

Art Finance

English law considerations

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Contents

Introduction	3
Recent Developments in the Market	3
What is an artwork and what rights are reserved to the artist?	5
Key points for lenders to consider in relation to loans secured on art	6
Enforcement of security over works of art	10
Further considerations for lenders	12

Art Finance: English law considerations

Introduction

Although there is no shortage of borrowers in the market, traditionally many lenders have not had a large appetite for providing finance secured against works of art. This is because of a number of factors, being:

- issues of authenticity and the risk of the art being a forgery;
- the volatility of the art market;
- the identity of the art;
- the portability of the art;
- the archaic method of taking security over art from an individual under English law;
- the possibility of a challenge to title, for example, a holocaust restitution claim;
- the fact there is no compulsory art register in the United Kingdom ("UK"), unlike those for other assets, for example, real estate and aircraft; and
- there is no real equivalent to UCC-1 filings in the UK.

However, there are ways for a lender to overcome many of these issues and obtain valid and effective security over the art. We discuss these issues and the specific features of lending against art in this paper.

Before we consider the nuances of taking security over art under English law, it is helpful to note some recent general trends and developments in the global art market, as well as what an artwork actually is from a legal perspective.

Recent Developments in the Market

Overview

Art as an asset class has seen increasing growth. When the first Art and Finance report was published by Deloitte in 2011, one-third of wealth managers said they were aware of art as an asset class. In 2021, however, 85% of wealth managers and 96% of art professionals believed that art should be included as part of a wealth management service.

The Knight Frank Luxury Investment Index, which reflects the relative importance of some luxury investment assets including cars, equities and gold, is a good indicator of the growing significance of artwork among mainstream luxury investment classes. Within the index, art has become the top performer, rising by 29% in 2022 and with 59% of ultra-high net worth individuals looking to invest in artwork in 2023 (the Wealth Report).

The art market remained resilient and strong in the past two years despite the challenge of inflationary and recessionary pressures, the prolonged COVID-19 pandemic, supply chain disruptions and the war in Ukraine. It grew by 3% year on year, reaching \$67.8 billion in 2022.

Social media and blockchain

Social media has gained popularity among art buyers and online sales. According to Hiscox Online Art Trade Report 2023, 42% of art buyers were influenced by social media, the highest since 2015, up from 40% in 2022 and 33% in 2020. Its influence is strongest among younger online art buyers, the majority of whom said they were influenced by social media.

Art market digitisation with technological advancements, blockchain innovations (despite the value loss by 63% in 2022) and improvements in access to information have also opened up the market, making it more accessible to a wider audience. More online platforms are accepting cryptocurrency payments and there is a significant rise in the number of online art platforms that intend to embed blockchain technology into their businesses. The fact that NFT-backed digital art accounted for a considerable amount of the growth in art sales in 2022 indicates how

Art Finance: English law considerations

the art market continues to embrace the technology, evolve and adapt to changes, although more recent market movements have somewhat undermined such rapid growth.

Please see our paper 'Digital Art and NFTs—An Overview and Lender Considerations' for more information. [Digital Art and NFTs – An Overview and Lender Considerations | Fieldfisher](#)

Expansion of wealth

The expansion in wealth for the world's richest individuals has also helped the art market maintain its steady growth. Despite the economic downturn in 2022, both billionaire wealth and the population of global billionaires have more than doubled in 10 years.

This increased wealth has helped establish an expansion in the art market in Asia and MENA (while also boosting spending in the market's traditional/mature hubs) and the number of countries importing and exporting art has expanded significantly. The growth of trade in Asia, particularly Mainland China and (until recently) Hong Kong, is one of the clearest examples of the global proliferation of art sales.

There are three major international art hubs: the US, the UK and Greater China. These accounted for 80% of the value of global sales in 2022. The US is the leader of the market having 45% of global sales and UK and Greater China are the next significant players, having 18% and 17%, respectively (Art Basel & UBS Global Art Market Report 2023).

Overall, high-net-worth collectors remained optimistic about the market last year, spending more in 2022 than the pre-pandemic period. Whilst macro-economic volatility and geopolitical risk are the major concerns in 2023, high net worth collector confidence is traditionally resilient.

