESTATEMENT (SECOND) OF TORTS §§ 525–526, 531, 537–538, and 546 (1977). Fraud theories have also arguably broadened in some jurisdictions. *See* W. PAGE KEETON ET AL., PROSSER AND KEETON ON TORTS 740 (5th ed. 1984) (noting some courts "allow recovery in deceit for misrepresentation which falls short of actual intent to deceive").

42. *See* Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467–71 (S.D.N.Y. 1978) (liability for a piece when opposing expert conceded it may have been misattributed and no liability for another piece when all experts agreed upon authenticity)*;* Greenberg Gallery, Inc. v. Bauman, 817 F. Supp. 167, 169–71 (D.D.C. 1993) (no liability when piece's distinguishing characteristics were a result of damage done in transit by purchaser and therefore not indicative of mistaken authenticity); *see also* Pritzker v.

### *B. The Symbiosis of Warranty and Fraud Claims*

Contemporary American law provides additional protection to art purchasers by creating a symbiotic relationship between these two theories.[43] A breach of warranty claim is easier to prove since a fraud claim requires a showing of specific intent.[44] On account of the "discovery rule," a fraud claim provides buyers with more protection since it is not subject to the UCC statute of limitations.[45] Courts combine these theories by allowing the "discovery rule" to toll the UCC statute of limitations when there is evidence of fraudulent concealment.[46]

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Krishna Gallery of Asian Arts Inc., No. 93 C 4147, 1996 WL 563442, at *5 (N.D. Ill. Sept. 30, 1996) (authenticity is the least appropriate issue for summary judgment when both sides present experts with opposite views). Some jurisdictions subject authenticity to a standard of proof by inquiring whether the seller had "a reasonable basis in fact." *See Dawson*, 463 F. Supp. at 467; *Balog*, 745 F. Supp. at 1566.

43. *Balog*, 745 F. Supp. at 1572–73; *Rosen*, 894 F.2d at 35.

44. *Compare* U.C.C. § 2-313(3) (2004) ("It is not necessary to the creation of an express warranty that the seller use formal words such as 'warrant' or 'guarantee' or that he have a specific intention to make a warranty . . . ."), *with* RESTATEMENT (SECOND) OF TORTS § 526 (1977) (scienter requirement for fraud). This distinction permeates the difference between contract and tort law and is apparent in the concept of efficient breach of contract. While discussing efficient breaches, contract professors note that "students are sometimes troubled by the rather stark fact that the law does not actually require a promisor to keep his promise, but instead treats the payment of money damages as a wholly adequate remedy for breach." MARVIN A. CHIRELSTEIN, CONCEPTS AND CASE ANALYSIS IN THE LAW OF CONTRACTS 176 (5th ed. 2006).

45. *See e.g.*, *Rosen*, 894 F.2d at 35. The UCC statute of limitations varies by state. *Compare* COLO. REV. STAT. ANN. §§ 4-2-725(1), 13-80-101(1) (West 2010) (three years), *with* S.C. CODE ANN. § 36-2-725(1) (2010) (six years). The 2003 amendments to the UCC expanded temporal protection for warranties. *Compare* U.C.C. § 2-725(1) (2004) (suit for breach must be brought within the later of four years of the accrual of the cause of action or one year after the breach was or should have been discovered subject to a five-year statute of repose), *with* U.C.C. § 2-725(1)–(2) (1995) (suit for breach must be brought within four years and action accrues upon tender of delivery). The benefit of this change to the UCC is limited in the auction house context since many auction houses warrant authentication for five years or more. *See supra* note 40.

46. *Compare Balog*, 745 F. Supp. at 1572–73 (allowing evidence of fraudulent concealment to toll the statute of limitations under Hawaii's adoption of UCC § 2-725(1)), *with* Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 821 (E.D. Pa. 1987) (refusing to toll the statute of limitations under Pennsylvania's adoption of UCC § 2-725(1) in the absence of fraudulent concealment). In both *Balog* and *Firestone*, the sellers assured the buyers that the pieces were originals after the sale. *Balog*, 745 F. Supp. at 1572–73; *Firestone*, 672 F. Supp. at 820. Yet the nature of these assurances is distinguishable as the *Firestone* seller gave a single oral assurance with respect to a particular piece whereas the *Balog* sellers provided multiple certificates of authenticity during continued sales to the buyers spanning several years. *Id.* at 820; *Balog*, 745 F. Supp. at 1558–59. The context of the assurances is also

Depending on the jurisdiction, this extension may even be applicable in the absence of fraudulent concealment.[47] In *Rosen v. Spanierman*, the Second Circuit rejected the view that the authentication of artwork automatically constitutes an explicit warranty under UCC § 2-725(2) without the seller expressly stating that the warranty applies to future performance.[48] Instead, the court remanded the fraud claim[49] and indicated that in its view of the facts it was not time-barred.[50] In *Balog v. Center Art Gallery-Hawaii, Inc.*, on the other hand, a federal district court held that artwork automatically constitutes an explicit warranty of future performance under UCC § 2-725(2).[51] Nevertheless, this ruling was an alternative holding in addition to the tolling due to concealment[52] when the defendants were previously

distinguishable since the *Balog* buyers did not have prior actual notice to suspect misattributions, while the *Firestone* buyers had such notice based on the opinions of independent art experts. *Id.*; *Firestone*, 672 F. Supp. at 820. Finally, fraudulent intent was absent in *Firestone* since the painting was reattributed as a consequence of a post-sale article published by an art expert, a fact clearly distinguishable from *Balog* where the sellers were criminally convicted for selling counterfeit works. *Id.* at 820–21; *Balog*, 745 F. Supp. at 1560. As if all of this were not enough, the *Firestone* buyers were art dealers whereas the *Balog* buyers were a family of tourists (from the state of Washington no less) vacationing in Hawaii (perhaps even wearing Hawaiian shirts and flip flops during the first sale) and unknowledgeable about the art world. *Id.* at 1558; *Firestone*, 672 F. Supp. at 821.

47. Compare *Balog*, 745 F. Supp. 1569–72, *with Rosen*, 894 F.2d at 31–33.

48. 894 F.2d at 31–33; *see also* Wilson v. Hammer, 850 F.2d 3, 5 (1st Cir. 1988) (rejecting argument that warranty of future performance under UCC § 2-725(2) applies in absence of explicit promise). Perhaps the *Rosen* court did not discuss the issue of fraudulent concealment tolling the limitations period under UCC § 2-725(1) because it was not raised by the plaintiffs, who instead presented the seller's continued appraisal of the painting as evidence of an extended warranty. *See id.* at 31–33. *But see Balog*, 745 F. Supp. at 1568 (plaintiffs argue that all applicable statute of limitations are tolled by fraudulent concealment on the part of the defendant). Other courts have refused to toll the limitations period for negligent misrepresentation and constructive fraud actions. *See* Krahmer v. Christie's Inc., 903 A.2d 773, 777–83 (Del. Ch. 2006) (denial of motion to amend fraud pleadings to include "constructive fraud and/or negligent misrepresentation" since actions were time-barred). This denial was likely because the attempt to amend was a last ditch effort in a dying fraud claim. *See id.*

49. *Rosen*, 894 F.2d at 31–37.

50. *Id.* at 36 n.2.

51. 745 F. Supp. at 1569–72.

52. *Id.* at 1572–73. Therefore the wording is arguably dicta since the case involved fraudulent concealment that tolled UCC § 2-725(1). *See id.* Even if the wording is not dicta, the alternative holding is unnecessary for the same reason. *See id.* Moreover, the authority of this ruling is questionable since the Federal District Court of Hawaii was deciding issues of state law pursuant to diversity jurisdiction. *See id.* at 1558 n.1.

found guilty of criminal charges for selling counterfeits.[53] The courts effectively reached the same result through different legal holdings that were appropriate based on varying evidence of fraud.[54]

### *C. New Policy Concerns Regarding Art Merchant Liability*

The outcomes of *Rosen* and *Balog* provided an appropriate balance of several policy issues based on their relative findings of fact.[55] These cases balance the incentive to hire an independent appraiser in light of the value of the piece since the *Rosen* case involved a single work with an estimated value that was approximately seven times that of all four pieces in *Balog*.[56] They also balance the equitable principles of tolling with the relative indicia of fraud since *Rosen* had less evidence of fraud than *Balog* where the defendants had been criminally convicted for selling counterfeits.[57] Based on their facts, the case outcomes are reasonable.[58]

Yet their disparate legal holdings raise the question of how to structure art merchant liability in the absence of fraud given the unique nature of artwork.[59] Original artwork derives its value largely from authenticity,[60] yet the speculative nature of authentication is distinguishable from

53. *See id.* at 1560. Perhaps the federal judge was simply sending the message to con artists that they will not get away with ripping off tourists in Hawaii. *See id.*; *see also* DARRABY, *supra* note 1, § 4:33, at 252 (heavy-handed ruling may have been a result of tourist-oriented economy in Hawaii).

54. *Compare Balog*, 745 F. Supp. at 1572–73, *with Rosen*, 894 F.2d at 31–37. *See also supra* notes 46, 48; *infra* note 57 and accompanying text.

55. *See Balog*, 745 F. Supp. at 1572–73; *Rosen*, 894 F.2d at 31–37.

56. *See Balog*, 745 F. Supp. at 1561; *Rosen*, 894 F.2d at 30, 33. Unlike *Balog*, which involved the purchase of four purported Dali originals worth a total of $36,000 in the late 1970's to early 1980's, *see* 745 F. Supp. at 1561, the *Rosen* case involved a single work purported to be a John Singer Sargent with a market value ranging from $175,000 to $250,000 in the mid-1970's to mid-1980's. *See* 894 F.2d at 30, 33.

57. The seller in *Rosen* had not been criminally convicted of fraud and did not sell multiple works to the plaintiffs with "confidential certificates of authenticity," *contra Balog*, 745 F. Supp. at 1558, 1560, but did provide multiple post-sale insurance appraisals at the request of the buyers and the first independent appraiser immediately suspected it was a fake. *Rosen*, 894 F.2d at 30.

58. *See Balog*, 745 F. Supp. at 1572–73; *Rosen*, 894 F.2d at 31–37.

59. *See, e.g.*, DARRABY, *supra* note 1, § 4:36, at 254 (distinguishing artwork from utilitarian goods).

60. *See, e.g.*, Levy, *supra* note 3, § 10.02[A], at 834 (authenticity important factor in appraising value of artwork).

most other warranties.[61] Authentication can fail simply due to changes in expert opinion resulting from new information.[62] Additionally, transactions in artwork entail an expectation of the potential for appreciation in value not shared with transactions in many other goods.[63] The decisions therefore raise the question of whether the best means of addressing the uniqueness of art is to hold merchants indefinitely liable for authenticity.[64]

## III. SCHOLARS PROPOSE THEORIES TO ADJUST BUYER PROTECTION

There are three leading scholarly theories for imposing additional regulations upon the art market in order to protect unsophisticated purchasers.[65] The first theory creates a fiduciary duty or agency relationship between the buyer and merchant.[66] The second theory imposes strict liability upon sellers and auction houses for issues involving mistaken

61. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-25 (noting difficulty of establishing authenticity of aged pieces with 100% certainty); DARRABY, *supra* note 1, § 4:36, at 254 (discussing relative ease of evaluating warranties of goods covering intrinsic components with utilitarian functions).

62. *See, e.g.,* Firestone v. Union League of Phila., 672 F. Supp. 819, 820–21 (post-sale reattribution via art scholar publication). For this reason, some jurisdictions protect art merchants with "the reasonable basis in fact" inquiry such that they may only be held liable if their representations as to authenticity had no "reasonable basis in fact." *See* Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467 (S.D.N.Y. 1978); *see also Balog*, 745 F. Supp. at 1566.

63. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1 to -9 (discussing investment value of art); DARRABY, *supra* note 1, § 4:36, at 254 (utilitarian goods expected to depreciate in value and exit market). The price of artwork therefore reflects a combination of this potential for appreciation with the risk as to authenticity in light of warranties and disclaimers. *See, e.g.*, Krahmer v. Christie's Inc., 903 A.2d 773, 781 (Del. Ch. 2006) (risk as to authenticity is factored into bid price at auction); DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1 to -9 (art can appreciate in value).

64. *See Balog*, 745 F. Supp. at 1569–72 (authentication automatically constitutes a warranty of future performance under UCC § 2-725(2)). This Article answers the question with a resounding "no" and proposes a better approach to liability that will provide additional protection for buyers while promoting market principles. *See infra* Part VII.C.

65. This Article discusses scholarly arguments that either provide new legal theories or extend existing statutory actions for misattribution and mistaken provenance claims. For an excellent discussion of another means of addressing the problem that does not involve generating new legal theories or extending existing statutory claims see Leonard D. DuBoff, *Controlling the Artful Con: Authentication and Regulation*, 27 HASTINGS L.J. 973, 1016–21 (1976) (discussing potential prophylactic measures such as registration and self-policing).

66. *See infra* Part III.A.

authenticity.[67] As a derivative of this theory, the third proposal is to create quasi-strict liability for auction houses.[68]

### *A. The Agency or Fiduciary Theory and the Presumption of Buyer Reliance*

One theory for imposing additional liability on art merchants for a mistake in authentication is to establish a fiduciary or principal-agent relationship between art merchants and buyers.[69] The theory applies the standard when buyers reasonably regard merchants as acting on their behalf and cases would thus vary according to the relative knowledge and experience of the buyers.[70] Proponents of this theory recognize that the auction house already has a fiduciary or principal-agent relationship with the art seller.[71] Proponents acknowledge this conflict of interest[72] and address it primarily by pointing to "unusual cases" where courts found auction houses to be agents of purchasers.[73]

### *B. The Strict Liability Theory in Contract or in Tort*

Scholars also advocate a strict liability theory[74] that would apply either to a breach of warranty claim or to a tort claim.[75] Scholars primarily delineate the elements of the theory in a transactional framework[76] by proposing the automatic

67. *See infra* Part III.B.
68. *See infra* Part III.C.
69. Gerstenblith, *supra* note 1, at 557–59; *see also* Singer, *supra* note 1, at 450–51.
70. Gerstenblith, *supra* note 1, at 559.
71. *Id.* at 557–58; *see also* Singer, *supra* note 1, at 450–51. In part, the theory is concerned with the concept of the "secret seller" or situations where a buyer will be left without legal recourse for breach of contract when the consignor is known to the auction house only. Gerstenblith, *supra* note 1, at 554 n.261.
72. Gerstenblith, *supra* note 1, at 558; *see also* Singer, *supra* note 1, at 450.
73. Gerstenblith, *supra* note 1, at 558–59 (citing Parke-Bernet Galleries, Inc. v. Franklyn, 256 N.E.2d 506 (N.Y. 1970); Romani v. Harris, 255 Md. 389, 394–97 (Md. 1969)). They also analogize the theory to real estate transactions where a broker is only an agent for the seller, but may be held to be an agent for the buyer as well. Gerstenblith, *supra* note 1, at 558; *see also* Singer, *supra* note 1, at 450.
74. *See* Jauregui, *supra* note 4, at 2023–28; Gerstenblith, *supra* note 1, at 559–66; *see also* Singer, *supra* note 1, at 451–53 (discussing and critiquing the application of the strict liability theory to the art market).
75. Gerstenblith, *supra* note 1, at 561.
76. *Id.*; *see also* Jauregui, *supra* note 4, at 1984 (describing strict liability theory as the rationale supporting the holding of Balog v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556 (D. Haw. 1990)). Scholarly delineation of the elements in tort law simply

creation of an express warranty for seller affirmations regarding authenticity.[77] The theory eliminates the opinion-fact distinction and seller qualifications.[78] The theory potentially allows for disclaimers, but requires their placement within the description or attribution of a piece.[79] The primary rationale of the theory is cost allocation whereby sellers can absorb the cost of mistakes in authenticity by acquiring additional insurance[80] and by spreading the cost of the premiums among buyers.[81]

### *C. The Quasi-Strict Liability Theory and the Allowance of Qualifications*

The quasi-strict liability approach is narrower since it allows for qualifications.[82] The theory creates a rebuttable presumption of seller liability based on the relative knowledge of the buyer.[83] However, the quasi-strict liability approach is

includes reference to a proposed section of the Second Restatement of Torts entitled "Misrepresentation of Seller of Chattels to Public." Gerstenblith, *supra* note 1, at 561 n.287 (citing RESTATEMENT (SECOND) OF TORTS § 552D (1977) (Council Draft No. 17, at 76 (1963)). At least one scholar proposes the theory following a general discussion of negligent misrepresentation claims. *See* Jauregui, *supra* note 4, at 2011.

