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Valerie Medelyan
Chicago Stock Exchange

The Art of a Loan: "When the Loan Sharks Meet Damien Hirst's '$12-Million Stuffed Shark'"[1]

Valerie Medelyan*

I. Introduction

In 1851, Prince Albert of Great Britain observed that "works of art, by being publicly exhibited and offered for sale, are becoming articles of trade . . . ."[2] Today's art collectors "have long acknowledged [the art's] role as a store of value or as a commodity to be sold for gain. Others, aided by their bankers, have gone a step further: they treat their collections as working assets."[3]

Part I of this article introduces the reader to the typical types of loans that banks make, includes an in-depth description of a secured loan, and finishes with a discussion of the due diligence requirements of banks. Part II identifies the unique

1. The quote is taken from Shane Ferro's article titled *Navigating the Art Loan Biz, A Surging Industry Attracting Both Big Banks and "Loan-to-Own" Sharks*, *infra* note 51. Damien Hirst is an English artist who created a work titled "The Physical Impossibility of Death in the Mind of Someone Living," which consists of a tiger shark preserved in formaldehyde. *Damien Hirst*, ARTCHIVE, http://www.artchive.com/artchive/H/hirst.html (last visited May 21, 2015). The work was sold in 2004 for an undisclosed amount; however, Don Thompson's book titled *The $12 Million Stuffed Shark: The Curious Economics of Contemporary Art* suggests the work's price.

* Compliance Analyst, Chicago Stock Exchange. I dedicate this article to Igor and Alla Medelyan, for their constant support of my pursuits in both art, and law; to Dominic Johnson, for his insight, knowledge, and great editing skills; and to Larissa Bron, for everything that she has taught me.

2. CXI LONDON Q. REV. 98 (1862).

3. Ian Driscoll, *Top-Notch Art Oils the Wheels of Lending*, FINANCIAL TIMES (Jan. 27, 2009, 1:59 AM), http://www.ft.com/intl/cms/s/0/457d83f8-ec04-11dd-8838-0000779fd2ac.html#axzz32NbUoSiY.

complexities posed by art when it is used as collateral, comparing and contrasting the banks' process when approving a loan secured by commonly-used assets versus a loan secured by art. Part III discusses the banks' growing willingness to approve art-backed loans, and identifies the safeguards built into such deals. Part IV introduces the sub-prime lenders of the art market, discussing pawn shop regulations and loans made by "luxury pawn shops" and "art dealers." Part V compares and contrasts bank loans and "art lender" loans with an emphasis on defaulting borrowers. Part VI discusses the effects of art-backed loans in general, predicting that such practices may lead to a significant drop in the price of art in the market, placing more works in private collections, and thereby decreasing the amount of art available for viewing to the general public. Finally, Part VII briefly concludes.

II. Bank Loans

A. *Secured v. Unsecured*

Among many services that banks provide, "traditional banking activities" include the making and collecting of loans to and from the general public.[4] Most bank loans fall into two categories, secured or unsecured.[5] When a bank makes an unsecured loan, it lends money to the borrower in exchange for nothing more than the borrower's promise to repay the loan.[6] With a secured loan, a bank lends money not only in exchange for the borrower's promise to repay, but it also receives a security

4. Consorcio de Fomento Indus. S.A., de C.V. v. First Nat'l Bank, No. 93-c-0272, 1993 U.S. Dist. LEXIS 10707, at *8 (N.D. Ill. July 30, 1993); *see also* Edward L. Symons, Jr., *The "Business of Banking" in Historical Perspective*, 51 GEO. WASH. L. REV. 676 (1983) (discussing the business of banking generally and what activities are permitted).

5. John J. Chung, *A Fundamental Flaw with Uncitral's Approach to Cross-Border Secured Transactions: The Failure to Address Creditor Due Diligence Issues*, 20 AM. BANKR. INST. L. REV. 557, 564 (2012).