ESG

There has been also a growing awareness of sustainability issues, although it remains further down the list of concerns than in other sectors. The environmental impact of collecting is a growing concern: A Survey of Global Collecting 2022 (by UBS and Art Basel) show evidence of increasing awareness of the importance of

sustainable options in artwork sales and the management of collections (from 62% considering these options in 2019 to 77% in 2022). Despite the increased awareness, a majority of collectors said they were willing to travel more to fairs, exhibitions, or events overseas in 2023. For those who were planning to travel less, the main reason was to reduce their carbon footprint (An Art Basel and UBS Report of A Survey of Global Collecting in 2022).

Dealers and borrowing

Of the few dealers who borrow against art, more than 90% operate in the US. The disparity between US and dealers in other jurisdictions is largely the result of features of the US Uniform Commercial Code ("UCC") that allow, in particular, individual borrowers to maintain possession of their collateral (in this case, artwork) throughout the loan term. The advantage is that borrowers can continue to display and potentially sell their artworks while using them as collateral, providing flexibility for art collectors and dealers who rely on their inventory for exhibition, promotion, and sales purposes..

The due diligence required by responsible lenders is a major turn-off to many dealers. Among dealers resistant to art-secured financing, 44% cited the slow-moving and lengthy due diligence process. The wealthiest, well-resourced art sellers are the ones most willing and able to satisfy lenders' concerns about provenance, authenticity, valuation, and other need-to-know aspects about the work in question.

Establishment of the Court of Arbitration for Art

A joint initiative of the Netherlands Arbitration Institution and the non-profit group Authentication in Art, launched in May 2018, established the Court of Arbitration for Art ("CAfA"). The CAfA is to use mediation and arbitration to respond to difficult claims such as those relating to authenticity, chain of title, and copyright and other contractual disputes related to art transactions.

Art Finance: English law considerations

If disputes do arise, it is useful for those dealing in art to recognise that they potentially have an alternative recourse to a court that specialises in art law disputes.

Reasons why the UK retains its leading role in the global art market

The UK is home to international auction houses such as Sotheby's, Christie's, Bonhams and Phillips, as well as a host of major public and commercial art galleries, including, respectively, Tate Modern and Britain and the Gagosian and David Zwirner.

Many ultra-high net worth individuals and potential art buyers traditionally have had first or second homes in London.

The UK is governed by business-friendly policies and is home to financial institutions, which assist with funding major art acquisitions and who view artworks as a burgeoning asset class.

London legal and accounting firms are experienced at establishing trusts in which art can be held, negotiating import and export contracts and advising on lending against, and taking security over, artwork.

Fractional ownership

The most active and experimental area has been in investment in art, notably fractional ownership or tokenisation, allowing individuals to buy a small share of a work of art and trade it. This is purely an investment: the art never leaves a freeport or secure warehouse. From a collector's viewpoint, they could list a percentage of their work on a blockchain platform (like an IPO) and investors then buy into that percentage enabling the collector to raise capital.

This is still in the very early stages of development when looked at in the context of the art market in general, but could prove to be another possible source of raising finance by art owners.

What is an artwork and what rights are reserved to the Artist?

An artwork normally comprises a physical object that may have an aesthetic and/or conceptual value. This often comprises a personal, tangible, moveable item of property known as a personal chattel and so could include a painting, a sculpture, a photograph, an installation, a drawing or a collage.

In the UK, artists and artworks are automatically protected in three ways:

- copyright law which prevents the artists' work being copied or reproduced without the consent of the artist;
- moral rights which gives the artist the right to prevent the use or reproduction of the work in ways that the artist does not approve of; and
- the artist's resale right which gives the artist the right to be paid a percentage of the sale price of the artwork each time it is resold.

Copyright

Copyright is a form of intellectual property that allows the creator of an original creative work to control the copying of their artwork for a limited period. UK legislation governing copyright is the Copyright, Designs and Patents Act 1988 ("CPDA"). Copyright exists in amongst other things original artistic works including a graphic work, photograph, sculpture or collage.

Since 1996, copyright protection expires 70 years after the death of the artist.

Although it is possible for an artist to assign the copyright in an artistic work to a buyer, this rarely happens in practice. This means that although the buyer of the artwork is entitled to display the artwork in their premises, they cannot make or sell reproductions of such artwork without the consent of the copyright owner.

