

As Art Values Rise, So Do Concerns About Market's Oversight



Peter Foley/European Pressphoto Agency

Tobias Meyer, a principal auctioneer at Sotheby's, takes bids at a 2006 sale. Some say the art market needs closer monitoring.

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When some of the world's richest people gather for the glittering New York auction season this spring, they will spend hundreds of millions of dollars in an art market that allows opaque transactions and has few outside monitors.

At major auctions the first bids announced for a piece are typically fictional — numbers pulled from the air by the auctioneer to jump-start bidding.

Collectors can find themselves being bid up by someone who, in exchange for agreeing in advance to pay a set amount for a work, is promised a cut of anything that exceeds that price.

And year round, galleries ignore with impunity a 42-year-old law that says they must post their prices.

Art sales in New York, at galleries or at auction, are estimated at \$8 billion a year. Yet the last significant change in the city's auction regulations took effect more than two decades ago, when the value of transactions was less than half of what it is today.

Many in the art world insist there is no need for further scrutiny of a market that prompts few consumer complaints and is vital to the New York economy. But other veterans of the business say there is mounting concern that monitoring has not kept pace with the increasing treatment of art as a commodity.

“The art world feels like the [private equity](#) market of the '80s and the hedge funds of the '90s,” James R. Hedges IV, a New York collector and financier, said. “It's got practically no oversight or regulation.”

For two decades some New York State lawmakers have been trying to curb the practice known as “chandelier bidding,” a bit of art-market theater in which auctioneers begin a sale by pretending to spot bids in the room. In reality the auctioneers are often pointing at nothing more than the light fixtures.

“The time has come to give up this fiction that there are actual real bidders,” said David Nash, a gallery owner who spent 35 years as a top executive with [Sotheby's](#).

But nine bills submitted in Albany over the years to ban the practice failed. So today, in a city that seeks to regulate soda consumption, chandelier bidding remains 100 percent legal. The law says auctioneers can announce such bids as long as they stop before reaching a sale item's reserve price, the confidential minimum amount that sellers have agreed to accept.

Auction houses say that the bidding practice is harmless, fully disclosed and widely understood by collectors, and that it protects the seller by, among other things, preserving the drama that draws buyers to a sale.

“People like to say that the art market is unregulated,” said Jane A. Levine, senior vice president and compliance director for Sotheby’s. “Nothing could be further from the truth. There are bespoke auction rules that cover this very tiny market that actually do govern the auction process.”

The New York City Consumer Affairs Department, which oversees the art market, reports few complaints from buyers or sellers, and auctioneers point to additional consumer protections provided by the state Uniform Commercial Code.

Auction officials say most criticism of their practices comes from gallery owners — their rivals for sales — who they say operate without oversight. “The dealers are not regulated at all,” said Patricia G. Hambrecht, chief business development officer for the Phillips auction house.

Some perceptions of the market as an insiders’ game stem from recent lawsuits against galleries, including three by collectors who [accused Knoedler & Company, now defunct, of fraud](#).

“Is there any reason to believe that regulating the art market will be any more effective than regulating the financial markets has been?” asked Jonathan Brown, a professor at New York University’s Institute of Fine Arts. “Many of the players are identical.”

But others say that, given the money involved and the number of newly wealthy buyers, stricter rules are a must.

“Ideally any tightening of the rules would be self-imposed,” said Michael Plummer, a former [Christie’s](#) executive who is now a principal in Artvest Partners, an art advisory company. “Unfortunately I don’t think the markets are going to have the discipline to do that.”

Price Tags Are ‘Tacky’

Perhaps nothing illustrates the art market’s laissez-faire spirit better than the way galleries flout New York City’s “truth in pricing” law. It says items for sale, including art, must have a price tag conspicuously displayed. None of 10 galleries visited at random this month had posted prices, though a few smaller ones produced price lists when asked. At the David Zwirner gallery in Chelsea a woman at the front desk seemed indignant when asked if she had a price list.

“I do not,” she said.

In 1988 Consumer Affairs officials cracked down on galleries that did not post prices; 19 violators were cited.

“We brought it out from behind the curtain,” said Angelo J. Aponte, the former consumer affairs commissioner. “There was a lot of blowback. That industry has a lot of clout in New York.”

There does not appear to have been a similar enforcement effort in recent years. Consumer affairs officials declined to be interviewed or to detail whether any galleries were cited last year for violating the pricing law. In the past the agency’s inspectors have focused on industries that draw the largest share of complaints, like home-improvement contracting.