6. LAW J. PRESS, DUE DILIGENCE IN BUSINESS TRANSACTIONS §10.01, at [2]a.iii. (2013).

interest[7] in some asset owned by the borrower,[8] commonly referred to as collateral.[9]

B. *Due Diligence Requirements*

Article 9 of the Uniform Commercial Code (UCC) controls the creation of security interests in personal property.[10] By consolidating the differing laws of all 50 states into one uniform code, the UCC resolved a gigantic transaction cost issue that many were faced with when dealing with the different laws of different states.[11] Specifically, Article 9 of the Uniform Commercial Code was an enormous achievement in assisting the banks' loan process.[12] Importantly, it guides lenders as to how they should perform their due diligence prior to approving a secured loan.[13] Performance of due diligence requires the bank, prior to making any kind of loan, to determine whether "the borrower is willing and able to repay the loan."[14] At times, certain borrowers have no intentions, from the beginning, of repaying the loan, while others are simply unable to do so.[15] Therefore, before approving a loan, the bank must ensure that the borrower is both willing, and able, to repay it.[16] When making an unsecured loan, the due diligence requirements often end when the bank is satisfied that the borrower is both willing

7. "'Security interest' means an interest in personal property or fixtures which secures payment or performance of an obligation." U.C.C. § 1-201(a)(35) (2011).

8. Neil B. Cohen, *Harmonizing the Law Governing Secured Credit: The Next Frontier*, 33 TEX. INT'L L.J. 173, 430-31 (1998).

9. JOAN F. GARRETT, BANKS AND THEIR CUSTOMERS 99 (1995).

10. U.C.C. § 9-109(a) (2011) (stating that "this article applies to: (1) a transaction, regardless of its form, that creates a security interest in personal property or fixtures by contract . . . .").

11. Chung, *supra* note 5, at 558.

12. Donald J. Rapson, *Default and Enforcement of Security Interests under Revised Article 9*, 74 CHI.-KENT L. REV. 893, 893 (1999) (stating that "Article 9 has been rightfully lauded as the 'jewel' of the Uniform Commercial Code . . . .").

13. U.C.C. § 1-202(f) (2011).

14. Chung, *supra* note 5, at 565.

15. *Id.*

16. Marshall E. Tracht, *Renegotiation and Secured Credit: Explaining the Equity of Redemption*, 52 VAND. L. REV. 599, 622 (1999).

and able to repay the loan.[17]

However, before approving a secured loan, the bank must also inquire into the collateral that the borrower is offering to brace the loan.[18] In order to satisfy its due diligence in connection to the asset being used as collateral, the bank must ask, and answer, certain questions about the asset.[19] First, does the asset actually exist?[20] Second, does the borrower actually own the asset, and is therefore, able to grant a security interest to the bank?[21] Third, does the value of the asset reasonably cover the amount of the loan?[22] And fourth, does the asset have any liabilities or liens on it?[23]

III. Art: A Problematic Collateral

A. *The Common Asset*

In order to fully understand the unique complexities that art poses when it is used as collateral for a loan, let us first examine the process a bank would go through to approve a loan backed by a more commonly used asset. Consider for example, a luxury car, such as a Lamborghini Veneno Roadster, which retails for $4.5 million.[24] Using the due diligence questions mentioned above, a bank would first ask: does the asset exist? Not an unreasonable question, considering that Lamborghini only built nine of these cars.[25] In order to assure itself of the

17. Chung, *supra* note 5, at 565.

18. LAW J. PRESS, *supra* note 6, at §10.01, [4] ¶ 3.

19. Chung, *supra* note 5, at 565.

20. *Id.*

21. *Id.*; *see also In re* Hendry, 77 B.R. 85, 90 (Bankr. S.D. Miss. 1987) (discussing the borrower's use of cattle that he did not own in order to secure a loan).

22. Chung, *supra* note 5, at 565.

23. *Id.* In order to fulfill its due diligence, the bank should check the U.C.C. filings to ensure that there are no prior security interests on the asset. Citizens State Bank v. Peoples Bank, 475 N.E.2d 324, 331 (Ind. Ct. App. 1985).