Moral Rights

The CPDA gives the artist certain moral rights so that the artist can prevent the artwork being used or reproduced in a way in which the artist does not approve. Briefly, they include a right of paternity (i.e. a right to claim

Art Finance: English law considerations

authorship of the work) and a right of integrity (i.e. a right to prevent the artwork being subjected to derogatory treatment).

The right of paternity lasts the same time as copyright in the artwork. The right to object to false attribution expires 20 years after the artist's death.

These rights can be waived in writing, but unlike copyright, they cannot be assigned, sold or given away.

Artist's Resale Right

This gives authors of original works of art (including paintings, engravings, sculptures and ceramics) the right to a royalty each time one of their works is resold through an art market professional. Subject to certain exemptions, the right applies when the sale price reaches or exceeds the sterling equivalent of €1,000 and is calculated on a sliding scale which culminates with a royalty rate of 0.25% calculated in relation to artwork where the sales price exceeds €500,000. At the date of this paper, the total amount of royalty payable on an artwork is capped at €12,500.

The right to this royalty lasts for the same period as copyright, being the life of the artist plus 70 years.

Resale royalties in the UK is managed by collecting societies. The seller is liable to pay the royalty jointly and severally with the seller's agent (and, if no agent) the buyer's agent (and if no buyer's agent) the buyer.

The above rights relating to copyright and royalties reserved to the artist are relevant to a lender as a lender needs to know, apart from the artwork itself, what other rights it could potentially take security over and, on enforcement, what royalty rights would rank ahead of its security.

Key points for lenders to consider in relation to loans secured on art

Lending against art as an asset gives rise to particular issues for lenders to consider when structuring and documenting a transaction. As well as touching on the required due diligence in respect of valuation and provenance of the artwork, we will look in detail at the principal ways of taking security over art located in England and Wales. We will also consider the issues that may arise when the artwork leaves this jurisdiction and, finally, the protections that a lender should seek if art is being exhibited by a third party.

Valuation and provenance

The valuation of, and title to, a work of art offered as security are, of course, key issues. Unless they have the capability to attend to these matters in-house, lenders will require valuation advice from one or more specialist independent valuers, and that advice will consider the provenance of the work of art i.e., its origin and authenticity. Valuations can be problematic because the art world is very small and owners can therefore be concerned about confidentiality.

In addition, a lender should investigate the borrower's title to the work of art. As well as requesting a copy of the most recent invoice, ideally ownership of the art needs to be traced from creation to its acquisition by the current owner. This will include ensuring that any necessary export licences were obtained on previous dealings with the art, and considering whether any such licences will be required if the security has to be enforced. It will also include verifying whether the art work might have changed hands in a jurisdiction under a dictatorship (including occupied territories in World War II) as it might be vulnerable to a restitution claim or, indeed, checking if the surrounding circumstances indicate any other possible restitution claim.

It is good practice for the lender to check whether or not the work of art is registered with any register of stolen art. There are various registers (the Art Loss Register in the UK is a leading example) against which searches can be made, but the coverage of these registers is not complete and registration of claims at the Art Loss Register (whilst common practice) is not compulsory.

In addition, the lender should consider whether or not there are any ancillary rights over which security can be

Art Finance: English law considerations

taken, such as rights against a seller or valuer. Where the borrower is purchasing the art, however, the seller seldom gives an outright guarantee of authenticity, and an auction house is likely to restrict its potential liability by the terms of the auction contract.

What type of security interest can a lender take under English law?

Under English law, security over a work of art may be in the form of a mortgage, charge, pledge or bill of sale. Forms of quasi-security, such as a sale and leaseback, could also be considered. The most appropriate form of security for a lender to take will depend on the nature of the security provider and the location where the work of art is to be held.

A key issue is whether the work of art is stored by, or on behalf of, the lender, or left in the possession of the borrower. For both legal and practical reasons, a lender requiring watertight security over a work of art is, given the inherent portability of artworks, best advised not to leave it in the borrower's possession or control.