77. *See* Gerstenblith, *supra* note 1, at 563 (citing MICH. COMP. LAWS ANN. § 442.322(2)(a)–(b); N.Y. ARTS & CULT. AFF. LAW § 13.01(a)). The theory only applies to transactions between a merchant and a non-merchant. *Id.* at 562. The theory applies to all affirmations of authenticity, including date and provenance. *Id.* at 563. Scholars advocate this approach while acknowledging that the majority of art merchants act in good faith and to the best of their ability to authenticate and attribute works. *See* Jauregui, *supra* note 4, at 2024; *see also* Singer, *supra* note 1, at 452.

78. *See* Gerstenblith, *supra* note 1, at 563–65.

79. *Id.* at 564. The theory negates a single disclaimer placed in the beginning of the catalogue and would also likely negate a single disclaimer placed in the Conditions of Sale. *See id.* One interpretation of the theory negates all disclaimers. *See id.* (discussing true strict liability with an example negating all disclaimers); *see also* Jauregui, *supra* note 4, at 1984 (describing strict liability theory as the rationale supporting the holding of *Balog*); *Balog*, 745 F. Supp. at 1569–72 (authentication is automatic warranty of future performance under UCC § 2-725(2)).

80. Jauregui, *supra* note 4, at 2024–25. Scholars insist that "while the amount of the loss may be staggering, the actual premium would be a small percentage of the price." *Id.*

81. *Id.*; Gerstenblith, *supra* note 1, at 562; *see also* Singer, *supra* note 1, at 451. The other two rationales are that strict liability encourages accident prevention, *see* Jauregui, *supra* note 4, at 2024; Singer, *supra* note 1, at 451, and that proving fault or negligence is "antiquated," Jauregui, *supra* note 4, at 2024, "expensive," *id.*; Singer, *supra* note 1, at 451, or "overly burdensome." *Id.* at 451.

82. Singer, *supra* note 1, at 453–55.

83. *Id.* The presumption would be applicable "even in cases where the original attribution was consistent with generally accepted opinion and authenticating

broader in that it definitively negates all disclaimers irrespective of their location[84] and mandates an "extremely broad warranty along with high attribution standards."[85] Scholars rely on The European Fine Art Fair at Maastricht and England's Grosvenor House Fair,[86] which adopt high authentication standards, guarantee authenticity,[87] and demand the highest prices.[88] The fairs undertake expansive insurance policies[89] and allocate these costs by passing the additional premiums onto consumers.[90]

## IV. SCHOLARS ALSO PROPOSE THE APPLICATION OF SECURITIES LAWS TO PROTECT CONSIGNORS AND THIS ARGUMENT CAN ADJUST TO PROTECT BUYERS

Additional theories may also be available pursuant to securities regulations. Art has investment value and is sensitive to market fluctuations.[91] For this reason, scholars propose the application of securities regulations by requiring auction houses to owe duties of due diligence and disclosure to consignors of artwork.[92] A logical adjustment of the argument is to impose these requirements on sellers and consignees in order to protect fine art purchasers.[93]

### *A. The Investment Value of Art*

Art has investment value.[94] People often use art to hedge against inflation.[95] There are a number of indexes that measure the art market.[96] For example, the Mei/Moses Fine Art Index tracks the repeated sale of art at auction houses.[97] This index outperformed the Hedge Fund Research Composite

standards" and its rebuttal is based on buyer art expertise. *Id.* at 454.

84. *Id.*
85. *Id.* at 453.
86. *Id.* at 453 n.104; *see also* Jauregui, *supra* note 4, at 2026.
87. Singer, *supra* note 1, at 453; *see also* Jauregui, *supra* note 4, at 2027.
88. Singer, *supra* note 1, at 453; *see also* Jauregui, *supra* note 4, at 2026.
89. Singer, *supra* note 1, at 453; *see also* Jauregui, *supra* note 4, at 2026–27.
90. Singer, *supra* note 1, at 453 n.104; *see also* Jauregui, *supra* note 4, at 2027.
91. *See infra* Part IV.A.
92. *See infra* Part IV.B.
93. *See infra* Part IV.C.
94. DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1 to -9.
95. *Id.* at J-1.
96. *See id.* at J-6.
97. *Id.*

Index by approximately three percent in 2005.[98] Yet the market fluctuates.[99] These factors raise the question of the applicability of securities laws to artwork.[100]

### *B. Imposing Securities Laws on Auction Houses to Protect Consignors*

Scholars argue that securities regulations can protect consignors of artwork by requiring auction houses to adhere to an underwriter's duty of due diligence and disclosure.[101] The argument analogizes the sale of artwork at an auction house to the issuance of securities through an underwriter,[102] which may constitute an initial public offering (IPO).[103] The analogy compares the role of the auction house to the role of an underwriter.[104] It compares the role of the consignors to investors.[105] The argument seeks to enhance auction house duties of due diligence and disclosure to the seller.[106]

The argument analogizes the appraisal and authentication process to an underwriter's due diligence in assessing the financial and operational condition of the issuer.[107] The auction house would furnish a truthful opinion as to the value of the piece.[108] The auction house would be required to keep the consignor informed regarding any material changes that might affect their relationship or the decision to sell at auction.[109] An auction house, like an underwriter, would incur liability for a breach of due diligence and disclosure duties to the consignor.[110]

98. *Id.* at J-6 to -7.

99. *See id.* at J-5 to -6 (noting a late 1980's bubble pop in the art market).

100. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at J-27.

101. Reginald Bullock, Jr., *Imposing the Underwriters' Duty of Care on Art Auctioneers*, 7 CARDOZO ARTS & ENT. L.J. 359, 360–61 (1989).

102. *Id.* at 361.

103. *See* 1 LOSS ET AL., SECURITIES REGULATION 485 n.1 (4th ed. 2006) [hereinafter 1 LOSS] (noting that in 2002 the SEC reviewed 610 IPOs composing approximately $2 trillion in securities). IPOs and public offerings generally are handled via underwriting syndicates whose underwriters consist of major financial institutions. *Id.* at 500, 505. These syndicates are typically run by a managing underwriter. *Id.* at 500.

104. Bullock, *supra* note 101, at 361.

105. *Id.* at 361 n.15.

106. *Id.* at 361.

107. *Id.* at 383–84.

108. *Id.* at 385.

109. *See id.* at 384–85.

110. The argument contends that the liability would be easier to establish if it were

### *C. Imposing Securities Laws on Art Sellers and Consignees to Protect Buyers*

Since the purpose of securities regulations is to protect investors,[111] a logical adjustment of the argument applies the analogy to art buyers.[112] The extension would compare a seller and an auction house to an issuer and an underwriter, respectively.[113] The argument would still involve accurate authentication and valuation of a piece, which is analogous to an underwriter's due diligence and valuation of a security.[114] The disclosure requirements would involve conveying any material facts contributing to the assessment of authenticity to art purchasers as an analogue to an issuer's disclosure requirements to prospective investors.[115] Art sellers and auction houses would thus owe duties of due diligence and disclosure to art buyers.[116]

Section 10(b) of the Securities and Exchange Act of 1934 ("the '34 Act") could provide additional protection to art purchasers.[117] Section 10(b) can provide more temporal protection than a breach of warranty claim because it includes the "discovery rule" as opposed to an automatic accrual at tender of delivery.[118] Even in actions where the

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akin to liability in the securities context. *See* Bullock, *supra* note 101, at 383–84. In drawing the analogy, the argument relies heavily on the continuous disclosure policy of the Securities and Exchange Act of 1934, as well as section 11 actions and defenses. *Id.* at 384 n.167, 361 n.20.

111. *See* 1 LOSS, *supra* note 103, at 4 ("[T]he problems at which modern securities regulation is directed are as old as the cupidity of sellers and the gullibility of buyers.").

112. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at J-6 (questioning whether securities regulations should protect the art purchaser).

113. *See* 1 LOSS, *supra* note 103, at 327 (Securities Act of 1933 ("the '33 Act") concerned with initial distribution of securities). The seller is analogous to the issuer, which acquires funds through the sale. *See id.* The argument therefore extends to dealers either because they are analogous to issuers or because they are analogous to firm commitment underwriters who assume distribution risk. *See id.* at 492–94. Auction house sales via consignment, on the other hand, are comparable to best efforts underwriting where the underwriters do not purchase the securities. *See id.* at 525.

114. *See, e.g.*, *id.* at 499–500 (managing underwriters' letter of intent typically includes a contemplated price range or mechanism for determining the price of the securities); Levy, *supra* note 3, § 10.02[A], at 834 (appraisal depends on authenticity).

115. *See* 1 LOSS, *supra* note 103, at 4 (securities laws protect against seller avarice).

116. *See, e.g.*, Basic, Inc. v. Levinson, 485 U.S. 224, 226, 231–32 (1988) (underwriter owes duties of due diligence and disclosure to purchasers of securities).

117. *See* 15 U.S.C. § 78j(b) (2006) (section 10(b) of the '34 Act prohibits manipulation or deception in connection with the purchase or sale of a security).

118. *Compare* 28 U.S.C. § 1658(b)(1) (2006) (section 10(b) claims can be brought two years from the time of discovery of facts constituting the violation), *with* U.C.C. § 2-

limitations period is not of concern, section 10(b) can expand liability by barring fewer claims for factual reasons.[119] Section 10(b) could potentially dismiss fewer claims than common law fraud because its intent requirement is equivalent to gross recklessness,[120] which eases the burden of

725(2) (1995) (statute of limitations accrues upon tender of delivery), *and* N.Y. U.C.C. § 2-725(2) (McKinney 2011) (statute of limitations accrues upon tender of delivery). *But see* U.C.C. § 2-725(1) (2004) ("discovery rule" in breach of contract actions). Section 10(b) is the theory of choice because other enforcement provisions either provide less temporal protection, *see* 15 U.S.C. § 77m (2006) (filing periods for violation of sections 12(a)(1) and (2) of the '34 Act are respectively capped at three years from bona fide offerings and sales), or are only applicable to registered securities in addition to providing less temporal protection. *See id.* § 77k (section 11 of the '33 Act imposes liability for material misstatements or omissions in an effective registration statement); § 77m (section 11 limitations period capped at three years from bona fide offerings). While an auction house catalogue of sale or an art dealer's other means of written communication is analogous to a prospectus, *see id.* § 77b(a)(10) (defining prospectus), section 11 of the '33 Act, *see* § 77k, could not provide an alternative pleading because an art merchant's sales materials do not constitute an effective registration statement. *See id.* § 77f(a)(8) (defining registration statement); *see also id.* § 77g(a) (registration statement shall be accompanied by documents in Schedule A and Schedule B); 17 C.F.R. §§ 210, 229 (listing disclosure requirements of regulations S–X and S–K necessary for a registration statement). Section 10(b) is not limited to registered securities and provides better protection. *See generally* 15 U.S.C. § 78j(b).

119. *Compare* United States v. Hagan, 521 U.S. 642, 741 (1997) (liability for fiduciary's material nondisclosure of non-public information), *with* RESTATEMENT (SECOND) OF TORTS §§ 528–529, 550–551 (1977) (common law fraud liability for ambiguous and incomplete statements requires intention to mislead and for nondisclosures typically requires defendant concealment of information, intentional action to prevent plaintiff from acquiring information, or a special relationship with plaintiff invoking a duty to disclose). *See also* U.C.C. § 2-313 (2004) (warranty provisions do not mention nondisclosure as forming a "basis for the bargain"). *But see* KEETON ET AL., *supra* note 41, at 739 (noting "amorphous tendency" of some courts to require "what the ordinary ethical person" would disclose); *see also* RESTATEMENT (SECOND) OF TORTS § 539(2) (liability for implied statements of fact made pursuant to an expression of opinion coupled with nondisclosure of known incompatible facts).

120. *See* Ernst & Ernst v. Hochfelder, 425 U.S. 185, 193 n.12 (1976) ("We need not address here the question whether, in some circumstances, reckless behavior is sufficient for civil liability under [section] 10(b) and Rule 10b-5"); Kushner v. Beverley Enters., Inc., 317 F.3d 820, 828 (8th Cir. 2003); City of Phila. v. Fleming Co., Inc., 264 F.3d 1245, 1260 (10th Cir. 2001); Philips v. LCI Int'l, Inc., 190 F.3d 609, 620 (4th Cir. 1999) (scienter requirement may be shown by recklessness); Hoffman v. Comshare, Inc. (*In re* Comshare, Inc. Sec. Litig.), 183 F.3d 542, 549–50 (6th Cir. 1999) (scienter requires pleading facts supporting a strong inference of recklessness); SEC v. Carriba Air, Inc., 681 F.2d 1318, 1324 (11th Cir. 1982); Dirks v. SEC, 681 F.2d 824, 844 (D.C. Cir. 1982), *rev'd on other grounds*, 463 U.S. 646 (1983); Broad v. Rockwell Int'l Corp., 642 F.2d 929, 961–62 (5th Cir. 1981) (en banc); McLean v. Alexander, 599 F.2d 1190, 1198 (3d. Cir. 1979) ("[R]eckless disregard for its truth or falsity."); Hoffman v. Estabrook & Co., Inc., 587 F.2d 509, 516 (1st Cir. 1978) (approving jury instruction of "carelessness approaching indifference"); Rolf v. Blyth, Eastman Dillon & Co., Inc., 570 F.2d 38, 45–46 (2d Cir. 1978) (willful or reckless disregard); Nelson v. Serwold, 576 F.2d

pleading specific intent.[121] Section 10(b) can provide middle ground between breach of warranty and common law fraud.[122]

## V. THE PROPOSED THEORIES DO NOT SUPPLEMENT PROTECTION IN A SIGNIFICANT MANNER AND WILL DISRUPT THE MARKET FOR FINE ART

The imposition of a fiduciary relationship between auction houses and buyers will not appropriately supplement buyer protection and its conflict of interest is of clear concern.[123] Any additional benefit to buyers under the strict liability approach is marginal at best and the theory will generate illiquidity.[124] The same is true for the quasi-strict liability approach, which evidently is prone to merchant insolvency.[125]

### *A. Contract Law Presumes Buyer Reliance and the Agency or Fiduciary Theory Creates a Substantial Conflict of Interest*

Components of the fiduciary theory provide less protection than the common law and the theory generally conflicts with well-established legal principles. With respect to the reliance element, the fiduciary theory provides less protection than the UCC because it requires the buyer to demonstrate a reasonable belief of an agency relationship[126] whereas breach of warranty presumes buyer reliance on a seller's affirmations.[127] The theory also stands contrary to well-

1332, 1337 (9th Cir. 1978); Bailey v. Meister Brau, Inc., 535 F.2d 982 (7th Cir. 1976).