24. Jim Henry, *10 Most Expensive Cars of 2014: Keeping Up With The 1 Percent*, FORBES (Dec. 19, 2013, 1:27 PM), http://www.forbes.com/sites/jimhenry/2013/12/19/10-most-expensive-cars-for-2014-keeping-up-with-the-joneses/#./?&_suid=139794642571108755596856015492.

25. *Id. See also* Peter Braun, *Dream Wheels: The Top Ten Most Expensive*

existence of the asset, the bank may require the borrower to actually present the physical car and allow the bank to inspect it.[26] Once the existence of the car is established, the bank will inquire whether the prospective borrower is the true owner of the vehicle. This question may be easily answered by having the borrower present the title of the vehicle in his name for the bank to verify. For valuation of the asset, the bank will likely make an estimate by looking at the pricing of "comparable" assets in the current market,[27] as well as its depreciation value over time, and the potential market for such an asset. Further, the bank will check to make sure that no liens were placed on the vehicle, and that there are no liabilities associated with it. If the borrower purchased the car with cash, and has never used this particular asset for any other loans, the bank will easily be able to satisfy itself regarding the asset's liens and liabilities.

As one can see, although due diligence is certainly necessary, there is often readily available information out there for the bank to request, review, and rely on, in order to accurately decide whether the asset is sufficient collateral to approve the loan that the borrower is requesting. The same is true whether the asset is a car, a boat, or a plane – some of the most commonly used personal property. However, the same is not the case when the asset being used as collateral is a work of art. Let us now go through the same process as we did with a Lamborghini, but using an artwork instead.

B. *The Art Asset*

The first inquiry, once again, is whether the asset exists. The question is not whether a rectangular canvas with water lilies painted on it exists, but rather, whether a *Monet* painting of water lilies exists.[28] The monetary value of a work of art is

Cars in the World, DIGITAL TRENDS (Nov. 6, 2014), http://www.digitaltrends.com/cars/dream-wheels-the-top-ten-most-expensive-cars-in-the-world/.

26. LAW J. PRESS, *supra* note 6, at § 10.01, [4] ¶ 3.

27. Charles Smithson, *Valuing "Hard-to-Value" Assets and Liabilities: Notes on Valuing Structures Credit Products,* J. APPLIED FIN, at 2 (2009), *available at* http://www.rutterassociates.com/pdf/smithson%20typeset.pdf.

28. Claude Monet was a French Impressionist painter who found inspiration in his immediate surroundings, and painted what he knew best,

not based solely on its aesthetic value, but more importantly on the value of the name of a particular artist within the art market.[29] Therefore, the initial inquiry by the bank automatically triggers the need for authenticity of the artwork.[30] In order to fulfill its due diligence the bank cannot simply rely on the certificate of authenticity that the borrower may have from an expert or auction house. There have been instances where the same expert who had authenticated an artwork some years prior, later found the same artwork to be a forgery.[31] Additionally, in numerous cases it has been shown that works of art that auction houses represented as authentic were later found to be forgeries.[32] Therefore, in order to fulfill its due diligence, a bank must engage a reputable expert to re-authenticate the work of art the borrower is attempting to use

such as his water garden in Giverny, France. *See* Laura Auricchio, *Claude Monet (1840 – 1926)*, THE METROPOLITAN MUSEUM OF ART, http://www.metmuseum.org/toah/hd/cmon/hd_cmon.htm (last visited Feb. 25, 2014). Monet painted his prized water garden in Giverny 250 times between 1900 and his death in 1926. *See Water Lillies*, CLAUDE MONET, http://www.claude-monet.com/waterlilies.jsp (last visited Feb. 11, 2015).

29. One of Monet's Water Lilies paintings sold at a Christie's auction in 2012 for $43.8 million. *Monet Water Lilies Painting Sells for $43.8 Million at Auction*, TELEGRAPH (Nov. 8, 2012, 6:50 AM), http://www.telegraph.co.uk/culture/art/art-news/9663180/Monet-water-lilies-painting-sells-for-43.8-million-at-auction.html. Another one of these paintings was sold in a May 6, 2014 auction by Christie's in New York for $27 million. *Monet's 'Water Lilies' Auctioned in NY For $27M*, INQUIRER.NET (May 7, 2014, 12:37 PM), http://lifestyle.inquirer.net/159135/monets-water-lilies-auctioned-in-ny-for-27m.