A word on liens. A lien is a right to detain goods until money owed has been paid, and may be created by contract or arise by implication. Examples in relation to a work of art are (i) the right of a restorer to detain a work of art which has been restored until the cost of restoration has been paid and (ii) the right of a bailee (for example, a warehouse or gallery) to retain bailed goods until the bailee has been paid storage costs. A lender will not take a lien over a work of art, but needs to be aware of liens that may exist over a work of art as they could affect that lender's security and its ability to enforce that security.

Mortgage or charge

A legal mortgage (often referred to in this context as a "chattel mortgage") involves the transfer of legal ownership in the art to the lender, subject to the borrower's right to re-transfer on repayment, and will be contained in a written agreement.

The mortgage will be equitable where the borrower's interest in the work of art is itself an equitable one, such as an interest under a trust. An equitable mortgage may also be created where some formality required for a legal mortgage is missing, but this will not always be the case. It would be unusual for a lender to be satisfied with an equitable mortgage over an artwork.

A charge involves an agreement by the borrower to give the lender a proprietary interest in an asset as security for a liability. In most cases this is effected very simply by the borrower executing a document by which the debtor is expressed to charge a particular asset as security for a particular debt. The distinction between an equitable mortgage and a charge is a narrow one.

There are certain advantages in taking a legal mortgage rather than an equitable mortgage or charge. In particular, an equitable mortgage or charge will generally be overridden by a purchaser in good faith of the legal interest in the art without notice of the lender's security and only a legal mortgagee can transfer legal title to the art to a purchaser without the help of the court or some other device.

A charge over goods (for example, works of art) may be fixed or floating. To achieve a fixed charge over goods, the lender needs a sufficient control mechanism in the charging document, and to apply that mechanism in practice. An unrestricted right for the borrower to sell or replace the goods without the specific consent of the lender on a case by case basis is likely to render a charge floating. In practice, this will seldom be an issue when the security comprises valuable works of art, since the lender will usually insist on these remaining under its possession or control, but the issue should not be overlooked.

Pledge

A pledge is an altogether different form of security. A pledge requires the delivery of possession of the work of art to the lender, with the intent to create a pledge. The delivery may be actual or constructive. Actual possession is where the lender actually has possession of the work of art, but for practical reasons lenders are often reluctant to physically hold works of art themselves. Constructive possession is where a third party is in possession of goods and undertakes to the lender to hold them to the order of the lender (a process known as "attornment"). The pledge must, however, arise by actual or constructive delivery of possession, not under a security document. A pledge agreement may regulate the rights of the parties, but if it operates as a written assignment passing title it is likely to be subject to the Bills of Sale Acts.

Note that if the lender requires security over the insurances relating to an artwork, it cannot take a pledge over the policy as a policy is not a document of title, instead it needs to take an assignment by way of security over the insurances.

Art Finance: English law considerations

The effect of a pledge is that the borrower retains ownership of, and title to, the work of art, but the lender takes possession of it (whether actual or constructive). In other words, a pledge does not allow for the work of art to be kept by the borrower in their home.

Bill of Sale

A security interest (other than a pledge) created by an individual or a partnership (other than a limited liability partnership) over “personal chattels” is subject to the Bills of Sale Act 1878 and the Bills of Sale Act (1878) Amendment Act 1882 (together, the “**Bills of Sale Acts**”). A work of art such as a painting or sculpture is a personal chattel for this purpose. Unless it falls within one of the very limited statutory exemptions, the security and the underlying loan will be void unless it is in the strict form required by, and is registered under, the Bills of Sale Acts. The statutory formalities include that: (i) the bill of sale must secure a sum certain; (ii) the bill of sale must be created contemporaneously with the loan being advanced; (iii) the original bill of sale together with an affidavit must be registered by the lender with the registrar at the King's Bench Division of the High Court within seven days of execution; and (iv) registration must be renewed every five years.

In practice, because these formalities are onerous (and non-compliance would have the effect of rendering the security and loan void) this means that although technically possible, a bill of sale over works of art from an individual is seldom taken by lenders. That said, careful consideration and analysis of the precise nature of the facility – for example ensuring that the bill of sale secures a fixed principal loan amount (not a revolving facility) and a fixed interest rate (with, perhaps, a floating rate of interest and / or future advances being secured by non-art collateral) – means that lenders might be willing to consider security by way of a bill of sale for the right set of circumstances and the right borrower relationship.