121. *See* LOUIS LOSS & JOEL SELIGMAN, FUNDAMENTALS OF SECURITIES REGULATION 1020–25 (5th ed. 2004) [hereinafter LOSS, FUNDAMENTALS] (section 10(b) scienter less demanding than that of common law deceit).

122. *See supra* notes 44–45 and accompanying text. While both the common law and the securities laws provide for rescission and damages, section 10(b) has the potential to expand greatly the measure of damages. *See* LOSS, FUNDAMENTALS, *supra* note 121, at 1185–87, 1285–87 (common law and section 10(b) respectively measure damages at the time of the delivery and the time of the action).

123. *See infra* Part V.A.

124. *See infra* Part V.B.

125. *See infra* Part V.C.

126. *See* Gerstenblith, *supra* note 1, at 559.

127. U.C.C. § 2-313, cmt. 5 (2004) ("In actual practice affirmations of fact made by the seller about goods during a bargain are regarded as part of the description of those goods; hence no particular reliance need be shown in order to weave them into the fabric of the agreement."). Though the presumption of buyer reliance, *see* § 2-313, negates the concern of scholars for knowledge asymmetry, *see* Gerstenblith, *supra* note 1, at 559, some courts still discuss relative knowledge in assessing reliance. *See* Balog

established principles because an auction house rarely assents to buyer control, and fiduciary obligations result from agent assent to control generating the potential for principal liability due to agent conduct.[128] As an agent of the consignor,[129] the auction house owes a duty of loyalty to the seller.[130] Consequently, it must place the seller's interests above even its own.[131]

v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556, 1565 (D. Haw. 1990) (pointing to superior expertise of art seller when discussing buyer reliance); Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 821 (E.D. Pa. 1987) (noting plaintiffs were art dealers); *see also* De Sewhanberg v. Buchanan, (1832) 172 Eng. Rep. 1004, 1005 (pointing to relative knowledge in determining reliance). While the imposition of a fiduciary relationship theoretically provides the added protection of liability for omissions in a deceit action, this provision is limited to "matters known" to the party under the duty, *see* RESTATEMENT (SECOND) OF TORTS § 551(2)(a) (1977) (fiduciary relationship requires disclosure of matters known), and thus does not supplement liability in practice because breach of warranty simply requires mistaken authentication. *See* U.C.C. § 2-313 cmt. 5 ("The issue normally is one of fact."); *see also* Greenberg Gallery, Inc. v. Bauman, 817 F. Supp. 167, 169–71 (D.D.C. 1993) (no liability when piece's distinguishing characteristics were a result of damage done in transit by purchaser and not indicative of mistaken authenticity); Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467–71 (S.D.N.Y. 1978) (liability for a piece when opposing expert conceded it may have been misattributed and no liability for another piece when all experts agreed upon authenticity); Power v. Barham, (1836) 111 Eng. Rep. 865, 866 (breach where expert testimony unequivocally found a misattribution); Jendwine v. Slade, (1797) 170 Eng. Rep. 459, 459 (no breach where expert testimony conflicted).

128. RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt b (2006) ("An agent assents to act subject to the principal's control and on the principal's behalf."); *id.* § 8.11 cmt. b ("Within an agency relationship, an agent assents to act subject to the principal's control."); *see also id.* ("An agent's duty to provide information to the principal facilitates the principal's exercise of control over the agent."). Due to this lack of control, the theory cannot supplement temporal protection by tolling the statute of limitations in a buyer's negligence action against a seller. *See* Wilson v. Hammer, 850 F.2d 3, 9 (1st Cir. 1988) (refusing to toll limitations period in buyer negligence claim against auction house by distinguishing the action from legal malpractice claim in Hendrickson v. Sears, 365 Mass. 83 (1974), where attorney-client relationship invoked fiduciary duties). If the theory allowed tolling, it would then be subject to the same policy concerns as the strict liability and quasi-strict liability approaches. *See infra* notes 152–156, 161–166 and accompanying text.

129. *See, e.g.*, Cristallina S.A. v. Christie, Manson & Woods, Int'l, Inc., 117 A.D. 284, 292 (N.Y. App. Div. 1986) ("The Auctioneer is the agent of the consignor.").

130. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 (agent has fiduciary duty to act loyally on the principal's behalf in all matters connected with the agency relationship); *see also* Steven Mark Levy, *Liability of the Art Expert for Professional Malpractice*, 1991 WIS. L. REV. 595, 609 (1991) [hereinafter Levy, *Liability*] (Maastricht vetting committee disclaimer states that it acts solely for the benefit of the Fair).

131. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (Duty of loyalty requires agent to "put the principal's interests first as to matters connected with the agency"); *cf.* Meinhard v. Salmon, 249 N.Y. 458, 464 (1928) (standard of conduct among joint adventurers is a "punctilio" of honor). While proponents of the theory express fear of

The theory therefore generates policy concerns based on the old adage: "No one can serve two masters."[132] Scholars rely on "unusual cases" to circumvent the conflict of interest inherent in the theory.[133] Yet these cases dealt with situations where the auction house signed the sales agreement on behalf of the highest bidder preceding a suit by the seller for non-payment.[134] The net result of these cases was to honor the auction house's fiduciary duty of loyalty to the seller by placing the interests of the seller above those of the buyer.[135] The better approach is for a buyer to seek the advice of an independent appraiser.[136]

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the "secret seller," Gerstenblith, *supra* note 1, at 554 n.261, this fear subsides under current agency law's approach to unidentified and undisclosed principles. RESTATEMENT (THIRD) OF AGENCY §§ 6.02(1)–(2), 6.03(1)–(2), 7.01, 7.04, 7.08 (agent conduct creates liability in contract and tort for unidentified or undisclosed principal); *see also*, *id.* §§ 2.05–2.06(1) (estoppel in absence of apparent authority and general liability of undisclosed principal).

132. *Matthew* 6:24.

133. *See* Gerstenblith, *supra* note 1, at 558–59 (citing Parke-Bernet Galleries, Inc. v. Franklyn, 308 N.Y.S.2d 337 (1970); Romani v. Harris, 255 Md. 389, 394–97 (1969)).

134. The first case primarily dealt with the issue of personal jurisdiction. *See Parke-Bernet*, 308 N.Y.S.2d at 341 (reversing motion to dismiss by holding that out-of-state bidder's participation in auction sale over the phone established sufficient contacts within the state for personal jurisdiction). The court secondarily relied on the concept of agency to establish sufficient contacts within the state, but narrowly held that the employee of the auctioneer was an agent when "loaned" to the buyer for the purposes of transmitting bids over the phone and expressly stated that the auctioneer itself was not an agent. *Id.* The second case narrowly held that the auction house could act as an agent for the highest bidder in signing a sale memorandum pursuant to a provision in the state's Statute of Frauds. *Romani*, 255 Md. at 393. Neither case dealt with an agency relationship beyond the scope of binding a remorseful buyer attempting to back out of a deal. See *Parke-Bernet*, 308 N.Y.S.2d at 339; *Romani*, 255 Md. at 390.

135. *See Parke-Bernet*, 308 N.Y.S.2d at 341; *Romani*, 255 Md. at 393; *see also* RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b ("[Agent must] put the principal's interests first as to matters connected with the agency."). Support from the real estate analogy is equally limited since modern transactions typically involve an extra broker representing the buyer. *See* FILMORE W. GALATY ET AL., MODERN REAL ESTATE PRACTICE 92 (16th ed. 2003) (discussing buyer agency agreements); ROGER BERNHARDT & ANN M. BURKHART, REAL PROPERTY IN A NUT SHELL 298 (6th ed. 2010) (buyer broker agreement is modern response to court treatment of buyer broker as seller sub-agent).

136. *See* Rosen v. Spanierman, 894 F.2d 28, 32 (2d Cir. 1990) ("Requiring a purchaser to obtain [an] appraisal from an expert other than the seller is not an onerous burden"); Wilson v. Hammer, 850 F.2d 3, 7 (1st Cir. 1988) ("[Plaintiffs] easily could have discovered the problem from the outset by means of a second expert opinion."); *see also* Levy, *Liability*, *supra* note 130, at 635 (two of the three major appraisers in the United States hold themselves out as fiduciaries to their clients). This approach would also benefit buyers because it has the potential to eliminate agency cost on the buy-side. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (interests of agent not always aligned with interests of principal); *cf.* Michael C. Jensen

### *B. Contract Law Does Not Require a Showing of Intent and the Strict Liability Theory Reduces Buyer Access*

"Strict liability" in its true legal sense is applicable to tort law.[137] The application of the doctrine via tort law will not increase buyer protection because contract law does not require proof of intent[138] and a breach of warranty claim often has a greater limitations period than a tort claim.[139] The application of the "strict liability theory" via contract law will also fail to supplement buyer protection because negating the opinion defense for a warranty of attribution[140] is unnecessary under the UCC, which equates an opinion with a fact if it forms "the basis of the bargain."[141] Since the presence of

& William H. Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305, 308 (1976) (discussing agency cost in organizations); 1 MILTON R. FRIEDMAN & JAMES CHARLES SMITH, FRIEDMAN ON CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 1:3, at 1-10 to -11 (7th ed. 2005) (broker's bias to closing transaction reflected in real estate forms). By hiring their own independent appraisers, buyers can structure the relationship on a fee-for-service basis without a closing commission. *See* RESTATEMENT (THIRD) OF AGENCY § 8.01 cmt. b (principals can align interests with agents). Caution is essential as some "experts" may present themselves as consultants and function as dealers. *See* Levy, *Liability*, *supra* note 130, at 635 (citing Fenton v. Friedman, 748 F.2d 1358 (9th Cir. 1984)).

137. *See* BLACK'S LAW DICTIONARY 998 (9th ed. 2009) ("[Strict liability is liability] that does not depend on actual negligence or intent to harm, but that is based on the breach of an absolute duty to make something safe. Strict liability most often applies either to ultrahazardous activities or in products-liability cases."). Scholars note this limitation and further highlight that it typically applies to "inherently defective and unreasonably dangerous" products causing personal injury or property damage. Gerstenblith, *supra* note 1, at 560.

138. U.C.C. § 2-313(3) (2004); *see also* CHIRELSTEIN, *supra* note 44, at 176 ("[T]he law does not actually require a promisor to keep his promise, but instead treats the payment of money damages as a wholly adequate remedy for breach."). Yet demonstrating a breach of the standard of care is necessary for negligence actions. *See* RESTATEMENT (SECOND) OF TORTS § 281 (1977); *see also id.* § 299A (standard of care in professional liability); *id.* § 552(1) (standard of care in negligent misrepresentation).

139. *Compare* MASS. GEN. LAWS ch. 106, § 2-725 (West 2010) (statute of limitations for UCC action is four years), *with id.* ch. 260, § 2A (statute of limitations for tort action is three years). *See also* U.C.C. § 2-725 (2004) ("discovery rule" for sale of goods subject to five-year statute of repose); Levy, *Liability*, *supra* note 130, at 627 (UCC § 2-725 is one of the most formidable statute of limitations for mistaken authentication claims).

140. *See* Gerstenblith, *supra* note 1, at 563–65. Scholars rely on a state statute governing art transactions to support this assertion. *Id.* at 563 (citing N.Y. ARTS & CULT. AFF. LAW § 13.03(1)).

141. U.C.C. § 2-313(2)(a); *see also* § 2-313(2) cmt. 10 (opinions are representations that "cannot fairly be viewed as entering into the bargain"). Even if a seller relied on the opinion-fact distinction under UCC § 2-313(2)(a), the buyer could easily argue that the authentication constituted a "description of the goods" that was part of "the basis of the bargain." § 2-313(2)(b). A description is technically not subject to the opinion

authenticity in the bargain is usually self-evident,[142] the primary question will still be whether or not the authenticity was mistaken.[143] Like the UCC,[144] the theory also allows reasonable disclaimers to limit or negate warranties.[145] The

defense and under each subsection the question is whether or not authenticity was a "basis of the bargain." § 2-313(2)(a)–(b).

142. *See* Levy, *supra* note 3, § 10.02[A], at 834 (authenticity and provenance are important factors in appraising the value of artwork); DARRABY, *supra* note 1, § 4:19, at 239 ("If on occasion authorship drops out of the bargain, a huge and palpable price differential would be apparent."); *id.* § 2:58, at 88 ("Certain prior owners or events may effectively enhance value by providing the artworks with a cachet."); *see also* Lomi v. Tucker, (1829) 172 Eng. Rep. 586, 588 (jury flatly rejects seller defense based on price).

143. *See* U.C.C. § 2-313 cmt. 5 (2004) ("The issue normally is one of fact."); *see also* Pritzker v. Krishna Gallery of Asian Arts Inc., No. 93 C 4147, 1996 WL 563442, at *5 (N.D. Ill. Sept. 30, 1996) (authenticity is the least appropriate issue for summary judgment when both sides present experts with opposite views); Greenberg Gallery, Inc. v. Bauman, 817 F. Supp. 167, 169–71 (D.D.C. 1993) (no liability when piece's distinguishing characteristics were a result of damage done in transit by purchaser and not indicative of mistaken authenticity); Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467–71 (S.D.N.Y. 1978) (liability for a piece when opposing expert conceded it may have been misattributed and no liability for another piece when all experts agreed upon authenticity); Power v. Barham, (1836) 111 Eng. Rep. 865, 866 (breach where expert testimony unequivocally found a misattribution); Jendwine v. Slade, (1797) 170 Eng. Rep. 459, 459 (no breach where expert testimony conflicted).

144. *See* U.C.C. § 2-316(1) (2004) ("Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other . . . . [N]egation or limitation is inoperative to the extent that such construction is unreasonable."); *id.* § 2-313 cmt. 6 ("In view of the principle that the whole purpose of the law of warranty is to determine what it is the seller has in essence agreed to sell, the policy is adopted of those cases which refuse except in unusual circumstances to recognize a material deletion of the seller's obligation.").

