

# MOVING BEYOND THE “JUST RIGHT”

GOLDBLOCKS APPROACH TO ART MARKET TRANSACTIONS

BY JUDITH L. PEARSON



**IN LIGHT OF THE RECENT** and widely reported art market litigation, many collectors, advisors, dealers, and galleries are more cautious and confused than ever about how to go about buying and selling art and collectibles without losses or lingering liabilities. Parties' due diligence obligations are unclear.

News from Munich of the discovery of a trove of over 1,400 works by seminal artists such as Picasso and Matisse has shaken the global art market and brought renewed emphasis to the Second World War restitution cases. The hoarder, Cornelius Gurlitt, is the 80-year-old son of Hildebrand Gurlitt, an art dealer authorized by the Nazi regime to buy and sell confiscated art. It is yet to be determined the ways in which a special task force, which was appointed by the German government, will manage the restitution interests of victims and their heirs under German law.

It is noteworthy that since the late 1960s, when his mother died, Cornelius reportedly put similar, allegedly looted artworks into the stream of commerce. Selling off his family's art collection was Cornelius' primary source of income, and many purchasers were likely unaware of the storied past of this fine art.

Coupling the Gurlitt controversy with the authenticity disputes surrounding Knoedler Gallery, LLC, and its sale of major works now in question, highlights the lack of clarity in global art trans-



**This page:** *One of the recently discovered paintings in Munich: "Landscape with Horses" by Franz Marc. Opposite page:* Judith L. Pearson, author of this piece and president of ARIS Title Insurance Corporation.

actions and what traditional due diligence standards can and cannot manage. The Knoedler-related cases in the U.S. District Court of the Southern District of New York involve several different buyers. Many of these buyers, who are sophisticated collectors and relied-on art advisors and other experts at the time of their Knoedler transactions, are seeking redress from the gallery, its former director, and other defendants for their multi-million-dollar purchases of allegedly fake American Modern works by the likes of Rothko and Pollock.

In a ruling on a motion to dismiss, the court effectively found that the two subject plaintiffs were not on inquiry notice of the possible art forgeries and were entitled to rely upon the gallery's alleged misrepresentations. In essence, the seller's actions were allegedly so egregious (rising to a conspiracy to defraud) that the buyer's investigation—irrespective of whether there were any red flags triggering a heightened duty on the buyer to investigate—was less important to the analysis.

For the past 30 years, art market

cases interpreting the Uniform Commercial Code and art transactions have vacillated, based on the facts, between imposing a duty on the buyer to investigate the transaction beyond standard norms based on the party's stature (for instance, sophisticated collectors or merchants) or red flags in the transaction (including disproportionate pricing, unusual negotiation tactics, or indications of financial distress such as a rushed sale), and finding that a buyer's baseline investigation is sufficient.

There are no apparent trends in U.S. case law establishing due diligence standards in the art transaction beyond the increased length, bitterness, and expense of art market litigation. In other words, because court decisions in art transaction cases are highly fact-dependent, there are no clear guidelines for stakeholders to follow to ensure problem-free art transactions and avoid future litigation.

A fundamental question facing all art market stakeholders—from buyers to advisors and dealers, who all presumably act in good faith—is how much due diligence is necessary to avoid

buying art with ownership claims and fake art; and if caught in possession of allegedly problematic artworks, how to avoid liability under claims of negligence or defeat claims of insufficient investigation.

Rather than trying to gauge the sufficiency of art market due diligence standards as "just right" in a Goldilocks-like approach, the market is demonstrating a sea change in which leading art market actors are adopting heightened best practices in art transactions as a standard, borrowed from the real estate and banking industries, including the required use of title insurance.

For best practice standards to have their intended effect, and for stakeholders to avoid pitfalls of the art market such as the Gurlitt and Knoedler scenarios, transactional standards should be (and are being) consistently applied in all art transactions, not just the seemingly higher-risk transactions. ♦

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