The Bills of Sale Acts do not apply to security given by a company, although in that case the security (unless in the form of a pledge) will require registration at the UK Companies House if the company is incorporated or has a registered place of business in England and Wales. Even in the case of a pledge, if the security also includes an assignment of insurances, the assignment will need to be registered at the UK Companies Registry as a charge on book debts. If a borrower that has created security over works of art located in England and Wales is incorporated

in a jurisdiction other than England and Wales, there may be formalities in the relevant jurisdiction of incorporation that need to be complied with. These can include registration and specific taxes or fees, so local counsel advice should be taken at the time.

If a work of art is purchased in the name of a company or transferred to a company, in order to enable that company to create a mortgage or charge outside the Bills of Sale Acts, the purchase or transfer must be a genuine one, and not a sham arrangement, otherwise the security might be re-characterised as a bill of sale or set-aside as, for example, a transaction at an undervalue under the Insolvency Act 1986. The risk of re-characterisation is increased if an individual controlling the company is left in possession of the mortgaged or charged work of art. Another possibility is that the art is transferred to a new company in exchange for shares in that company. The issue here, however, is that the transfer of artworks in exchange for shares is likely to be a taxable event in the UK triggering a tax liability, including capital gains tax.

Similarly, where any financing is structured as the purchase of assets by the person providing finance, the courts will look to the substance of the transaction to determine whether a document is within the Bills of Sale Acts, and may disregard the document as a sham if it was intended to conceal the fact that the transaction was a secured loan.

Following consultations in the context of laws around consumer finance and the use of personal assets as collateral, a new legislative framework (the Goods Mortgages Bill) was proposed to replace the current bills of sale laws with a more modern system under which the document creating security over personal chattels would be short and simple and the registration procedure modernised. It was primarily intended to cover 'log book loans' (that is, loans against motor vehicles), but it would have also covered artworks. The proposals, however, did not go as far as creating a registration system comparable to the UCC system in the US and were somewhat unsatisfactory to the extent that secured creditors would be vulnerable to third party purchasers without notice of the security. The proposals were withdrawn in May 2018 as the UK government redirected its focus towards tackling alternatives to high-cost credit provided to individuals. While there are ongoing industry initiatives to reform UK laws relating to security over personal chattels (including bills of sale), it is unlikely that any new legislative proposals will be published in the immediate future.

Art Finance: English law considerations

Note, however, that the Law Commission has a special procedure that allows uncontroversial bills to be introduced into Parliament. “Uncontroversial” means that the bill is broadly supported by all categories of interested stakeholders. It does not require unanimity of opinion. Based on the Law Commission’s previous experience, and responses to the Government’s consultation, the Law Commission considers that the draft Goods Mortgages Bill remains suitable for the special procedure and could be introduced in Parliament in the future. Moreover, other initiatives to reform the law relating to personal property security (such as those contemplated by the Secured Transactions Law Reform Project), may ultimately develop the law in this area.

Issues arising if the work of art is held outside England

Particular issues, too numerous to be covered fully in this briefing paper, arise when the works of art are located outside England and Wales. The general principle is that the law of the place where the work of art is located will govern whether or not effective security is created (*lex situs*). Local legal advice is needed to check whether or not security under English law will be effective (it will often not be) and also what local formalities, stamp and registration requirements apply.

Many jurisdictions (other than the US) are hostile to any form of security leaving art in the possession of the borrower (often referred to, in the case of a mortgage, as a “non-possessory chattel mortgage”), given the increased risk of concealment and fraud. “Debtor friendly” local law or practice may also make recovery or enforcement difficult or time-consuming.

Exhibited Artwork

The lender’s position needs to be protected if the work of art is to be sent to a gallery, museum or other private collection by the borrower for exhibition.

Issues such as possession of the art (if secured by a pledge), physical security, transportation of the art, atmospheric conditions and insurance are relevant if the borrower wishes to provide a work of art that is subject to security for display in an exhibition, particularly where the relevant gallery or museum is outside England.

A major exhibitor may have its own forms of documentation and procedures, but if the work of art is

subject to security, a security holder willing to agree to the art being exhibited needs to be satisfied that its security will remain effective and is held to its order. If the exhibition is in another jurisdiction it will be necessary to take additional security in accordance with the laws of the relevant jurisdiction. Insurance and security of the art also need to be considered. For example, the National Gallery self-insures and will issue a Government indemnity to the owner of the art. The exhibitor may be paying a fee to the borrower, but the security holder seldom requires security over this unless it is substantial.