145. *See* Gerstenblith, *supra* note 1, at 56. Similarly, the New York Arts and Cultural Affairs Law construes disclaimers reasonably with warranties. N.Y. ARTS & CULT. AFF. LAW § 13.03(4)(a) (McKinney 2011). While the New York statute has provisions that specify when a disclaimer with respect to authenticity is unreasonable, it considers the representations of authenticity at the time of the sale or exchange and judicial application of the statute asks whether the authenticity had a "reasonable basis in fact." *See* § 13.03(4)(b)(iii); *Dawson*, 463 F. Supp. at 467 (case decided under predecessor to Arts & Cultural Affairs Law). These additional requirements may provide less protection than the UCC since warranty liability is merely dependent on authenticity forming "a basis of the bargain." U.C.C. § 2-313(2)(a)–(b). Similarly, criticism of *Weisz v. Parke-Bernet Galleries, Inc.* ought not to be directed at the UCC or the common law. 325 N.Y.S.2d 576 (Civ. Ct. 1971), *rev'd* 351 N.Y.S.2d 911 (N.Y. App. Term 1974) (per curiam). The controversial case denied a warranty claim after New York's adoption of the UCC because prior statutory law emphasizing caveat emptor controlled the action due to the timing of the sale. See *id.* at 583; *see also Weisz*, 351 N.Y.S.2d at 912. Perhaps the trial judge was more lenient in considering the UCC as a benchmark than the appeals court. DUBOFF & HOLT CAPLAN, *supra* note 1, at K-91; *see also id.* at K-94 (discussing Robert Miller Gallery, Inc. v. Shepard Gallery Assocs., Inc., 6 UCC Rep. Serv. 2d 1076 (N.Y.S. Ct. 1988), where the UCC provided for rescission

UCC approach already protects buyers by finding liability based on the terms of the deal.[146]

The theory also stands contrary to well-established legal principles. In addition to the limited applicability of strict liability to inherently dangerous products,[147] the theory could only toll the filing period for negligence by undermining the requirement of a fiduciary relationship.[148] Similarly, an interpretation of the theory that negates reasonable disclaimers and holds merchants liable indefinitely will substantially limit the freedom of contract of parties.[149] Warranties and disclaimers are fundamental parts of contract law, which focuses on the ability of parties to reach a "bargain."[150] Merchants are free to warrant or disclaim goods

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based on mistaken authentication for a case between merchants and thus falling outside of New York's Arts & Cultural Affairs Law).

146. U.C.C. §§ 2-313(2), 2-316(1); *see also* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-93 (Illinois rejects attempt to adopt specific legislation for art transactions due to adequacy of UCC coverage). The paradox that becomes apparent when contrasting UCC § 2-316(1) with UCC § 2-313(2) will result in a natural resolution in each case depending on the relevant facts and opposing counsels' respective ability to assert what was or was not "a basis of the bargain." § 2-313 cmt. 10.

147. Gerstenblith, *supra* note 1, at 560. This concession couples proponent acknowledgement that the drafters of the Second Restatement of Torts did not adopt the proposed section addressing misrepresentations by sellers of chattels. *Id.* at 561 (citing RESTATEMENT (SECOND) OF TORTS § 552D (1977) (Council Draft No. 17, at 76 (1963)). Both points stand against the application of the theory even in jurisdictions where a negligence action has a greater limitations period than breach of warranty. *See, e.g.*, Bernier v. Raymark Indus., Inc., 516 A.2d 534, 543 (Me. 1986) (Maine allows physical manifestation of injury to accrue six-year limitations period in asbestos cases). The application of the theory to a negligent misrepresentation claim is equally inappropriate because the drafters of the Second Restatement of Torts limited this pure economic loss claim by including a specific intent requirement with respect to a limited class of persons and transactions. *See* RESTATEMENT (SECOND) OF TORTS § 552(2); *see also* JAY M. FEINMAN, PROFESSIONAL LIABILITY TO THIRD PARTIES 61–62 (3d ed. 2007) (discussing intent and knowledge requirement limitations under section 552).

148. *See, e.g.*, Wilson v. Hammer, 850 F.2d 3, 9 (1st Cir. 1988) (refusing to toll limitations period in buyer negligence claim against auction house by distinguishing the action from legal malpractice claim in Hendrickson v. Sears, 365 Mass. 83 (1974), where attorney-client relationship invoked fiduciary duties).

149. *See* Gerstenblith, *supra* note 1, at 564 (discussing true strict liability with an example negating all disclaimers); *see also* Jauregui, *supra* note 4, at 1984 (describing strict liability theory as the rationale supporting the holding of Balog v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556 (D. Haw. 1990)); *Balog*, 745 F. Supp. at 1569–72 (holding art authentication automatically constitutes an express warranty of future performance under UCC § 2-725(2)). The same is true for interpretations of the theory that expand its scope beyond attribution to all components of authentication and provenance. *See* Gerstenblith, *supra* note 1, at 563 (asserting that the doctrine could apply to all components of authenticity, including provenance and the date of the piece).

150. *See* U.C.C. § 2-313 cmt. 6 ("This is not intended to mean that the parties, if they

pursuant to acceptable legal standards and buyers are free to negotiate terms or select different sellers.[151]

There is also a strong policy argument against the theory because it will have the net effect of decreasing buyer access. To the extent the theory allows disclaimers and is only applicable in sales to non-merchants,[152] sellers may either refuse to authenticate pieces, fully disclaim warranties of authenticity, or be disinclined to sell certain pieces to non-merchant buyers.[153] To the extent the theory provides for indefinite art merchant liability,[154] the cost allocation rationale behind the theory will increase prices.[155] Either

consciously desire, cannot make their own bargain as they wish."). Buyers are free to negotiate for or to select a seller providing an unequivocal guarantee and merchants are free to set an acceptable price for or to decline to extend such a guarantee. *Cf.* Jauregui, *supra* note 4, at 2026–27 (discussing how European fairs providing unlimited guarantees have the highest prices). The law entitles autonomous individuals to the benefit of the bargain. *See* U.C.C. § 2-313 cmt. 6.

151. *See* U.C.C. § 2-313 cmt. 6 ("[T]he whole purpose of the law of warranty is to determine what it is the seller has in essence agreed to sell . . . ."). Contract law also does not require the placement of disclaimers of express warranties in a particular location. *But cf. id.* § 2-316(2) (disclaimers excluding implied warranty of merchantability and fitness must be conspicuous). A disclaimer specifically mentioning attribution at the beginning of a catalogue as a component of the conditions of sale is enforceable because the buyer is deemed to be on notice. *See* § 2-316 cmt. 1. Requiring a disclaimer in the description of each piece, *see* Gerstenblith, *supra* note 1, at 56, would not only be overly redundant, but would also, to put it gently, reduce the aesthetic appeal of catalogues that typically display upwards of a hundred pieces. *See generally* Christie's, *Fine American Paintings, Drawings and Sculpture*, NEW YORK SALE 2342, Sept. 28, 2010 (151 pages with 278 lots).

152. *See* Jauregui, *supra* note 4, at 2023–28; Gerstenblith, *supra* note 1, at 559–66 *see also* Singer, *supra* note 1, at 451–53 (discussing and critiquing the application of the strict liability theory to the art market).

153. These potential results are particularly true for antiquities where authentication is inherently speculative. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-25 (establishing authenticity of aged pieces with 100% certainty "is difficult even under the most favorable circumstances"). However, these potential results are less likely to occur in jurisdictions that bridle the elimination of the opinion defense with a requirement that the seller's representations had no "reasonable basis in fact." *Balog*, 745 F. Supp. at 1566; Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467 (S.D.N.Y. 1978).

154. *See* Gerstenblith, *supra* note 1, at 564 (discussing true strict liability with an example negating a disclaimer); *see also* Jauregui, *supra* note 4, at 1984 (describing strict liability theory as the rationale supporting the holding of *Balog*); *Balog*, 745 F. Supp. at 1569–72 (holding art authentication constitutes an express warranty of future performance under UCC § 2-725(2)).

155. *See* Jauregui, *supra* note 4, at 2024–25; Gerstenblith, *supra* note 1, at 562; *see also* Singer, *supra* note 1, at 451. A fundamental principle of economics is that an increase in price corresponds with a decrease in demand. *See* WALTER J. WESSELS, ECONOMICS 32 (3d ed. 2000) (discussing the law of demand). This principle is exponentially true for elastic goods and luxury goods involve greater price elasticity.

result will decrease liquidity as well as access for non-merchant or unsophisticated buyers.[156]

### *C. Contract Law Allows for Qualifications and the Quasi-Strict Liability Theory Generates Merchant Insolvency*

Many of the provisions of the quasi-strict liability theory do not supplement buyer protection and others contradict well-established legal principles. The theory's allowance of qualifications[157] is already a component of the UCC, which limits liability to the extent the qualifications become a "basis of the bargain."[158] The theory also does not supplement buyer protection in ways similar to the other theories, including its rebuttable presumption and focus on intent.[159] Moreover, its

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*Id.* at 294, 302. Though scholars insist that the "staggering" losses will only generate insurance premiums that are "a small percentage of the price," Jauregui, *supra* note 4, at 2024–25, the veracity of this assertion is questionable given the tendency of insurance companies to concern themselves with shareholder profits. *See, e.g.*, DUBOFF & HOLT CAPLAN, *supra* note 1, at L-3 (policy premiums from stock companies incorporate payment of share holder dividends). Even assuming the truth of the assertion, this "small percentage of the price" may impose substantial hardship on merchants for reasons discussed in the critique of the quasi-strict liability theory below. *See infra* notes 162–166 and accompanying text. Finally, insurance companies are demonstrating an increasingly smaller appetite for risk, which may limit the ability to acquire such insurance. *See, e.g.*, DUBOFF & HOLT CAPLAN, *supra* note 1, at L-1 (discussing negative impact of hurricane Katrina on art insurance market).

156. *See* WESSELS, *supra* note 155, at 114 (aggregate demand decreases when price level rises). The rationale that strict liability encourages accident prevention, *see* Jauregui, *supra* note 4, at 2024; Singer, *supra* note 1, at 451, is unjustifiable not only because the doctrine typically applies to "inherently defective and unreasonably dangerous" products that cause personal injury or property damage, Gerstenblith, *supra* note 1, at 560, but also because it contradicts scholarly acknowledgement that merchants make a good faith effort to authenticate works. *See* Jauregui, *supra* note 4, at 2024; Singer, *supra* note 1, at 452. Similarly, there are enumerable responses to the contention that proving negligence is "overly burdensome," Singer, *supra* note 1, at 451, "expensive," *id.*; Jauregui, *supra* note 4, at 2024, or "antiquated." *Id.* The responses include, inter alia, that breach of warranty does not require proof of intent, *see* U.C.C. § 2-313(3) (2004); CHIRELSTEIN, *supra* note 44, at 176, negligence is the lowest standard of intent, *see* RESTATEMENT (SECOND) OF TORTS § 282 (1977), the burden or cost of its proof is marginal given the requirement of expert testimony to establish a mistake in authentication, *see supra* note 143 and accompanying text, and antiquated legal principles often carry greater authority as exemplified by the principle of stare decisis. *See, e.g.*, Osborne v. IRS (*In re* Osborne), 76 F.3d 306, 309 (9th Cir. 1996) (the common law principle of stare decisis is short for *stare decisis et non quieta movere* or "to stand by and adhere to decisions and not disturb what is settled").

157. *See* Singer, *supra* note 1, at 454 (quasi-strict liability allows qualifications like "probable" or "perhaps").

158. U.C.C. §§ 2-313(2)–(3), 2-316(1) (2004).

159. Even though the theory's rebuttable presumption considers the relative

"very broad warranty" and negation of disclaimers[160] stand contrary to well-established legal principles by substantially limiting freedom of contract.[161]

This limitation creates equally substantial policy concerns. The theory will increase the cost of insurance premiums for sellers, which will result in higher prices for buyers or even merchant insolvency.[162] Most notably, the Maastricht Fair and the Grosvenor House Fair have met with disparate results.[163] The Grosvenor House Fair, after seventy-five years

knowledge of the parties, *see* Singer, *supra* note 1, at 453–54, it does not add anything to a breach of warranty claim. *See* U.C.C. § 2-313 cmt. 10 (2004) ("Concerning affirmations of value or a seller's opinion or commendation under subsection (3), the basic question remains the same: What statements of the seller have become part of the basis of the bargain? As indicated above, *all of the statements of the seller do so unless good reason is shown to the contrary*.") (emphasis added). *But see* Balog v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556, 1565 (D. Haw. 1990) (pointing to superior expertise of art seller when discussing reliance); De Sewhanberg v. Buchanan, (1832) 172 Eng. Rep. 1004, 1005 (noting relative knowledge when discussing reliance). Applying the presumption even when "attribution was consistent with generally accepted opinion and authenticating standards," Singer, *supra* note 1, at 454, also does not supplement protection since a warranty claim does not necessitate proof of standard of care, or of negligent intent, or of any intent generally. *See* U.C.C. § 2-313(3) (2004); CHIRELSTEIN, *supra* note 44, at 176.

160. Singer, *supra* note 1, at 454.

161. *See* U.C.C. § 2-316 (allowing specific disclaimers of express warranties); *see also* § 2-313 cmt. 6 ("[T]he whole purpose of the law of warranty is to determine what it is the seller has in essence agreed to sell . . . ."). The same can be said for its mandatory imposition of "rigorous attribution standards." Singer, *supra* note 1, at 454. With respect to the negotiations themselves, the limitation on freedom of contract for buyers under both the strict and quasi-strict liability theories appears minor in the auction house setting since these transactions are governed by the Conditions of Sale and buyers only negotiate price. *See, e.g.*, Krahmer v. Christie's Inc., 903 A.2d 773, 781 (Del. Ch. 2006) (buyer control over bid price); RESTATEMENT (SECOND) OF CONTRACTS § 28(2) (1981) (bid terms set by publications of which bidders are or should be aware). Yet the limitation has substantial implications for buyers due to the fact that auction houses often set minimum bid prices, *see* Olsoff, *supra* note 1, § 11.01[B][2][a], at 902, and the theories will generate significant price increases. *See supra* notes 155–156 and accompanying text; *infra* notes 162–166 and accompanying text.

162. *See* Singer, *supra* note 1, at 453 (quasi-strict liability results in higher insurance premiums with costs spread among consumers); *see also* Jauregui, *supra* note 4, at 2024–27 (cost spreading to buyers in both quasi-strict liability and strict liability theories); *cf.* Gerstenblith, *supra* note 1, at 562 (cost allocation to buyers under strict liability theory). Scholars assert that the fairs providing the guarantee offset the higher insurance costs with admission ticket revenues. *See* Singer, *supra* note 1, at 454 n.104; Jauregui, *supra* note 4, at 2027. Yet it is reasonable to infer that costs are also offset by artwork transactions since these merchants receive the highest prices. Jauregui, *supra* note 4, at 2026. Though ascertaining the exact mechanisms of allocation is impossible without opening up the books of the merchants, it is clear that the theory does not work for all merchants in practice.