But the pricing law is enforced against other retailers. The Adry Furniture Corporation of Brooklyn, for example, was fined \$500 in 2011 for failing to display prices for a red stool and an end table.

Dealers said posting prices on valuable works in an open gallery creates security concerns and disrupts an exhibition’s aesthetics by transforming artworks into commodities.

“We consider it tacky to do that,” Richard L. Feigen, a longtime dealer, said.

Others say posting prices would reduce the market’s elitism. Galleries, experts say, often choose to whom they will sell and favor good customers, especially those whose ownership will add luster to an artist’s market standing.

“You can’t deny someone the opportunity to buy something if the price is posted and the work is unsold,” said Robert Storr, dean of the Yale University School of Art. “Unless there is the will to enforce these things,” he said of pricing laws, “there is no point in having them.”

Profits From Risk

When you talk to dealers about what most needs policing in the art market, many mention third-party guarantees.

A guarantee typically operates as it sounds. When someone offers a piece for auction, the house will sometimes guarantee that the seller will make at least a minimum amount by arranging with a third party to purchase the work for a specific price, undisclosed to the public, should it fail to sell for more. In exchange for putting up the funds, the guarantor, whose name is also not revealed, gets a cut of any proceeds above the guarantee.

So if a third party commits to a \$10 million guarantee, and the bidding reaches \$12 million, the third party receives a piece (often 30 percent to 50 percent) of the additional \$2 million.

Auction houses use guarantees to compete for coveted consignments. Because they primarily profit from fees tied to sale prices, it's in their interest to attract the most valuable works.

Although only a small percentage of works are sold with guarantees, they are often the most expensive. And since 2008, when the auction houses lost heavily during a market slump on works they had guaranteed themselves, they have often turned to third parties to take on that risk.

Christie's, for example, was able to sell Picasso's "Nude, Green Leaves and Bust" in 2010 after it found a third party willing to put up an undisclosed guarantee. When the painting, with a low estimate of \$70 million, sold for \$106.5 million — at the time, the highest price ever for a work sold at auction — the unnamed guarantor presumably walked off with a good bit of money.

The problem, some dealers, collectors and art advisers say, is that the neutrality of an auction is lost when these underwriters can bid on a work they've guaranteed. Critics argue that the guarantors have an undisclosed interest in the outcome and an unseen advantage over other bidders because a buyer who wants the work might wind up competing against someone who only wants to bid up the price.

"In a market that purports to be transparent and offering disclosure of conflicts of interest, this is not a level playing field," Mr. Hedges, the collector, said.

At Christie's and Phillips, both large auction houses, even if a guarantor ends up owning the work, he would still pay less for it than anyone else. For example, if a guarantor's bid of \$12 million turned out to be the winning bid, the guarantor would not pay the full \$12 million because he or she still gets the cut — called a financing fee — of any amount above the \$10 million guarantee.

That means the prices in auction records — the industry's prime metric for measuring value — are not always accurate.

"If the price is not the price because the guarantor has bought it and gotten a discount, there is no longer any transparency in the market," said Michael Moses, a retired New York University professor whose company, Beautiful Asset Advisors, tracks the art market.



Estate of Pablo Picasso/Artists Rights Society, New York

Picasso's "Nude, Green Leaves and Bust" (1932) was sold at auction above a guaranteed minimum price.

Sotheby's, which refers to its arrangement as "an irrevocable bid," said it does not allow a guarantor who ends up owning a work to share in the financing fees. "Our view is, people aren't bidding on the same terms," said Jonathan A. Olsoff, senior vice president and worldwide director of litigation. "The guarantor is getting a discount."

Christie's and Phillips said that they allowed guarantors to earn a financing fee, even if they bid successfully for a work, because to do otherwise might dissuade them from bidding and, thus, deprive a seller of the best price.

Auction houses say guarantees create liquidity and give sellers the confidence to bring important works to market. If there are abuses, they say, it is the guarantors' conduct that is the issue, not their own.

The houses typically secure the guarantees from wealthy collectors and private dealers, some of whom agree to be guarantors because it can help maintain the value of an artist in whose work they have invested.

Though bidders never know who in a salesroom might be a guarantor or what price has been guaranteed, the auctioneers, as required by law, do disclose at the start of a sale that some works will be sold with guarantees and denote them with small symbols in the catalog. The auction houses also disclose that guarantors may be bidding, even though, they say, consumer affairs regulations do not expressly require that.