Art Finance: English law considerations

Enforcing security over works of art

In an enforcement scenario (whereby a lender's right to enforce under the relevant security document has arisen, typically by virtue of the sum secured having been due and payable and then remaining unpaid by the borrower), there are particular considerations where the security is over works of art.

Enforcement of Mortgages and Pledges

If security is created over the art by way of a chattel mortgage or charge, the lender would usually appoint a Law of Property Act Receiver ("**LPA Receiver**") in order to enforce their mortgage or charge over the artwork.

If security is created over the art by way of a pledge, the lender has rights under common law to sell the artwork - without having to go through a court process.

In either case, the lender has duties upon enforcement to achieve the best price reasonably obtainable for the artworks. A challenge by the borrower or guarantor that "the best price reasonably obtainable" has not been achieved can arise when the security comprises valuable paintings or other works of art where there is a thin market. Therefore an LPA Receiver (or lender directly) would be well advised to instruct specialist art advisors to oversee and manage the sale process. With art in particular, if a receiver takes time to do their research as to provenance and the condition of the artwork before presenting the art to the auction houses for sale, they can often add value to the portfolio. Advisors will provide a strategy as to how the asset is marketed and often the receiver will be guided by both specialist advisors and the auction houses themselves. It is often recommended (although not always possible) that the art is sold with the cooperation of the borrower, who will not wish to see items sold in a fire sale, and for this reason too the auction houses may not be told that a receiver is involved.

From the lender's perspective, disposal at auction is often safer than a private sale, although a borrower might still claim that the chosen auction house, timing or reserve price was inappropriate. Moreover, if a painting fails to reach its reserve price at auction, this can have a dramatic effect on value, making it more difficult to sell

the painting privately. However, a challenge by the borrower on the ground that the disposal should have been delayed to allow an improvement in the market is unlikely to succeed under English law.

If the valuation advice is that the best price is likely to be achieved by sale at auction in another jurisdiction (for example, that a painting held in England should be put into an auction in New York), advice is needed on whether or not the lender's security will remain effective when the painting is in transit and exported. The advice should also cover any particular obligations under local law as to the means of disposal, local filing requirements (e.g. a UCC 1 filing in the relevant state in the US), and any notice period that must be given to the borrower before a disposal. See below under 'Transport of art across jurisdictions' for more information on transporting art in these circumstances.

Enforcement under a Bill of sale

If security has been granted by way of a bill of sale, the bill of sale entitles a lender to seize the property (i.e. the artwork) following certain specific defaults (including, notably, a payment default), without the need to seek a court order. Where a bill of sale is regulated by the Consumer Credit Act 1974 ("**CCA**"), the lender must serve a default notice before enforcement. However, if any of the exemptions under the CCA are being made use of (for example the high net worth exemption), such that the facility agreement will not therefore be regulated under the CCA, this requirement should not apply. A lender would have to wait five days after seizing the art works before selling them, which would allow the borrower to apply to court, should they so wish. However in practice this timeframe would not usually be an issue as a lender is bound to obtain the best price reasonably obtainable for the art works and a proper marketing exercise for such art works would extend over a much longer time period.

Personal Guarantee

A lender lending against works of art will often require personal recourse from the ultimate beneficial owner ("**UBO**") of the art, by way of a guarantee (assuming that the art is held by a special purpose vehicle rather than the individual). A guarantee can be a useful tool in helping to persuade the UBO to cooperate with the lender in relation to any enforcement process and sale of the artworks.

Art Finance: English law considerations

Issues arising out of third party possession of the work of art

A lender requiring watertight security over art is well advised to take actual or constructive possession of it. In practice this means engagement with a third party fine art storage provider, or sometimes a lender may consider whether a gallery may be suitable for this role, in order to hold the artwork on behalf of the lender for the duration of an exhibition or perhaps even whilst the artwork is being marketed for sale. In these circumstances there are certain issues for a lender to be aware of.