163. *Compare* Roger Webster & Jason Grant, *The European Fine Art Fair a*

of setting the standard for elegance and excellence, closed its doors in 2009[164] primarily because of insurance costs.[165] If voluntary adherence to these standards was impossible for a world-renowned fair, their involuntary application will bring down smaller, lesser-known merchants.[166]

## VI. SECURITIES LAWS PROVIDE MARGINAL PROTECTION AND WILL DISRUPT THE ART MARKET

In most situations, securities regulations fair no better. A typical art transaction is not likely to constitute a "security."[167] Even if an art sale were a "security," section 10(b) would only provide marginal protection to buyers on account of its statute of repose and reckless intent standard.[168] Moreover, the inclusion of art in the definition of a "security" will generate illiquidity.[169]

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*Smashing Success!*, HAMPTONS, Mar. 18, 2010, http://www.hamptons.com/The-Arts/Top-Stories/10306/The-European-Fine-Art-Fair-A-Smashing-Success.html, *with* Deidre Willar, *Grosevnor House Antiques Fair Shuts Down*, LUXIST, July 1, 2009, http://www.luxist.com/2009/07/01/grosvenor-house-antiques-fair-shuts-down/. The Maastricht Fair continues to guarantee the authentication of some of the world's most impressive pieces, *see* Webster & Grant, *supra*, pursuant to its exemplary vetting process. *See Buying with Confidence: Vetting*, TEFAF MAASTRICHT, www.tefaf.com (click on "About TEFAF" then "Buying With Confidence") (last visited March 28, 2010).

164. Press Release, The Grosvenor House, The Grosvenor House Art & Antiques Fair Comes To An End After 75 Glorious Years (June 30, 2009), http://www.grosvenor-antiquesfair.co.uk/fair_closure.html. The Chairman of the Fair was very candid regarding the economic nature of the closure when he publicly stated: "I quite understand that it no longer makes financial sense to continue the Fair." *Id.*

165. *See* Willar, *supra* note 163 (main reason for closure was rising cost of insurance); *see also* note 155. Of course, the Grosvenor House's inability to pay its insurance premiums or to remain operational raises the question of who will now guarantee authenticity for its past transactions. *See id.* In other words, buyers ought to be concerned with the insolvency of their merchants. *See id.*

166. At the bottom of this "slippery slope" is the elimination of middle markets where merchants providing limited warranties or mid-level vetting evaporate and only buyers that can afford to fly to Europe to shop at Maastricht have access to authenticated art. *See* William W. Stuart, *Authenticity of Authorship and the Auction Market*, 54 ME. L. REV. 71, 83–93 (2002) (contrasting sale conditions at large and small auction houses).

167. *See infra* Part VI.A.

168. *See infra* Part VI.B.

169. *See infra* Part VI.C.

### *A. Arguing Art Is a "Security" Is Difficult for the Typical Art Transaction*

The ordinary sale of art is not likely to constitute an "investment contract" under the *Howey* test, which requires an "investment" in a "common enterprise" where the purchaser expects profits from the "efforts of others."[170] An art sale may fail the first prong of *Howey* because an "investment" ordinarily precludes consumer goods.[171] The typical art sale would also not be a "common enterprise" under "horizontal commonality" or "strict vertical commonality."[172] Success in a "broad vertical commonality"[173] jurisdiction would still depend on the unlikely consideration of substantially pre-purchase "efforts of others" and a derivation of value from past occurrences.[174] Further, a court may even find art is not an "investment contract" without ever applying *Howey* because it "does not fall within the ordinary concept of a security."[175] This analysis, however, does not extend beyond the scope of an ordinary art sale.[176]

The ordinary sale of art is not likely to constitute an "investment." The purchase of real or personal property for

170. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 298 (1946). Since "art" is not listed under the definition of "security" in either the '33 Act or the '34 Act, *see* 15 U.S.C. § 77b(a)(1) (2006); *id.* § 78c(10), it may only constitute a "security" under the term "investment contract" in both acts. *See Howey*, 328 U.S. at 298. Courts have found an "investment contract" in arrangements involving personal property that would ordinarily be a less likely candidate for a "security" than artwork. *See, e.g.*, Miller v. Cent. Chinchilla Grp., Inc., 494 F.2d 414, 417–18 (8th Cir. 1974) (*Howey* test finds an arrangement involving the sale of chinchillas to constitute an "investment contract").

171. *See* Hous. Found., Inc. v. Forman, 421 U.S. 837, 858 (1975); Hocking v. Dubois, 885 F.2d 1449, 1462 (9th Cir. 1989) (en banc); Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994); Wals v. Fox Hills Dev. Corp., 24 F.3d 1016, 1019 (7th Cir. 1994).

172. *See* 2 LOUIS LOSS ET AL., SECURITIES REGULATION 932–36 (4th ed. 2006) [hereinafter 2 LOSS] (discussing the three types of "commonality" capable of satisfying the "common enterprise" requirement).

173. *See id.* at 934 (defining "broad vertical commonality").

174. *Compare* SEC v. Life Partners, Inc., 87 F.3d 536, 547–48 (D.C. Cir. 1996) (substantially pre-purchase "efforts of others" do not qualify), *with* SEC v. Mut. Benefits Corp., 408 F.3d 737, 744 (11th Cir. 2005) (considering substantially pre-purchase "efforts of others") (citing *Life Partners*, 87 F.3d at 551 (Wald, J., dissenting)). *See also* Gary Plastic Packaging Corp. v. Merrill Lynch, Inc., 756 F.2d 230 (2d Cir. 1985) (secondary market-making "efforts" relate to on-going and future occurrences).

175. Marine Bank v. Weaver, 455 U.S. 551, 559 (1982) (quoting Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 556 (1979)).

176. *But see, e.g.*, Landreth Timber Co. v. Landreth, 471 U.S. 681, 697–98 (1985) (*Howey* is unnecessary when instrument possesses normal attributes of a "stock").

consumption does not satisfy the first prong of *Howey*[177] unless the primary purpose of the transaction is an "investment."[178] The test for the primary purpose of the transaction is usually objective and therefore focuses on the conduct of the promoter and the manner of the offering.[179] Irrespective of the means of evaluating investment intent, courts may very well require a pooling of funds from the arrangement in order to transform the purchase of property otherwise associated with consumption into an "investment."[180]

The typical art sale is not likely to become an "investment." The aesthetic value of art is undeniable and the motivation behind an ordinary art transaction is primarily consumption and secondarily "investment."[181] Under an objective analysis,[182] the conduct of established art merchants is likely to reflect this priority of motivations

177. *See Forman*, 421 U.S. at 858 (no "investment contract" for sale of stock in residential co-op).

178. *See* Hocking v. Dubois, 885 F.2d 1449, 1455, 1462 (9th Cir. 1989) (en banc) ("investment contract" for sale of vacation condominium promising rental income).

179. *See, e.g.*, Teague v. Bakker, No. 96-2186, 1998 U.S. App. LEXIS 7079, at *8 (4th Cir. Apr. 8, 1998) (per curiam) ("The proper focus of the inquiry is on the transaction itself and the manner in which it is offered."), *reprinted in* [1998] Fed. Sec. L. Rep. (CCH) ¶ 90, 182, at 90, 630. Subjective intent, however, can be evidence of the objective intent. *See id.*; *see also Hocking*, 885 F.2d at 1453 (Plaintiff testifies that "but for" promise of rental profits he would not have entered the agreement). Nevertheless, the offering must clearly display investment as its primary purpose. *See, e.g.*, SEC v. Brigadoon Scotch Distribs., 388 F. Supp. 1288 (S.D.N.Y. 1988) (advertisements for rare coins in airplane magazines routinely referred to the opportunity as an investment and compared coin growth to stock market growth).

180. *See Hocking*, 885 F.2d at 1462 (pooling of rental income). While *Hocking* did not expressly hold a profit pooling arrangement was necessary for a consumption purchase to become an "investment," the case involved a pooling arrangement. *See id.* Moreover, courts assessing cases on similar facts declined to find "investment contracts" absent rental pooling arrangements. *See, e.g.*, Wals v. Fox Hills Dev. Corp., 24 F.3d 1016, 1019 (7th Cir. 1994) (pooling of rents without pooling of rental profits does not satisfy vertical commonality requirement). Pooling appears to speak more directly to the commonality requirement, but it remains critical in the consumption versus investment analysis because jurisdictions that have yet to definitively adopt either horizontal or vertical commonality use one or the other to knock out consumption purchases without fund pooling. *See, e.g.*, Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994) (lack of rental pooling fails horizontal commonality); Mechigian v. Art Capital Corp., 612 F. Supp. 1421, 1426 (S.D.N.Y 1985) (Second Circuit has not decided on horizontal or vertical commonality).

181. DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1 (art historically purchased for enjoyment and concept of investing in art initially greeted with controversy).

182. *See, e.g.*, *Teague*, 1998 U.S. App. LEXIS 7079, at *8, *reprinted in* [1998] Fed. Sec. L. Rep. (CCH) ¶ 90, 182, at 90, 630.

because the analysis requires a relatively untoward display of investment promotion[183] and the art community has historically shunned the purchase of art purely for investment.[184] Even with a primary motivation of investment, the secondary presence of consumption property may very well require a pooling arrangement,[185] which cannot exist in the usual art sale conveying full title to a single purchaser.[186]

For similar reasons, the sale of art requires the application of "broad vertical commonality" in order to satisfy the "common enterprise requirement." Lower courts[187] vary in

183. *See, e.g.*, *Brigadoon Scotch Distribs.*, 388 F. Supp. 1288 (rare coin advertisements in airplane magazines routinely referred to the opportunity as an investment and compared coin growth to stock market growth).

184. DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1. *But see id.* at J-28 (some merchants tout ability to create secondary markets); Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 145–46 (7th Cir. 1984) (plaintiff alleges art gallery promoted investment value of art, ability to create secondary market, and a re-purchase plan). Nevertheless, *Stenger* would still not pass objective review because the facts indicate that the plaintiff approached the art gallery looking for an investment and galleries typically do not even make an "offer." *See id.*; RESTATEMENT (SECOND) OF CONTRACTS § 26 cmt b. (1981) (advertisements of goods not ordinarily intended or understood to be offers even when stating terms of suggested bargains in detail); *infra* note 218 and accompanying text. Even under a subjective analysis, the motivation for an ordinary art buyer is likely to involve some combination of consumption and investment on account of the aesthetic value of art. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1; *Hocking*, 885 F.2d at 1453 (plaintiff testifies that "but for" promise of rental profits he would not have entered the agreement). *But see Stenger*, 741 F.2d at 145–46 (plaintiff alleges he approached art gallery with purely investment intent). Nevertheless, the success of allegations comparable to the facts in the *Stenger* pleadings is questionable since the court assumed their truth pursuant to appellate review of a dismissal and a jury may not find them credible. *See id.* Of course, a jury may find such allegations more credible when dealing with certain works by Picasso, which can have exceptional investment potential yet substantially lack aesthetic value. *See, e.g.*, Pablo Picasso, *Man with a Lollipop* (1938). *But see* Pablo Picasso, *Standing Nude* (1907).

185. *See, e.g.*, Revak v. SEC Realty Corp., 18 F.3d 81, 88 (2d Cir. 1994) (lack of rental pooling fails horizontal commonality); Mechigian v. Art Capital Corp., 612 F. Supp. 1421, 1426 (S.D.N.Y 1985) (Second Circuit has not decided on horizontal or vertical commonality); *see also* case analysis *supra* note 180.

186. *See, e.g.*, *Christie's Conditions of Sale*, *supra* note 40, at 934 (title passes to buyer upon sale); *Sotheby's Conditions of Sale*, *supra* note 40, at 939 (title passes to buyer upon sale). Here we see our first key difference between the typical transaction in artwork and the chinchilla case. *See* Miller v. Cent. Chinchilla Grp., Inc., 494 F.2d 414, 417–18 (8th Cir. 1974). Most people do not consume chinchillas (at least not in the traditional sense of the word) and certainly do not "consume" them in multiple breeding pairs pursuant to a re-purchase plan that pools investor funds. *See id.* at 415.

187. The Supreme Court has not specified the manner for meeting the "common enterprise" requirement. *See* Mark J. Loewenstein, *The Supreme Court, Rule 10b-5 and the Federalization of Corporate Law*, 39 IND. L. REV. 17, 37 (2005) (arguing the Court punted on the opportunity to specify the requirement in SEC v. Edwards, 540

requiring either "horizontal commonality,"[188] "strict vertical commonality,"[189] or "broad vertical commonality."[190] While "horizontal commonality" requires a pooling of investor funds[191] and cannot exist with a single investor,[192] "strict vertical commonality" requires a sharing of the risks and rewards among promoters and investors.[193] "Broad vertical commonality," however, merely needs a connection between promoter expertise and the gain or loss of the investment.[194]

Art sales are only likely to meet this lower standard. The typical art transaction does not satisfy "horizontal commonality" or "strict vertical commonality" because it conveys full ownership to a single buyer[195] and therefore involves neither a pooling of investor funds[196] nor a sharing of the risks and returns among promoters and investors.[197] An ordinary art sale can meet "broad vertical commonality," however, because the merchant's authentication expertise is connected to a work's growth potential.[198] Yet courts have

U.S. 389 (2004)). This lack of specification gives lower courts a variety of tools for fighting securities fraud. *See Mechigian*, 612 F. Supp. at 1426 (horizontal or vertical commonality available in Second Circuit). The flexibility may indicate an intentional oversight of the Court as the requirement has remained unspecified for over sixty-five years. *See generally* SEC v. W.J. Howey Co., 328 U.S. 293 (1946).

188. *See* 2 LOSS, *supra* note 172, at 932 (discussing "horizontal commonality").

189. *See id.* at 936 (discussing "strict vertical commonality").

190. *See id.* at 934 (discussing "broad vertical commonality").

191. *Id.* at 931–33. They may also include investment schemes. *Id.* at 932 n.134 (citing SEC v. SG Ltd., 265 F.3d 42, 49–51 (1st Cir. 2001) (endorsing the SEC's suggestion that Ponzi schemes satisfy horizontal commonality)).

192. *Id.* at 933 (citing Milnarik v. M-S Commodities, Inc., 457 F.2d 274, 276–77 (7th Cir. 1972)); *see also* Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 146–47 (7th Cir. 1984) (discussing "horizontal commonality").

193. *See* 2 LOSS, *supra* note 172, at 936–38 (citing Brodt v. Bache & Co., Inc., 595 F.2d 459, 460–61 (9th Cir. 1978)); *see also* Mechigian v. Art Capital Corp., 612 F. Supp. 1421, 1427–28 (S.D.N.Y 1985) (discussing "strict vertical commonality").

194. *See* 2 LOSS, *supra* note 172, at 934–35 (citing SEC v. Cont'l Commodities Corp., 497 F.2d 516, 521–23 (5th Cir. 1974)) *see also Mechigian*, 612 F. Supp. at 1427–28 (dicta analyzing hypothetical result under "broad vertical commonality").