30. Stylistic authentication is the most frequent method used by art experts. Gareth S. Lacy, *Standardizing Warhol: Antitrust Liability for Denying the Authenticity of Artwork*, 6 WASH. J.L. TECH. & ARTS 185, 189 (2011). Such methods include connoisseurship, reviewing the catalogue raisonne, and establishing the artwork's provenance. *Id.*

31. *See, e.g.*, Greenberg Gallery v. Bauman, 817 F. Supp. 167 (D.D.C. 1993) (discussing a case where the expert who provided authentication for an Alexander Calder mobile later stated that the same mobile was no longer an authentic Calder); *see also* Tony Shafrazi Gallery, Inc. v. Christie's Inc., No. 112192/07, 2011 N.Y. Misc. LEXIS 5578 (Sup. Ct. Nov. 22, 2011) (discussing a case where Christie's invited the father of Jean-Michel Basquiat who was also on the Basquiat Authentication Committee, to view a Basquiat painting prior to auction, later that same Authentication Committee found the painting to be a forgery).

32. *See, e.g.*, Valerie Medelyan, *Says Who?: The Futility of Authenticating Art in the Courtroom*, 36 HASTINGS COMM. & ENT. L.J. 1 (2014) (discussing numerous instances where buyers acquired artwork from auction houses they later found to be fakes).

as collateral.

Once the authentication of the artwork is reasonably confirmed, the bank must inquire whether the borrower actually owns the artwork.[33] This too, is not as easy to answer as it is with a car. In order to fulfill its due diligence the bank cannot simply accept the proof of purchase that the borrower may have from a gallery or auction house. This is so because art theft is one of the world's most prevalent crime problems.[34] Additionally, after the initial theft, the artwork may be sold numerous times in good faith, without the buyer or the seller knowing of its murky provenance.[35] Further, the Association of American Museum Directors has stated that many artworks will not have a complete documented ownership history, even after the most thorough research.[36] Therefore, since one cannot acquire a clean title from a thief, the lender must not only verify that the borrower purchased the artwork in good faith, but also conduct research into prior purchases and sales of that work. The bank's risk of a possible future claim against the title of an artwork is significantly higher than it is with most other personal property.[37] Regardless of who wins, such legal battles can drag on for many years, costing the parties millions of dollars.[38]

Nevertheless, once the bank can reasonably confirm that the artwork has a clean ownership history, it must then determine the value of the work.[39] While concerns about the true value of collateral are certainly not unique to art, the valuation risks posed by art are greater than with any other kind of asset.[40] "The art market is remarkably different from all other

33. Chung, *supra* note 5, at 565.

34. Jennifer Anglim Kreder & Benjamin Bauer, *Protecting Property Rights and Unleashing Capital in Art*, 2011 UTAH L. REV. 881, 881 n.1 (2011).

35. Ashton Hawkins, *The Tale of Two Innocents: Creating an Equitable Balance Between the Rights of Former Owners and Good Faith Purchasers of Stolen Art*, 64 FORDHAM L. REV. 49, 69-75 (1995).

36. Kreder & Bauer, *supra* note 34, at 889.

37. *Id.* at 884.

38. Joseph F. Sawka, *Reconciling Policy and Equity: The Ability of the Internal Revenue Code to Resolve Disputes Regarding Nazi-Looted Art*, 17 U. MIAMI INT'L & COMP. L. REV. 91, 101 (2009).