As a general rule, no one can transfer a better title to goods than they themselves possess (this is the *nemo dat quod non habet* rule). It follows that a purchaser cannot generally acquire any better title to goods than that of a seller who does not own the goods. Likewise, a good faith purchaser who acquires goods from a mortgagor wrongfully selling such goods does not generally obtain priority over a prior legal mortgage. In the following two situations, however, it is possible for a bona fide purchaser of goods without notice to acquire title to such goods from a third party that has priority to the title of the owner/mortgagee:

- where the owner has by their conduct held out a third party as having authority to sell the goods or as being the owner of the goods. Section 23(1) of the Sale of Goods Act 1979 provides that an owner of goods may by their conduct (that is, by representing or holding out the truth of a fact or state of affairs which led the buyer to believe that the seller is the owner of goods or is authorised to deal with them on the owner's behalf) be precluded from denying the seller's authority to sell; or
- where the owner gives possession of the goods (or documents of title) to a mercantile agent and the agent disposes of such goods in the ordinary course of its business. Section 2 of the Factors Act 1889 gives a bona fide purchaser of goods or bills of lading priority over a pledge if the purchaser acquired its interest from a mercantile agent in possession of the goods or bills of lading with the consent of the owner.

The fact that a lender allowed the owner or a third party to retain possession of mortgaged art would not, of itself, amount to the lender holding out that the owner or third

party was the owner or had authority to sell such art, but if the third party was a gallery (whose business was to buy and sell art) the mercantile agent exemption referred to above could apply.

Generally, a lender with a duly perfected pledge or chattel mortgage over art would not lose its priority to a subsequent mortgagee or chargee or a purchaser, except in the very limited circumstances above, or if the art is taken abroad, as described immediately below.

If a borrower managed wrongfully to take a work of art outside England and Wales, the risk to the lender of defeat of its mortgage is significantly greater as the law of the jurisdiction in which the art is situated would apply and such law may well not recognise an English law chattel mortgage.

So where does this leave a lender? The risk to a lender is potentially twofold. First, art is often portable and there is a risk that prior to enforcement it disappears. Secondly, in certain very limited circumstances an innocent third party (for example, a purchaser or another lender) could defeat the lender's mortgage. A lender thinking of permitting an owner or third party to retain possession of the art therefore needs to be comfortable about the integrity of the owner or third party. A lender needs to take special care if it allows the artwork to be held by a gallery that could be regarded as a mercantile agent and will need to be comfortable about the integrity and reputation of the gallery, which should be truly independent of the owner.

In order to mitigate the risks, lenders should consider tagging the work of art, and should always register their security where they can (for example, at the UK Companies House or the High Court if the Bills of Sale Acts apply). See also the section below in respect of the Art Loss Register.

A lender should also reserve the right to inspect the work of art at regular intervals and to give itself the right to require the work of art to be delivered into its possession at any time and certainly after the occurrence of an event of default under the relevant financing agreement.

Art Finance: English law considerations

Further considerations for lenders

The Art Loss Register

An ownership interest in artwork (which would include the interest of a mortgagee/pledgee in artwork) may be registered at the Art Loss Register. Despite its name, the Art Loss Register can record ownership details before any relevant item has been lost or stolen. Details will be held in a “positive database”. The Art Loss Register advises that as a deterrent to theft, misappropriation or matters of ownership dispute, maximum publicity should be given to the fact that items have been so registered. Aside from matters of ownership dispute, where the Art Loss Register has been useful in the past is when a pledge is taken from an individual in England and Wales and there is no ability to register the lender’s security in the work of art in any other register. Even here, however, provided the work of art is held with a reputable third party under an attornment arrangement, there should be no risk to the lender in practice. Some lenders, as a matter of routine, register their mortgages as well as pledges at the Art Loss Register as ‘belt and braces’ protection.

Regulated Credit Agreements

Loans to individuals, and to small partnerships, unincorporated trustees and unincorporated associations, must be considered in the context of the UK consumer credit regulations to determine whether they are regulated credit agreements. If a loan agreement is a regulated credit agreement, it will be subject to various requirements and restrictions prescribed by law, or an exemption may be available that would take the loan outside the scope of the consumer credit regulations. In addition, the lender itself would need to be authorised to carry on a regulated activity if an exemption did not apply to what would otherwise be a regulated loan.