195. *See, e.g.*, *Christie's Conditions of Sale*, *supra* note 40, at 934 (title to the auctioned lot passes to buyer upon sale); *Sotheby's Conditions of Sale*, *supra* note 40, at 939 (title to the auctioned lot passes to buyer upon sale).

196. *See* 2 LOSS, *supra* note 172, at 931–33; *see also Stenger*, 741 F.2d at 147 (transaction in artwork fails "horizontal commonality").

197. *Id.* at 936–38; *see also Mechigian*, 612 F. Supp. at 1427–28 (sale of art printing plate fails "strict vertical commonality"). Here we see the second key difference from the chinchilla case, which involved the pooling of funds via a pyramid scheme. *See* Miller v. Cent. Chinchilla Grp., Inc., 494 F.2d 414, 415 (8th Cir. 1974).

198. *See Mechigian*, 612 F. Supp. at 1427–28 (dicta indicating sale of art printing plate may satisfy "broad vertical commonality"); *e.g.*, Levy, *supra* note 3, § 10.02[A], at

thus far declined to apply "broad vertical commonality" to mistaken authentication claims in art transactions.[199]

Assuming judicial application of "broad vertical commonality," an art sale may still fail the "efforts of others" prong depending on how the jurisdiction handles pre-purchase activities. In *SEC v. Life Partners, Inc.*, the D.C. Circuit excluded viaticals from the term "investment contract" since the "efforts of others" occurred primarily before the transactions.[200] In *SEC v. Mutual Benefits Corp.*, on the other hand, the Eleventh Circuit held that viaticals fall under the term "investment contract" notwithstanding their substantially pre-purchase "efforts of others."[201] The argument therefore depends on the jurisdictional view regarding substantially pre-purchase activities.

The choice of jurisdiction or judge could be fatal to the argument that an art transaction satisfies the "efforts of others" requirement. A judge or jurisdiction that does not consider substantially pre-purchase efforts would decline to allow authentication to meet this requirement[202] since art valuation generally occurs prior to sale.[203] Such a jurisdiction would make post-purchase merchant activities, like creating secondary markets, a threshold requirement.[204] Absent such post-purchase activities, the case would need to be in a jurisdiction or before a judge that allows predominately pre-purchase activities to constitute "efforts of others."[205]

834 (authentication important for appraisal).

199. *See Stenger*, 741 F.2d at 147 (art transaction does not pass "horizontal commonality" and dicta indicates that it would not pass "vertical commonality"); *Mechigian*, 612 F. Supp. at 1427–28 (printing plate fails "strict vertical commonality").

200. 87 F.3d 536, 547–48 (D.C. Cir. 1996).

201. 408 F.3d 737, 744 (11th Cir. 2005) (citing *Life Partners*, 87 F.3d at 551 (Wald, J., dissenting)).

202. *See Life Partners*, 87 F.3d at 547–48 (profit generation substantially from pre-purchase activities does not satisfy the "efforts of others" prong).

203. *See, e.g.*, Dawson v. G. Malina, Inc., 463 F. Supp. 461, 468 (S.D.N.Y. 1978) (authentication occurred prior to sale).

204. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at J-28 (some merchants tout ability to create secondary markets). Moreover, their sales pitch may have to be overwhelmingly focused on the promotion of secondary markets, which is unlikely to occur with more respectable art merchants. *See supra* note 183 and accompanying text.

205. *See, e.g.*, *Mut. Benefits Corp.*, 408 F.3d at 744. Here we see the third critical distinction from the chinchilla case since it was the post-purchase "efforts" of the buy-back provision that the seller's alleged would generate profits. *See* Miller v. Cent. Chinchilla Grp., Inc., 494 F.2d 414, 415 (8th Cir. 1974). Apparently, chinchillas are much more difficult to raise than the sellers originally proposed. *Id.*

Even with secondary market creation or jurisdictional consideration of pre-purchase activities, art is not likely to satisfy this prong on account of an implied requirement that the value of the efforts primarily depends on future occurrences or on-going conduct.[206] The *Mutual Benefits* court considered pre-purchase activities, but their value depended primarily on the timing of future events.[207] Similarly, the Second Circuit in *Gary Plastic Packaging Corp. v. Merrill Lynch, Inc.* held that promoter creation of a secondary market constituted "efforts of others,"[208] but its value derived from the on-going negotiation of favorable interest rates and the future re-purchase option without redemption fees.[209] Further, its value primarily derived from these activities because the lower interest rates and the ability to circumvent federally mandated early redemption fees served to entice investment in the program over direct purchase of the products.[210]

Ordinary art sales are not capable of meeting these implied requirements. Unlike the pre-purchase activities in *Mutual Benefits*, the authentication efforts of art merchants relate to authorship and provenance and therefore derive their value from past occurrences.[211] Like *Gary Plastic*, art merchant creation of secondary markets relates to on-going or future activities since it involves their ability to resell or

206. *See Mut. Benefits Corp.*, 408 F.3d at 744; Gary Plastic Packaging Corp. v. Merrill Lynch, Inc., 756 F.2d 230, 233, 240–41 (2d Cir. 1985).

207. *Mut. Benefits Corp.*, 408 F.3d at 744. The pre-purchase efforts of the promoters in the *Mutual Benefits* case included the viatical valuation and selection based on the probable aggregate cost of insurance premiums contingent on the future timing of the policy benefit. *Id.*

208. *Gary Plastic*, 756 F.2d at 240–41.

209. *Id.* at 233, 240–41.

210. S*ee id.* The *Gary Plastic* products were CDs. *Id.* at 233. The promoter's market presence and bulk purchasing allowed lower interest rates over an individual transaction directly from a bank. *Id.* at 233, 240–41. The option of the investor to mandate promoter buy-back prior to maturity circumvented early redemption fees set by federal banking laws. *Id.* These factors enticed investment in the program over direct purchase from banks. *Id.* In other words, the value of the investment depended on the fungibility of the products. *See id.* Additionally, all of the cases involved the pooling of investor funds. S*ee id.* at 235; *Mut. Benefits Corp.*, 408 F.3d at 743 n.4. The *Mutual Benefits* case clearly satisfied both horizontal and vertical commonality. *Id.*

211. *See* Levy, *supra* note 3, at 847–48 (discussing methods of authenticating artwork and the effect of authenticity in the appraisal process); *see also* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-168 (inauthentic copy of Picasso's *Boy with a Pipe* sells for $2500 and original sells for $104 million); Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 821 (E.D. Pa. 1987) (reattribution drops market value of painting from $500,000 to $50,000 in the 1980's).

repurchase the work.[212] However, the distinguishing feature of an ordinary art transaction is that it still primarily derives its value from past occurrences because merchant ability to re-sell or desire to repurchase evaporates in the event of a mistake in authentication.[213]

A court may even refuse to apply the *Howey* test from the outset. In *Marine Bank v. Weaver*, the United States Supreme Court opted not to apply *Howey* to a bi-lateral privately negotiated transaction.[214] The Court pointed to the fact that the transactions in question involved neither offers nor sales to multiple people.[215] The Court also noted the transaction involved an instrument that was not fungible nor designed to be publicly traded.[216] Instead of applying *Howey*, the Court relied on these factors to reason that the transaction did "not fall within the ordinary concept of a security."[217]

The typical art transaction also involves a bi-lateral privately negotiated agreement. A transaction with a dealer[218] or an auction house via reserve bidding does not involve offers to multiple people nor even offers at all.[219]

212. *See* Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 145–46 (7th Cir. 1984) (allegations of gallery promotion of secondary market-making and a re-purchase plan).

213. *See, e.g.*, Rosen v. Spanierman, 894 F.2d 28, 30 (2d Cir. 1990) (purchase of painting from dealer that later turns out to be fake precludes resale at auction house). The creation of secondary markets is also not comparable to the mandatory buy-back option in *Gary Plastic* because a buyer may acquire profits on the secondary market independent of the promoter efforts and a unique piece of artwork is not fungible. *See Stenger*, 741 F.2d at 147. Additionally, a pooling arrangement cannot exist in the usual art transaction conveying full title to a single purchaser. *See, e.g.*, *Christie's Conditions of Sale*, *supra* note 40, at 934; *Sotheby's Conditions of Sale*, *supra* note 40, at 939. For all of these reasons, a court may simply decline to apply the *Howey* test in the first place.

214. 455 U.S. 551, 559–60 (1982).

215. *Id.* at 560.

216. *Id.*

217. *Id.* at 559 (quoting Int'l Bhd. of Teamsters v. Daniel, 439 U.S. 551, 556 (1979)).

218. *See* RESTATEMENT (SECOND) OF CONTRACTS § 26 cmt b. (1981) ("Advertisements of goods by display, sign, handbill, newspaper, radio or television are not ordinarily intended or understood to be offers. The same is true of catalogues, prices lists, circulars, even though the terms of suggested bargains may be stated in some detail.")

219. *See id.* § 28 cmt. b (an auctioneer excepting bids with reserve is requesting "that the bidders make offers to him, as indeed he frequently states in his remarks to those before him"). Most auction house sales are with reserve. *See id.* § 28(1)(a) (auction is with reserve "unless a contrary intention is manifested"); *see Christie's Conditions of Sale*, *supra* note 40, at 934 (Christie's reserves bids); *Sotheby's Conditions of Sale*, *supra* note 40, at 938 (Sotheby's reserves bids). The buyer then is

While bidding without reserve may constitute a public offering,[220] the end result of all of the transaction types is full conveyance of a good to a single purchaser.[221] An original work of art is neither fungible nor designed to be publicly traded.[222]

This analysis is of course limited to the ordinary art transaction that primarily derives its value from authentication. An arrangement that meets the elements of *Howey* or that possesses all of the attributes of other regulated instruments may constitute a "security."[223] *Howey* itself involved an appreciable asset, but the value of the "investment contract" derived from the on-going and future management efforts of the promoters.[224] Additionally, the Supreme Court held in *Landreth Timber Co. v. Landreth* that the *Howey* test is unnecessary for instruments that possess all of the attributes of a "stock."[225]

The analysis does not cover arrangements falling outside the scope of the ordinary art transaction, which may either

negotiating price based on the Conditions of Sale and the relative value of the artwork. *See* Krahmer v. Christie's Inc., 903 A.2d 773, 781 (Del. Ch. 2006) (buyer at auction negotiates price through competitive bidding).

220. *See* RESTATEMENT (SECOND) OF CONTRACTS § 28(1)(b) (An auctioneer accepting bids without reserve "makes an offer to sell at any price bid by the highest bidder . . ."); *see also* U.C.C. § 2-328 (2004) (auction sale complete upon fall of the hammer). The Dutch Auction method for securities sales is similar to bidding without reserve since in each method the highest bidder(s) win(s). *See* § 28(1)(b); 1 LOSS, *supra* note 103, at 569–71.

221. *See, e.g.*, *Christie's Conditions of Sale*, *supra* note 40, at 934 (title passes to buyer upon sale). The Dutch Auction method for selling securities is therefore distinguishable because it typically involves the sale of multiple fungible instruments to several institutional purchasers. 1 LOSS, *supra* note 103, at 569–71. Under the Dutch method, sales are made to the top bidders covering the desired quantity of all of the securities in the offering at the lowest price offered among these bidders. *See id.* The method was recently used in the IPO for Google. *Id.* at 570.

222. *See, e.g.*, DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1 (discussing aesthetic value of art); *id.* at K-168 (inauthentic copy of Picasso's *Boy with a Pipe* sells for $2500 and original sells for $104 million). These factors constitute the final distinctions between artwork and the chinchilla case since the latter involved offerings and sales to multiple investors, as well as fungible goods. *See* Miller v. Cent. Chinchilla Grp., Inc., 494 F.2d 414, 417 (8th Cir. 1974). The Chinchilla arrangements were fungible because they "had equivalent values to most persons." *See Marine Bank*, 455 U.S. at 560.

223. *See* SEC v. W.J. Howey Co., 328 U.S. 293, 299–300 (1946) (contrasting purchase of fee simples with investment in management of citrus acreage); Landreth Timber Co. v. Landreth, 471 U.S. 681, 697–98 (1985) (*Howey* is unnecessary when the instrument in question possesses the normal attributes of a stock).

224. *Howey*, 328 U.S. at 299–300.

225. *Landreth,* 471 U.S. at 697–98.

satisfy *Howey* or possess the attributes of a regulated instrument.[226] Assuming an arrangement meets the other elements, it is likely to be an "investment contract" if post-purchase "efforts" create a primary market for a particular piece or collection that otherwise lacks value.[227] Similarly, a "security" is likely to exist via the creation of fungible instruments designed to be publicly traded that derive their value from an art index or via the distribution of shares in a company that invests in artwork.[228] These more sophisticated arrangements may be subject to federal regulation.[229]

### *B. Judicial Application of Securities Laws Provides Marginal Protection*

Even if art constitutes a "security," judicial application of the securities laws will provide limited protection to buyers. The statute of repose associated with section 10(b) would cap the limitations period at five years.[230] Section 10(b) therefore provides the same temporal protection as states adopting the 2004 version of the UCC[231] and less in states with a limitations period greater than five years.[232] Certain

226. *See Howey*, 328 U.S. at 299–300; *Landreth,* 471 U.S. at 697–98.

227. *See Howey*, 328 U.S. at 299–300; A Special Report on the Art Market, *The Pop Master's Highs and Lows*, ECONOMIST, Nov. 26, 2009 (discussing $100 million dollar sale of *Eight Elvises* and describing Warhol as the "bellwether" of the art market). Such works, however, do not otherwise derive their value from the talent of the artist or arguably do not even constitute art. *See id.* (noting *Eight Elvises* is the only work by a pop artist to sell for over $100 million and that a Swiss-based dealer was "the driving force behind *distribution* of Warhol's work" (emphasis added)); Rogers v. Koons, 960 F.2d 301 (2d Cir. 1992) (successful copyright infringement action against another pop artist). If it is not art, then it may be a "security."

228. *See Landreth,* 471 U.S. at 697–98; DUBOFF & HOLT CAPLAN, *supra* note 1, at J-1 to -9 (discussing Mei/Moses Fine Art Index). If it is a security, then it is a "security."

229. For these reasons, many securities law professors liken the definition of a "security" to Justice Stewart's test for obscenity. *See* Jacobellis v. Ohio, 378 U.S. 184, 197 (1964) (Stewart, J., concurring) ("I know it when I see it . . . ."). An ordinary art sale is not a "security" because it is just not obscene enough for federal regulation.

230. *See* 28 U.S.C. § 1658(b)(2) (2006) (section 10(b) "discovery rule" subject to a five-year statute of repose).

231. *See* U.C.C. § 2-725(1) (2004) (adopting "discovery rule" subject to a five-year statute of repose). It would also provide the same temporal protection in states adopting a five-year limitations period. *E.g.*, OKLA. STAT. ANN. tit. 12A, § 2-725(1) (West 2010) (five-year limitations period accrues regardless of knowledge of party).