39. Chung, *supra* note 5, at 565.

40. Stephen D. Brodie, *The Risk Calculus of Art Loans: Lending Against Value in an Extraordinary Market*, 12 ART LAW NEWSLETTER OF HERRICK,

asset classes – it is opaque, illiquid, unregulated, non-commoditized and emotional,"[41] said Stephen D. Brodie, a partner of a New York law firm. The value of an artwork is dependent upon numerous subjective factors, such as taste and cultural trends. Art is viewed as a volatile asset by lenders.[42] Therefore, in order to use art as collateral, lenders often require biannual valuations.[43] However, even the best appraisers are unable to see the entire market.[44] While auction sales information is widely available, less than half of all art sales take place at auction.[45] Therefore, virtually all art valuations are flawed.[46] Finally, since liquidity is of most importance to the lending bank, there needs to be an active market for the artwork.[47] The availability of such a market depends on several factors, such as the status of the artist, and the present appeal of the artist's work. Hence, the value of the artwork can significantly fluctuate over time; greatly affecting any bank's lending decision.[48]

Finally, once the bank is able to establish a reasonable value of the work, it must inquire into any liens and liabilities attached to the collateral.[49] This final step is extremely similar to any other asset. Article 9 of the UCC provides different methods for a bank to attach and perfect its security interest in an asset, as well as to inquire into any other possible liens on the collateral.[50] While assuring itself that the artwork has no liens or liabilities attached to it still poses certain risks to the lender, such risks are no different from other property used to secure

FEINSTEIN LLP, at 3 (2012) *available at* http://www.herrick.com/siteFiles/Practices/A74B71A40B32492FDCB11D819B5D8504.pdf.

41. *Id.* (citation omitted).

42. Philip Davis & Graham Ludlam, *The Issues Involved in Using Works of Art to Secure Loans*, ART NEWSPAPER (May 6, 2009), http://www.theartnewspaper.com/articles/The-issues-involved-in-using-works-of-art-to-secure-loans/17324.

43. *Id.*

44. Brodie, *supra* note 40, at 4.

45. *Id.*

46. *Id.*

47. Davis & Ludlam, *supra* note 42.

48. *Id.*

49. Chung, *supra* note 5, at 565.

50. *Id.* at 570-72.

loans.

IV. Banks Are Willing, But. . .

While art seems to represent everything that a banker hates – subjective, illiquid, volatile, and without any documents of title to enforce – loans secured by art have greatly increased over the last several years.[51] "It isn't that art is suddenly looking safe enough to bet the house on . . . it is more that there isn't much left to raise money against."[52] With traditional lines of credit drying up since 2008, art has become a very viable, and for some, the only, option to secure a loan.[53] Feeling pressure from their wealthiest clients, more banks are beginning to offer art-secured loans.[54]

For example, Michael Steinhardt, a former hedge-fund manager, was able to receive a loan from JPMorgan Chase Bank to purchase buildings in Manhattan for $65 million in cash.[55] Steinhardt pledged 20 works of art, including five Picassos and one Pollock, for the loan.[56] Steinhardt was able to borrow money "at rates that were much lower than those for commercial real estate projects . . . ."[57] Similarly, the Metropolitan Opera at

51. Shane Ferro, *Navigating the Art Loan Biz, A Surging Industry Attracting Both Big Banks and "Loan-to-Own" Sharks*, BLOUIN ARTINFO (Apr. 4, 2012, 4:37 PM), http://www.blouinartinfo.com/news/story/797602/navigating-the-art-loan-biz-a-surging-industry-attracting-both.

52. Melanie Gerlis, *Need a Loan? Use Your Art*, THE ART NEWSPAPER (Oct. 28, 2012), http://www.theartnewspaper.com/articles/Need-a-loan-Use-your-art/27226.

53. Colin Gleadell, *Does Art Make Good Collateral?*, TELEGRAPH (Mar. 9, 2009, 3:27 PM), http://www.telegraph.co.uk/culture/art/artsales/4962812/Does-art-make-good-collateral.html.

54. Jed Horowitz, *More Brokers Let Clients Borrow Against Their Bruegels*, REUTERS (Aug. 28, 2012, 7:03 AM), http://www.reuters.com/article/2012/08/28/us-usa-banks-art-loans-idUSBRE87R06520120828.

55. Miles Weiss & Katya Kazakina, *Steinhardt Pledges Picassos for Real Estate as Art Loans Surge*, BLOOMBERG (Oct. 18, 2011, 12:00 AM), http://www.bloomberg.com/news/2011-10-18/steinhardt-pledges-picassos-for-real-estate-as-art-loans-surge.html.