The most commonly used exemptions include the high net worth exemption (the loan must exceed £60,260 and be for a purpose other than renovation of residential property, or to acquire or retain property rights in land or in an existing or projected building), and the business purposes exemption (for loans exceeding £25,000 made for predominantly business purposes). Both exemptions are subject to the appropriate procedures being followed.

Documentation

Apart from obtaining actual or constructive possession of the artwork itself, a lender will also wish to collect relevant paperwork relating to the artwork including any bill of sale or invoice, any certificate of authenticity, any valuation report, any auction particulars, any export licences or import licences, any lab report and any searches at art registries including the Art Loss Register.

Insurance

Artworks are extremely delicate and often exhibited, loaned to galleries or transported to auction houses and can be damaged in transit, stolen and, even when in situ, can be affected by fire, flood and theft as well as atmospheric conditions and light. A lender will therefore require the artwork to be insured.

A lender will wish to be satisfied that the art itself is insured against all the usual risks (including fire, natural disasters, theft and accidental damage) for the full market value of the art and be named as composite insured and first loss payee. The insured should if possible seek to agree a 'total loss' value for the artwork. The policy needs to be carefully scrutinised for exclusions (e.g. inherent vice or terrorism cover) and the amount of any excess. A lender will also wish to take security over the policy itself so that its claim on the proceeds of the policy would not be defeated by a trustee in bankruptcy or liquidator of the owner.

A lender may also wish to consider taking out title insurance against its borrower having a defective title (including holocaust restitution claims) or insurance covering any shortfall in the proceeds of sale of the art against the amount of the secured loan.

Art storage

There are a number of issues to consider when hanging or storing art.

If the art is stored in a gallery or dedicated fine art storage facility it is likely that the issues below will be taken care of. The same may not be the case if the art is stored or hung in the borrower’s home.

The issues include climate. The ideal humidity to store artwork is 40-50% with a temperature of between 21 to 24 degrees Celsius. Severe climate can cause cracked paint, warping, yellowing of paper and mould growth.

Art Finance: English law considerations

Rapid changes in temperature and humidity can also cause serious damage to artwork.

The artwork should also always be elevated off the floor. It should be properly packaged (unless hung) and protected from moisture, dust, direct sunlight and air vents.

Transport of art across jurisdictions

If an artwork leaves a jurisdiction, it is likely that any security over that artwork will cease to be effective. What can a lender do to protect itself while the art is in transit? This will depend how the art is being transported. For example, if the art is being transported by ship it is possible for the lender to take a pledge over the bill of lading issued by the carrier as this is a document of title. If the art is being transported by air, the carrier will issue an air waybill (also known as an air consignment note) which serves as a receipt of goods by the airline (the carrier) as well as a contract of carriage between the shipper and the carrier. It is not, however, a document of title and cannot therefore be the subject of a pledge. In these circumstances, a lender could take a letter of

hypothecation over the goods. A letter of hypothecation is a form of equitable charge inferior to a pledge, but useful where the lender has neither property in nor possession of the goods. A letter of hypothecation is valid against a liquidator or trustee in bankruptcy (Re Hamilton Young & Co, ex p Carter [1905] 2 KB 772, CA), but can be defeated by a bona fide purchaser for value without notice of the lender's security. If a letter of hypothecation extends to proceeds of sale and is created by an English limited company it is registrable at the UK Companies Registry as a charge over book debts.

In addition, the lender would need to ensure that the art is insured during transit and take an assignment of such insurances as well as having itself named as first loss payee. In addition, the lender will wish to put security in place over the art when it arrives in a new jurisdiction according to the laws of that jurisdiction. In practice, if the art is temporarily leaving a jurisdiction e.g. because it is being lent to a gallery, often the easiest solution (if the loan is not fully drawn) is to have a temporary reduction in the amount of the facility until the art work returns to the jurisdiction in which the lender has established security.

Contacts



Hannah Rowbotham

Partner, Banking & Finance

+44 (0)330 460 6453

hannah.rowbotham@fieldfisher.com



Sebastian Crawford

Senior Associate, Finance

+44 (0)330 460 6468

sebastian.crawford@fieldfisher.com



Helen Mulcahy

Partner, Dispute Resolution

+44 (0)330 460 6625

helen.mulcahy@fieldfisher.com