232. *See* S.C. CODE ANN. § 36-2-725(1) (2010) (six years); WIS. STAT. ANN. § 402.725 (West 2010) (six years). The theory would provide limited additional protection in terms of the time for filing in states where the limitations period is shorter than five years. *E.g.*, COLO. REV. STAT. ANN. §§ 4-2-725(1), 13-80-101(1) (West 2010) (statute of

components of the expansion of liability under section 10(b) are also questionable.[233] The "recklessness" scienter for 10(b) liability is still one of the highest intent standards[234] and a private right of action under section 10(b) requires additional elements to establish a prima facie case.[235]

### *C. Judicial Application of Securities Laws Generates Illiquidity*

In addition to providing limited additional protection, judicial application of the securities laws to transactions in artwork would decrease liquidity and buyer access. A finding that art is a "security" would impose the registration and reporting requirements of the securities laws on a number of transactions in artwork.[236] To the extent art merchants constitute issuers or underwriters,[237] they may be inclined to

limitations for UCC is three years). These states do include New York. *See* N.Y. U.C.C. § 2-725(1)–(2) (McKinney 2011) (four years). Yet the five-year cap may still fail to increase temporal protection in these states since auction houses often provide warranties of five years or more. *See, e.g.*, Krahmer v. Christie's Inc., 903 A.2d 783 (Del. Ch. 2006) (six-year warranty in Christie's auction house sale increases protection of UCC four-year limitations period).

233. Section 10(b) liability for material omissions requires a duty to disclose based on a fiduciary relationship. *See* United States v. Hagan, 521 U.S. 642, 741 (1997). Given the reason for the issuance of securities and the critical distinctions in a securities derivation of value, *see infra* note 253, a court is not likely to find that an art seller has a fiduciary duty or agency relationship with a buyer and therefore would not impose a disclosure duty. *See* Chiarrella v. United States, 445 U.S. 222, 228 (1980) (fiduciary relationship necessary to invoke duty to disclose).

234. *See* RESTATEMENT (SECOND) OF TORTS § 500 (1977) (defining "recklessness"); *see also* Kenneth W. Simmons, *Rethinking Mental States*, 72 B.U. L. REV. 463, 471–72 (1992) ("recklessness" is second most serious mental state in torts); *cf.* MODEL PENAL CODE § 2.02(a)–(d) (1985) (listing the mens rea categories in criminal law). While section 10(b) liability could reduce the intent requirement for fraud, s*ee supra* notes 120–122 and accompanying text, the extent of this reduction would vary by circuit and the Seventh Circuit's more stringent standard of gross recklessness is the majority view. *See* LOSS, FUNDAMENTALS, *supra* note 121, at 1025–26.

235. 8 LOUIS LOSS ET AL., SECURITIES REGULATION 3719–32 (3d ed. 2004) [hereinafter "8 LOSS"]. The additional pleading requirements include proof of standing, reliance, and loss causation. *Id.* Additionally, section 10(b)'s calculation of damages at the time of the action, *see supra* note 122, would not provide additional protection to buyers because it benefits a seller's securities action against a buyer for a material nondisclosure when the stock price undergoes a post-sale increase in value. *See* LOSS, FUNDAMENTALS, *supra* note 121, at 1285–87.

236. *See* 15 U.S.C. § 77e(a)–(c) (2006) (outlawing the sale of any "security" without an effective registration statement).

237. *See supra* note 113 and accompanying text. Section 4(1) exempts from section 5 "transactions by any person other than an issuer, underwriter or dealer." 15 U.S.C. §

sell artworks via "exempted transactions."[238] Buyers would then have to hire securities lawyers upon resale in order to ensure full compliance with the regulations by determining the necessity of filing a registration statement versus seeking an alternate exemption.[239] These requirements may also reduce the access of unsophisticated buyers by creating seller preference for sophisticated or institutional purchasers in order to meet the requirements of a number of "exempted transactions."[240]

Moreover, art authentication methods vary too greatly to adhere to the standardized disclosure requirements of securities laws in particular or standardized requirements generally.[241] The process of due diligence and disclosure for securities primarily involves quantifiable financial information.[242] The methods for examining and disclosing this information are amenable to regulations that require consistent measures.[243] Art authentication methods, on the other hand, range from scientific[244] to stylistic forms and

77d(1) (2006). Since artwork derives its value primarily from authentication, it is to a large extent an analogue to both the issuer and the security, *see infra* notes 253–255 and accompanying text, making its owner a control person under section 2(a)(11). *See* 15 U.S.C. § 77b(a)(11) (2006). As a result, the owner is an issuer and is not exempt under section 4(1). *See id.* This exempted transaction alone highlights the difficulty of applying the securities laws to the typical art sale. *See id.*

238. § 77d(1). There are also "exempted securities," which do not include artwork. *See id.* § 77c(a).

239. *See, e.g.*, 17 C.F.R. § 230.504 (b) (2010) (limited offering exemption requires compliance with Rule 502); *id.* § 230.502(d) (resale of securities typically requires either registration or new exemption). Similarly, the section 4(2) exemption for "private placement" transactions is a fact specific inquiry that does not just depend on the size of the offering. *See, e.g.*, SEC v. Ralston Purina Co., 346 U.S. 119, 124–25 (1953).

240. *E.g.*, 17 C.F.R. § 230.144A(d)(1) (2010) (Rule 144A exemptions require that securities are offered and sold to a "qualified institutional buyer").

241. *E.g.*, 15 U.S.C. § 77e(a)–(c) (2006).

242. *E.g.,* 17 C.F.R. § 210 (2010) (Regulation S–X form and content for financial statement disclosure requirements in a registration statement). Securities may involve due diligence and disclosure of both quantitative and qualitative information, but even this qualitative information typically relates to quantitative financial factors. *E.g.*, *id.* § 229.305 (Regulation S–K quantitative and qualitative disclosures of market risk).

243. *See id.* The fungibility of securities provides for economies of scale not just in a single distribution of securities, but also through multiple distributions of securities in certain instances. *See* LOSS, FUNDAMENTALS, *supra* note 121, at 86 (Rule 415 "shelf registration" generates lower issuer costs and underwriting spreads).

244. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-26 to -48 (describing a host of scientific methods for authenticating art including radiocarbon dating, thermoluminescent analysis, obsidian hydration, analytical reconstruction of manufacturing technologies, microscopic techniques, x-ray diffraction, craquelure, and

expert selection of these methods often depends on the particular piece or its artist.[245] Attribution itself necessarily requires stylistic methods.[246] The flexibility necessary for art authentication and its inherently qualitative attribution process are therefore not amenable to the imposition of standardized requirements.[247]

Art authentication also analyzes information that is temporally distinct from the information associated with securities.[248] The due diligence and disclosure process for securities analyzes and relays information regarding contemporaneous circumstances surrounding an issuer that is well-documented or verifiable.[249] Art authentication analyzes information regarding past occurrences surrounding the piece, including, inter alia, attribution and provenance.[250]

dendrochronology). The scientific measures serve to eliminate inauthentic works of art. *Id.* at K-50.

245. *See id.* at K-49 to -50. Stylistic methods are qualitative in nature as they are all based on some combination of the expert's knowledge, experience, intuition, eye for detail, visual memory, and familiarity with the artist's entire collection. *See id.* at K-49 to -50; *see also* Krahmer v. Christie's Inc., 903 A.2d 773, 776 n.6 (Del. Ch. 2006) (detection of misattribution based on stylistic analysis of paintings subject and artist's signature). The comparison method is considered best practices and relies on these qualitative factors since it involves comparing the most minute details of a piece with those found in an artist's authenticated works. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-50.

246. *See id.* at K-49 to -50. Technically stylistic analysis is the sole means of attributing a piece since scientific methods serve only to verify or discredit an attribution. *Id.* Stylistic methods also compensate for "gray areas" that are otherwise indistinguishable by scientific means, including, inter alia, works produced by multiple artists or by artists and their apprentices. Jauregui, *supra* note 4, at 1960–62.

247. Unlike securities, *see supra* note 243, art authentication also does not often benefit from economies of scale since it typically requires analysis of each piece, *see supra* note 245 and accompanying text, and an auction house can sell hundreds of pieces at a single auction. *See, e.g.*, *Christie's, Fine American Paintings, Drawings and Sculpture*, NEW YORK SALE 2342, Sept. 28, 2010 (proposed sale of 278 lots).

248. *See supra* notes 206–210 and accompanying text.

249. *E.g.*, 17 C.F.R. § 240.15d-11(a)–(c) (2010) (required filing of current reports on Form 8–K); *see also id.* § 240.15d-13(a)–(e) (required filing of quarterly reports on Form 10–Q); *id.* § 229.301(a) (required reporting of financial data for each of last five fiscal years). Even the due diligence and disclosure of information other than that describing an issuer's present financial circumstances often consists of forward looking statements and financial projections. *Id.* § 229.10(b) (SEC policy on forward looking statements). Due diligence and data disclosure in securities primarily involves "known knowns" and secondarily involves "known unknowns." *See* SATYAJIT DAS, TRADERS, GUNS & MONEY: KNOWNS AND UNKNOWNS IN THE DAZZLING WORLD OF DERIVATIVES 12 (2006) (describing the division of data gathering into four categories of "known knowns," "known unknowns," "unknown knowns," and "unknown unknowns").

250. *See* Levy, *supra* note 3, § 10.02[A], at 834 (describing authentication,

Authentication outcomes are inherently speculative for antiquities in particular.[251] The retrospective nature of the authentication process makes it impossible for experts to meet the demands of standardized requirements and precise outcomes akin to those found in securities laws.[252]

The distinction between art authentication and securities underwriting highlights a critical difference between investing in securities and investing in artwork. Securities primarily derive their value from the on-going business activities of the issuer, as well as investor speculation regarding the future of these activities.[253] With respect to authentication, art derives its value primarily from the past occurrences of attribution and provenance.[254] On account of these different perspectives, the methods associated with the respective valuations are simply too disparate for art sales to conform to requirements like those found in securities laws.[255]

attribution, provenance, and appraisal).

251. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-25 (establishing authenticity of aged pieces with 100% certainty "is difficult even under the most favorable circumstances"); *see also* Greenberg Gallery, Inc. v. Bauman, 817 F. Supp. 167, 173 (D.D.C. 1993) (art provenance can range from nearly flawless to highly speculative). Indeed, leading experts and authorities in the world of art law note that it is best to think of authentication in terms of probabilities. *E.g.*, DUBOFF & HOLT CAPLAN, *supra* note 1, at K-25. Art authentication primarily involves "known unknowns" and can often involve "unknown unknowns." *See id*; DAS, *supra* note 249, at 12; *see also* Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467 (S.D.N.Y. 1978) ("[Authenticating] antiquity is by its very nature an inexact science.").

252. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-25; Levy, *supra* note 3, § 10.02[A], at 834; *Dawson*, 463 F. Supp. at 467.

253. STEPHEN A. ROSS ET AL., FUNDAMENTALS OF CORPORATE FINANCE 403 (1st ed. 2006) (discussing price behavior under the efficient market hypothesis). Similarly, in the primary market, an issuer typically offers securities to raise capital for these activities, *see id.* at 525, and in the case of stock the securities holder receives part-ownership in the company, creating an agency relationship. *See id.* at 14.

254. *See* DARRABY *supra* note 1, § 4:19, at 239 ("If on occasion authorship drops out of the bargain, a huge and palpable price differential would be apparent."); *id.* § 2:58, at 88 ("Certain prior owners or events may effectively enhance value by providing the artworks with a cachet."). While it is true that art auction houses tout the ability of art to appreciate in value, other appreciable assets, including real estate, do not fall within the framework of securities laws when they lack a derivation in value from present and future activities of the issuer. *See, e.g.*, SEC v. W.J. Howey Co., 328 U.S. 293, 299–300 (1946) (purchase of fee simples versus investments in management of citrus acreage).

255. In addition to highlighting critical distinctions in authentication and underwriting, these differences also highlight a shortcoming in the analogy of art sales and securities distributions. *See supra* notes 112–116 and accompanying text. The shortcoming is that the issuer must be comparable to both the art seller and the authentication itself. Even the example of securities sold on the secondary market, where the art seller would be analogous to a trader in securities, continues to require

In sum, authentication relies more heavily on an "artistic" touch than the underwriting of securities. Of course, one can be an "artist" at anything.[256] To the extent one may be an artist at both attributing a painting and valuing a security, the former is more comparable to French Impressionism whereas the latter is more comparable to Realism.[257] It would be a mistake to require Monet to draw precise lines and to use basic colors.[258]

## VII. LEGISLATIVE ADOPTION OF FLEXIBLE DISCLOSURE REQUIREMENTS SUPPLEMENTS BUYER PROTECTION AND WILL PROMOTE MORE EFFICIENT PRICING

The better approach is to design a statute tailored to the unique nature of artwork and its market. The legislative adoption of flexible disclosure requirements can increase protection by expanding the filing period and reducing the intent requirement.[259] These changes will minimally disrupt market fundamentals.[260] Further, they will generate a free flow of information that will theoretically enhance the pricing of fine art.[261]

### *A. Flexible Disclosure Requirements Increase Protection*

The legislative adoption of flexible disclosure requirements would successfully provide buyers with additional protection.[262] The statute would require art merchants to

that the art authentication is analogous to the issuer.

256. *See* AMERICAN HERITAGE DICTIONARY OF THE ENGLISH LANGUAGE (4th ed. 2006) (definition of "artist" includes "a person whose work exhibits exceptional skill"); *see also* MAN ON FIRE (Twentieth Century Fox 2004) ("A man can be an artist at anything . . . it depends on how good he is at it").

257. *See* JULES ADELINE & FREDERICK WILLIAM FAIRHOLT, ADELINE'S ART DICTIONARY 209, 331 (1891) (defining "Impressionism" and "Realism"); *see also* Richard Brettell, Lecture One: The Realist and the Idealist (April 2002), *in* FROM MONET TO VAN GOGH: A HISTORY OF IMPRESSIONISM (The Great Courses 2002) (describing difference between Impressionism and Realism within the stylistic climate of the era); Stenger v. R.H. Love Galleries, Inc., 741 F.2d 144, 145 (7th Cir. 1984) ("In a case that we might term one of first Impressionism . . . .").

258. *See Impressions*, *in The Talk of the Town*, NEW YORKER, December 18, 1926, at 23 (noting Monet was widely recognized as the father of Impressionism and discussing his perfection of the style).

259. *See infra* Part VII.A.

260. *See infra* Part VII.B.

261. *See infra* Part VII.C.