56. *Id.*

57. *Id.*

Lincoln Center in New York used its two Marc Chagall murals as collateral for a $35 million loan from JP Morgan Chase.[58] Such loans often charge a low rate, ranging from 0.71% to 3.25%.[59]

A. *Banks' Requirements*

Banks that choose to lend against art collateral have numerous safeguards built into the deal to protect themselves. First, the borrowers are very high net worth individuals, who have the ability to pay off the loan at the time it is made.[60] Second, the borrowers are expected to comply with liquidity and net worth covenants that are tested annually.[61] Third, the bank will require that the collateral consist of a diversified pool of art including work by contemporary artists as well as old masters.[62] This is done to make sure that if a particular artist becomes less favorable in the market, the collateral as a whole will still hold its necessary value. Fourth, such loans tend to be short-term, with two-year maturities, and rarely exceeding a five-year term.[63] Fifth, most lenders retain "post-closing appraisal rights," which they may exercise at least once a year.[64] And sixth, the bank will only lend up to 50% of the appraised value of the collateral, with many banks requiring the art to be valued at least $10 million total.[65] With so many restrictions in place, it seems that very few will ever qualify for these great, low interest art-backed loans from big banks. So what about the rest? The ones that are just plain rich, and not the ultra-very-

58. Daniel J. Wakin, *The Met Offers Chagalls as Collateral*, N.Y. TIMES, Mar. 4, 2009, at C3, http://www.nytimes.com/2009/03/04/arts/music/04oper.html.

59. AnnaMaria Andriotis, *Using a Picasso to Get a Home Loan*, WALL ST. J. (Jan. 10, 2013, 8:42 PM), http://www.wsj.com/articles/SB10001424127887323936804578227550737031398.

60. Horowitz, *supra* note 54.

61. Brodie, *supra* note 40, at 5.

62. *Id.*

63. *Id.*

64. *Id.*

65. John Arena, *Your Art Collecting as Loan Collateral*, U.S. TRUST, http://www.ustrust.com/publish/content/application/pdf/GWMOL/ARDE767A.pdf (last visited Feb. 12, 2015).

crazy rich? Well, for them, a newer market has emerged, consisting of "art lenders" and "luxury pawn shops" such as Art Capital Group,[66] borro,[67] ARTLoan,[68] and The Dina Collection.[69]

V. Loan Sharks Swimming in Art

The sub-prime lenders of the art world operate under state banking laws that regulate pawn shops.[70] Unlike collateral loans obtained from banks, a pawn shop actually takes possession of the artwork, and keeps it until the loan has been repaid.[71] While pawn shop laws vary from state to state, most have a few things in common.[72] Most states restrict the fees that a pawnbroker may charge through laws regulating small-business loans or usury laws.[73] For example, in Illinois, a pawnbroker cannot charge more than 3% interest per month.[74] In New York, no more than 4% interest may be charged per month,[75] while in Florida, a pawnbroker may charge as much as

66. ARTCAPITALGROUP.COM, http://www.artcapitalgroup.com (last visited Feb. 2, 2015).

67. BORRO.COM, https://www.borro.com (last visited Feb. 2, 2015).

68. *San Francisco Antique Dealers Indicted for Conspiracy and in Scheme to Commit Mail and Wire Fraud*, FBI (Jan. 16, 2014), http://www.fbi.gov/sanfrancisco/press-releases/2014/san-francisco-antique-dealers-indicted-for-conspiracy-and-in-scheme-to-commit-mail-and-wire-fraud.

69. DINA COLLECTION, http://www.thedinacollection.com/ (last visited Feb. 2, 2015).

70. Daniel Grant, *Pawn Brokers for the Art World*, BIG RED & SHINY (July 13, 2008), http://www.bigredandshiny.com/cgi-bin/BRS.cgi?section=article&issue=86&article=PAWN_BROKERS_FOR_24125024.

71. Jim Hawkins, *Regulating on the Fringe: Reexamining the Link Between Fringe Banking and Financial Distress,* 86 IND. L.J. 1361, 1388 (2011) (banks allow you to keep the work for the duration of the loan).