“We’re pro transparency,” said Karen Gray, Christie’s general counsel, “so actually our announcements are going farther than we are strictly required to.” Consumer affairs officials did not respond to that contention but said in a statement, “Fairness, accountability and transparency are the hallmarks of auctioneer regulation, and we’re interested in hearing from industry leaders about the changing face of the auction industry.”

Bills Perennially Stalled

Richard L. Brodsky said he knew his efforts as a New York State assemblyman in the 1990s to regulate the sale of art in the state further would draw yawns from fellow legislators. Many viewed the art world, he said, as a foreign place inhabited by wealthy people with little need for protection.

But Mr. Brodsky, a Westchester Democrat, said the public’s interest in fair and orderly markets was at stake. And if prices were artificially inflated, he said, taxpayer-supported institutions like museums could find themselves unable to afford important works.

So in 1991 he introduced a bill to ban chandelier bidding. Gallery owners had complained about the practice for years. But while the city had made other changes in the law, it had stopped short of banning such bids.

“I don’t think it’s unreasonable, given the clientele and players, to have that little bit of theater,” Mr. Aponte, the consumer affairs commissioner, had said in 1986 during an earlier debate.

Mr. Feigen, the art dealer, said in later hearings that he did not find that argument compelling.

“If I want drama, I’ll go to Broadway,” he said, “not to a financial market.”

Under the law in New York City and other places, auctioneers may make up bids at the beginning of a sale as long as they stop announcing such bids before the auctioneer reaches the undisclosed reserve, the minimum amount the consignor will accept.

Auctioneers say chandelier bidding (they prefer the term “consecutive bidding”) is necessary to keep the reserve secret and protect the seller. Without it, they say, bidding might end up starting at the reserve, since that is the minimum a seller will accept, and thus telegraph what it is. They liken it to real estate transactions in which sellers do not reveal the minimum amount they will accept so as to retain negotiating leverage.

City law requires auction houses to disclose in their catalogs and on a salesroom sign that such bidding may take place. The practice is also mentioned during the rapid recitation of auction rules before a sale.

But Mr. Plummer, the art adviser, said he had accompanied prospective buyers to auctions who were unaware of the practice. “It is absolutely not correct,” he said, “to assume that all participants in an auction are seasoned insiders who understand the nuances of chandelier bidding.”

Under the bill Mr. Brodsky introduced an auctioneer would have to make plain a fake bid by saying it was “for the consignor” as in, “I have \$1 million for the consignor.”

The consumer affairs agency backed the bill. At hearings Richard Schrader, its deputy commissioner, testified that chandelier bidding may inflate prices by snaring “unwitting bidders into thinking that they are competing with other potential purchasers.”

Auction houses argued, though, that the existing regulations in New York City were sufficient. Christie’s and Sotheby’s hired Stanley Fink, a powerful former Assembly speaker, to lobby on their behalf. “He was ferocious in support of his clients and his presence was meaningful,” Mr. Schrader recalled.

When Mr. Brodsky’s bill failed, he reintroduced it, session after session. The first eight bills never made it out of the Assembly. On his ninth try, in 2007, the bill got through the Assembly, but died in the Senate.

Mr. Brodsky said city officials seldom supported the legislation, a charge consumer affairs officials denied. In a statement the agency said it had “no record of former Assembly member Brodsky requesting changes in enforcement practices or oversight to address the changing face of the auction industry.”

Mr. Brodsky said: "I have had continuing and unsatisfactory communication with New York City on this matter for 15 years. I cannot speak to the adequacy of their record keeping."

In 2008 Mr. Brodsky toned down the bill in ways that extended the city's auction regulations to the entire state but effectively left the practice of chandelier bidding unchanged.

He said he decided a softened bill was better than no bill at all. "I can't get everything I want but I can make this part of the public policy dialogue," he said. "And I did."

The auction houses, pleased with the changes, sent a memo of support, and in 2010 the Legislature passed the amended bill.

But it would not become law. Gov. David A. Paterson vetoed the bill, citing concerns that counties had no way to enforce it.

The legislation lives on today, albeit in its weaker form. Its Senate sponsor, Daniel L. Squadron of Manhattan, says it still has value. Beyond extending the reach of the city law, the proposal would empower the state attorney general to enforce auction violations and provide additional grounds on which bidders might sue.

Senator Squadron said he had not lost hope that the legislation might pass. (Last fall the state did strengthen the law that protects artists and owners who consign their work to galleries.)

"The need to trust the credibility of an auction is as real a need as it was 20 years ago," Senator Squadron said.

Last year, though, his bill never made it out of committee.