262. Auction houses are already familiar with similar statutory requirements as

provide pre-sale written disclosure of the facts associated with the authentication process of each work to its potential buyers.[263] It would cover material misstatements and omissions[264] subject to a "gross negligence" standard and the "discovery rule" with a longer statute of repose.[265] In sum, art merchants would be liable for gross negligence in material misstatements and nondisclosures regarding the process and probability of authentication for an extended time period.[266]

The statute would provide additional protection to buyers that would complement the common law.[267] Disclosure

many key jurisdictions require disclosure of their financial relationship with consignees and reserve bidding techniques. Olsoff, *supra* note 1, § 11.03, app. at 934 (citing New York City Auction Regulations § 2-122(d)). These disclosure requirements are limited to financial arrangements associated with the piece, including guarantees, bidding by consignors, loans and advances, and reserve bidding. *Id.* Yet most state laws exclude auctioneers from disclosure requirements regarding authorship. DARRABY, *supra* note 1, § 5:8, at 295. Similarly, art merchants are not subject to disclosure requirements regarding a piece's provenance. *Id.* § 2:59, at 90. Under current law, the duty to request information regarding authentication assessment is typically placed upon the prospective buyer. *See, e.g.*, *id.* § 2:58, at 88 ("Prospective Buyers should request written disclosure of facts, methods, and procedures, and materials and sources relied upon or referred to by the seller, or used as a basis of the offer and sale.").

263. The duty to disclose would not be conditioned upon a fiduciary or agency relationship and only the actual buyer of a piece would be able to hold sellers liable for non-disclosures. *Cf.* RESTATEMENT (SECOND) OF TORTS § 552(2) (1977) (negligent misrepresentation claim independent of agency relationship limited to specific person(s) and transaction(s)). *But see* Chiarrella v. United States, 445 U.S. 222, 228 (1980) (fiduciary relationship or other relationship of trust necessary to invoke disclosure duty in securities law). The writing containing representations and disclosures should also provide buyers with notice of their rights under the statute, the nature of their relationship with the art merchant, and a recommendation to seek the post-transaction advice of an independent appraiser. One paragraph should suffice.

264. The materiality of the fact would be subject to analysis based at the time of the omission and not the time of its discovery or the time of trial. *Cf.* TSC Indus., Inc. v. Northway, Inc., 426 U.S. 438, 449 (1976).

265. *Cf.* 31 U.S.C.A § 3729(a)(1)(B) (2010) (False Claims Act liability for material false statement); § 3729(a)(1)(G), (b)(3) (False Claims Act liability for knowing non-disclosure and retention of obligation); *id.* § 3731(b)(2) (False Claims Act "discovery rule" subject to a ten-year statute of repose); United States v. Massenburg, No. 2:03-0437, 2004 WL 2370694, at *4 (S.D. W. Va. Oct. 21, 2004) (applying United States v. Krizek, 111 F.3d 934, 941–42 (D.C. Cir. 1997), to interpret "knowingly" under the False Claims Act as equivalent to "gross-negligence-plus"). Legal analysis in this Article assumes a ten-year statute of repose though the exact length of the cap ought to be based on actuarial analysis minimizing the negative impact on pricing. *See infra* note 276.

266. Under a ten-year statute of repose, the filing period would exceed the typical warranty. *See Christie's Conditions of Sale, supra* note 40, at 935–37 (five years); *Sotheby's, Conditions of Sale*, *supra* note 40, at 941–42 (five years).

267. *See* Balog v. Ctr. Art Gallery-Haw., Inc., 745 F. Supp. 1556, 1558–59 (D. Haw.

requirements subject to "gross negligence" would assist in all actions by finding liability for omissions under a low intent standard.[268] Assuming a ten-year statute of repose, the "discovery rule" would prevent the time bar of a number of actions.[269] Cases falling outside protection would either be just outcomes based on common law findings of fact[270] or casualties of a policy that balances both legal principles and market fundamentals.[271]

1990); Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 821 (E.D. Pa. 1987); Dawson v. G. Malina, Inc., 463 F. Supp. 461, 467–71 (S.D.N.Y. 1978). *But see* Wilson v. Hammer, 850 F.2d 3, 5 (1st Cir. 1988); Krahmer v. Christie's Inc., 903 A.2d 773, 778 (Del. Ch. 2006).

268. *E.g.*, *Dawson*, 463 F. Supp. at 468. Since *Dawson* was filed within the breach of warranty limitations period, the disclosure requirements would have provided an alternative pleading. *See id*. The *Dawson* seller's nondisclosure of his means for establishing provenance would have constituted gross negligence for the piece where he relied solely on a photographic comparison to represent that the piece was displayed in the Met. *See id.* Simply contacting the museum revealed that the piece still remained in the possession of the Met. *Id.*

269. *See Balog*, 745 F. Supp. at 1558–59 (filing approximately eight years after last sale); *Firestone*, 672 F. Supp. at 821 (filing a little over five years from time of sale). The disclosure requirements and extended filing period would have benefitted the *Firestone* case because the seller would have been liable if he knew or should have known of the facts relied upon in the scholarly publication reattributing the piece just four years after the sale and failed to disclose them. *See id*. A ten-year cap would not protect all of the *Balog* transactions since the first sale occurred eleven years prior to the filing of the action, but would protect the remaining sales spanning several years. *See Balog*, 745 F. Supp. at 1558–59. Additionally, *Balog* had a strong case for common law fraud and the evidence of fraudulent concealment tolled the UCC statute of limitations in the actual holding. *Id.* at 1572–73.

270. *See, e.g.*, Greenberg Gallery, Inc. v. Bauman, 817 F. Supp. 167, 169–71 (D.D.C. 1993) (no liability when plaintiff damage to piece in transit likely caused evidence alleged in support of misattribution); *see also Dawson*, 463 F. Supp. at 467–71 (no liability for piece where all experts agreed upon authenticity). Assuming sufficient evidence of fraudulent intent on remand, the *Rosen* case would fall under this category since the Second Circuit indicated that the "discovery rule" would toll the fraud claim. Rosen v. Spanierman, 894 F.2d 28, 36 n.2 (2d Cir. 1990).

271. *See Wilson*, 850 F.2d at 5 (action brought twenty-six years after sale); *Krahmer*, 903 A.2d at 778 (action brought eighteen years after sale); *see also Rosen*, 894 F.2d at 30 (action filed eighteen years after sale). Yet even these cases could have benefitted from the statutorily required notice, which may have induced the buyers to acquire independent appraisers within the statute of repose. *See, e.g.*, *id.* at 32 ("Requiring a purchaser to obtain [an] appraisal from an expert other than the seller is not an onerous burden."); *Wilson*, 850 F.2d at 7 ("[Plaintiffs] easily could have discovered the problem from the outset by means of a second expert opinion."). In each of these cases, the first independent appraiser retained by the buyers suspected a mistake in authentication. *Rosen*, 894 F.2d at 36 at 30; *Wilson*, 850 F.2d at 4; *Krahmer*, 903 A.2d at 776. This fact is particularly relevant in the *Rosen* and *Krahmer* cases where the buyers sought the first appraisal of the sellers within seven and four years of the transactions, respectively. *See Rosen*, 894 F.2d at 30; *Krahmer*, 903 A.2d at 775. The

### *B. Flexible Disclosure Requirements Minimally Disrupt Market Fundamentals*

The added protection will be minimally disruptive of well-established legal principles. The statute minimizes any conflict of interest associated with a disclosure duty because it does not impose an agency or fiduciary relationship in the absence of agent assent to principal control.[272] It also minimizes any limitation on the freedom of contract of the parties because it does not negate all disclaimers.[273] Instead, the theory balances a duty to disclose and a lower intent requirement with an extended filing period subject to an intermediate statute of repose.[274]

This balance results in a less substantial disruption of the market in the form of decreased access and liquidity.[275] The

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statute would also provide the benefit of allowing buyers to make this decision in light of the post-sale appreciation of a given piece of art. *See, e.g.*, *Rosen*, 894 F.2d at 30 (seller appraised piece at over ten times the initial purchase price within seven years of the transaction); *Krahmer*, 903 A.2d at 775 (seller appraised piece at more than double the purchase price within four years of sale). Stated with less naivety, buyers suspecting that sellers are inflating post-sale appraisals will often still have time to consult an independent expert and file an action if necessary. *See Rosen*, 894 F.2d at 30; *Krahmer*, 903 A.2d at 775. Nevertheless, the *Wilson* plaintiffs could have still benefitted from the disclosure requirements since their negligence claim was dismissed for want of a fiduciary relationship and the statutory requirement to suggest consultation with an independent appraiser may have encouraged a timelier filing of the action. *See Wilson*, 850 F.2d at 9 (distinguishing negligence claim from legal malpractice claim invoking fiduciary duties); *supra* note 263.

272. *See* RESTATEMENT (THIRD) OF AGENCY § 8.11 cmt. b (2006) (agent duty to disclose associated with agent assent to principal control). Admittedly, the statute expands liability by covering omissions without requiring the specific intent or the special relationship of trust necessary in a fraud action. *Contra* RESTATEMENT (SECOND) OF TORTS §§ 526, 528–529, 550–551 (1977). Yet the statute of repose bridles this leniency. *See supra* notes 265, 269 and accompanying text.

273. *See* U.C.C. § 2-316(1) (2004). *But see Balog*, 745 F. Supp. at 1569–72 (authentication automatically constitutes an express warranty of future performance under UCC § 2-725(2) even absent explicit wording of seller). The disclosure requirements do restrict freedom of contract by not relying on the typical requirements of privity for a professional negligence claim and a limitation of the duty to the client for a negligent performance of contract action. *See* FEINMAN *supra* note 147, at 31, 62 n.12. (privity in negligence action and limitation of duty element to client in claim for negligent performance of contract). Yet the heightened gross negligence standard bridles this restriction on freedom of contract. *See supra* notes 265, 268 and accompanying text.

274. *Cf.* 31 U.S.C. § 3729(a)(1)(B), (G) (2006); § 3729(b)(3); *id.* § 3731(b)(2); United States v. Massenburg, No. 2:03-0437, 2004 WL 2370694, at *4 (S.D. W. Va. Oct. 21, 2004).

275. *But cf. Balog*, 745 F. Supp. at 1569–72. In practice, the *Balog* decision as a

balance generates a smaller allocation of costs onto buyers as a consequence of mandatory legal requirements, which corresponds to a smaller increase in prices, a smaller decrease in buyer access, and a smaller increase in illiquidity.[276] Art merchants would be entitled to make business decisions about representations and disclosures for each piece[277] and buyers would be free to negotiate the terms of the contract depending on this information.[278] The market would continue to allocate a significant share of the risk.[279]

### C. *Flexible Disclosure Requirements Promote Efficient Pricing*

The statute would also enhance this market allocation of risk by promoting more efficient prices. The threat of litigation would encourage art merchants to engage in greater disclosure and more accurate representations regarding the process and probability of authentication for any given work of art.[280] Access to more complete and accurate information

whole may not generate extreme results for several reasons, including, inter alia, its adoption of a "reasonable basis in fact" inquiry. *See id.* at 1566. To test this hypothesis in particular, a case with the facts of *Firestone* would have to be brought in such a jurisdiction. *See* Firestone & Parson, Inc. v. Union League of Phila., 672 F. Supp. 819, 820–21 (E.D. Pa. 1987) (post-sale reattribution via art scholar publication); *Balog*, 745 F. Supp. at 1566 ("reasonable basis in fact"); *Dawson*, 463 F. Supp. at 467 ("reasonable basis in fact"); *supra* note 145.

276. *See* WESSELS, *supra* note 155, at 114 (aggregate demand decreases when price level rises). Actuarial analysis should thus determine the exact length of the statute of repose in order to minimize a negative impact on pricing by considering the costs associated with the probability and volume of additional litigation under the statute.

277. *Cf.* U.C.C. § 2-313 cmt. 6 (2004) ("[T]he whole purpose of the law of warranty is to determine what it is the seller has in essence agreed to sell . . . ."). These decisions would balance the desire to sell with the probability of authentication and the risk of liability. *See* DUBOFF & HOLT CAPLAN, *supra* note 1, at K-25 (establishing authenticity of aged pieces with 100% certainty "is difficult even under the most favorable circumstances.").

278. *See, e.g.*, Krahmer v. Christie's Inc., 903 A.2d 773, 781 (Del. Ch. 2006) (discussing buyer control over bid price); c*f.* U.C.C. § 2-313 cmt. 6 ("This is not intended to mean that the parties, if they consciously desire, cannot make their own bargain as they wish."). Buyers are also free to make decisions regarding whether to hire an independent appraiser for pre-purchase consultative purposes or for post-purchase insurance purposes or both. *See supra* note 263. Buyers would be able to make the post-purchase decisions in light of appreciation. *See supra* note 271.

279. *See* U.C.C. § 2-316(1) (2004).

280. *E.g.*, *Dawson*, 463 F. Supp. at 468 (photo comparison relied on for provenance in the Met without contacting the museum). It would also deter sellers from conducting inaccurate post-sale appraisals or from post-sale appraisal of their former pieces in

will allow buyers to decide the optimal price for the piece based on their judgment of the probability of the authentication and the risk associated with a mistake in authentication, including one resulting from the post-sale discovery of new information.[281] The free flow of information will generate more efficient prices for works of fine art.[282]

## CONCLUSION

The development of a transactional environment that will benefit purchasers of fine art for generations to come requires the same sophistication and attention to detail that is necessary to create a masterpiece. The legislative adoption of flexible disclosure requirements can appropriately expand buyer protection by supplementing the common law.[283] These changes will minimally disrupt well-established legal principles and market fundamentals.[284] They also have the potential to enhance the pricing of artwork.[285] "Warrior" Pope Julius II commissioned the painting of the Sistine Chapel against Michelangelo's better judgment.[286] Yet humankind may not have enjoyed this masterpiece for the last five centuries if the Pope had not granted Michelangelo the freedom to select biblical scenes of his choosing.[287]

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general. *See supra* note 271.

281. *See, e.g.*, *Krahmer*, 903 A.2d at 781 (buyer pricing considers risk of mistake in authenticity); Firestone v. Union League of Phila., 672 F. Supp. 819, 820–21 (post-sale reattribution via art scholar publication). Based on these disclosures, buyers will pay more for pieces whose authentication seems less speculative and less for pieces whose authentication seems more speculative. *See id*.

282. The free flow of information benefits pricing in any transaction because "unless you have the facts, you cannot make proper judgments about what is going on." HARRY S. TRUMAN, MR. CITIZEN 31 (1953).

283. *See supra* Part VII.A.

284. *See supra* Part VII.B.

285. *See supra* Part VII.C.

286. *See* ANDREW GRAHAM-DIXON, MICHELANGELO AND THE SISTINE CHAPEL 1 (2009) (Michelangelo initially resisted the commission because his talent was primarily in sculpting and he thought it was a set up for failure).

287. *See* JOHN T. PAOLETTI & GARY M. RADKE, ART IN RENAISSANCE ITALY 343–45 (1st ed. 1997) (Michelangelo persuaded the Pope to discard the original plan of the twelve disciples in favor of the narrative panels that exist today); ROBIN RICHMOND, MICHELANGELO AND THE CREATION OF THE SISTINE CHAPEL 63 (Crescent Books, 1999 ed.) (Letter from Michelangelo noted Pope stated "*quello che io volevo*" or to do what he wanted); BENJAMIN BLECH & ROY DOLINER, THE SISTINE SECRETS: MICHELANGELO'S FORBIDDEN MESSAGES IN THE HEART OF THE VATICAN 117 (1st ed. 2008) (Michelangelo's letter indicated that the Pope permitted his changes.).