72. Most pawn shop laws require licensing, recordkeeping, and have regulations regarding pawning stolen property; however, these regulations are outside the scope of this article.

73. Susan Payne Carter & Paige Marta Skiba, *Pawnshops, Behavioral Economics, and Self-Regulation*, 32 REV. BANKING & FIN. L. 193, 197 (2012).

74. Pawnbroker Regulation Act, 205 ILL. COMP. STAT. 510/2 (2014) ("It shall be unlawful for any pawnbroker to charge or collect a greater benefit or percentage upon money advanced, and for the use and forbearance thereof, than the rate of 3% per month.").

75. N.Y. GEN. BUS. LAW § 46 (Consol. 2005) ("Notwithstanding any general or special statutes, local laws and ordinances to the contrary, no

25% interest per month.[76] These loans tend to be very short-term, averaging 30-90 days.[77] However, compared to a bank loan secured by art that has a 3% to 4% annual interest rate, these lenders charge on average 40% annual interest or higher.[78] The borrower is not required to have a bank account or a job, and no credit check is conducted.[79] Anyone can borrow on a pawn loan, so long as they produce the collateral, and have a valid photo ID.[80]

Other than these few regulations,[81] pawn shops have not been given much attention by regulators. Unlike other forms of "fringe banking" such as payday loans, which the Consumer Financial Protection Bureau (CFPB) has identified as an area of interest,[82] pawn shops seem to be flying under the radar. One explanation for this is that pawn shop loans are traditionally small and short-term, with an average loan being under $100.[83] Most pawnbrokers deal in small-size items, such as jewelry, electronics, and guns.[84] Pawn shops are either unwilling, or unable by law, to accept collateral such as vehicles, boats, and real property.[85] Most easily-movable personal property items such as jewelry, electronics, or even coin collections, simply do not have a very high price tag, compared to a boat or home. Fine art, however, while being compact in size, can carry a price tag well into the millions of dollars.[86]

collateral loan broker shall ask, demand or receive any greater rate of interest than four per centum per month, or any fraction of a month . . . .").

76. Florida Pawnbroking Act, FLA. STAT. § 539.001(11)(a) (2013).

77. Carter & Skiba, *supra* note 73, at 194.

78. Ferro, *supra* note 51.

79. *See id.*

80. *See id.*

81. Most pawn shop laws require licensing, recordkeeping, and have regulations regarding the pawning of stolen property; however, these regulations are outside the scope of this article.

82. Zixta Q. Martinez, *Share Your Input on Payday Loans for the Official Record*, CONSUMER FIN. PROT. BUREAU (Mar. 23, 2012), http://www.consumerfinance.gov/blog/2012/03/.

83. Carter & Skiba, *supra* note 73, at 195.

84. *Id.* at 202.

85. *See, e.g.*, Pawnbroker Regulation Act, 205 ILL. COMP. STAT. 510/1(a) (2014) ("The business of a pawnbroker does not include the lending of money on deposit or pledge of property.").

86. Thierry Ehrmann, *Art Market Trends 2011*, ARTPRICE, http://imgpublic.artprice.com/pdf/trends2011_en.pdf. Pablo Picasso's "La

Due to pawn shops' light regulation by the states – either because such transactions have commonly been considered too small to be given more attention, or because they often affected the low-income consumers – "art lenders" and "luxury pawn shops" are able to charge high interest rates and make huge profits, while hiding behind the lax state pawn shop statutes that never envisioned pawn shops conducting $10 million transactions.

A. *Their Not-So-Happy Clients*

Annie Leibovitz, one of the most famous living photographers, borrowed a total of $15.5 million from a company called Art Capital Group.[87] Ms. Leibovitz put up as collateral all of her photographic negatives, copyrights, and contract rights, "existing or to be created in the future" to back the loan.[88] She ended up paying 44% interest.[89] "In other words, according to loan documents filed with the city, one of the world's most successful photographers essentially pawned every snap of the shutter she had made or will make until the loans are paid off."[90] In the end, Ms. Leibovitz was able to pay off the loan and get her collateral back. Others, however, have not been so lucky.

Evan Tawil, an apparel industry executive, borrowed $250,000 from Art Capital.[91] Mr. Tawil put up two Andy Warhol paintings, entitled "Hamburger" and "Mineola Motorcycle," as collateral.[92] An edition of "Hamburger" recently sold at auction for $173,000[93] while a similar print of "Mineola Motorcycle" was

lecture" sold for over $ 36.2 million at Sotheby's February 8, 2011, auction in London. *Id*. at 30. Egon Schiele's "Hä user mit bunter wä sche" sold for over $ 35.6 million at Sotheby's June 22, 2011 auction in London. *Id.* Andy Warhol's "Self-Portrait" sold for $ 34.2 million at Christie's May 11, 2011 auction in New York. *Id.*

87. Allen Salkin, *That Old Master? It's Down at the Pawnshop*, N.Y. TIMES, Feb. 24, 2009, at A1.

88. *Id.*

89. Ferro, *supra* note 51.

90. Salkin, *supra* note 87.

91. *Id.*

92. *Id.*; *see also* Fine Art Fin., LLC v. Tawil, No. 603534/09, 2010 N.Y. Misc. LEXIS 5831 (Sup. Ct. Nov. 22, 2010) (describing the dispute between Art Capital and Tawil).

93. Andy Warhol, *Hamburger,* ARTNET.COM,

sold in a 2009 auction for $218,000.[94] Mr. Tawil made all of his interest payment to Art Capital on time.[95] However, when the loan term ended, he asked Art Capital to release the paintings so that he might sell them in order to pay off the principal.[96] Art Capital politely refused.[97] These two Warhols now hang in Art Capital's Madison Avenue headquarters in New York.[98] Another client of Art Capital, the widow of Randolph Apperson Hearst (of the Hearst Corporation), put up two Rubens portraits as collateral for a loan, which she later defaulted on.[99] These too became the property of Art Capital.[100]

Across the country in California, Yossi Dina, of The Dina Collection, is engaged in a similar business.[101] Mr. Dina makes four-month loans, extending the term of the loan if the client requests, charging the maximum interest rate allowed under the California penal code, which adds up to 48% annual interest.[102] State law does not proscribe any required ratios between the value of the collateral and the value of the loan.[103] Therefore, Mr. Dina is free to loan $1 million while taking possession of an artwork with a fair market value of $10 million.[104] Which is

http://www.artnet.com/artists/andy-warhol/hamburger-VQS71ZfnxWLHIHjKjDLytw2 (last visited Feb. 12, 2015).

94. Andy Warhol, *Mineola Motorcycle*, PHILLIPS, http://www.phillips.com/detail/ANDY-WARHOL/NY010509/156 (last visited Feb. 12, 2015).

95. Salkin, *supra* note 87.

96. *Id.*; *see also Fine Art Fin., LLC,* No. 603534/09, 2010 N.Y. Misc. LEXIS 5831, at *3.

97. Salkin, *supra* note 87.

98. *Id.*; *see also* Courtney Comstock, *Picture This: Annie Leibovitz in Court*, FORBES (Aug. 4, 2009, 10:10 AM), http://www.forbes.com/2009/08/04/annie-leibovitz-lawsuit-photography-markets-faces-media.html (briefly commenting on the Warhols in Art Capital's collection).

99. Salkin, *supra* note 87*; see also* Vicky Ward, *The Mansion Trap*, VANITY FAIR, Dec. 2008, *available at* http://www.vanityfair.com/culture/features/2008/12/hearst200812 (detailing Veronica Hearst's many financial troubles).

100. Salkin, *supra* note 87.

101. Grant, *supra* note 70.

102. *Id.*

103. *Id.*

104. *Id.*; *see also* Ayala Or-El, *The Pawn King,* TRIBE MAGAZINE (Nov. 28, 2011), http://www.tribejournal.com/community/2011/11/the-pawn-king/ (Dina states that once he paid $4,000 for a painting and later sold it at auction for

exactly what he does.

Mr. Dina has boasted that he sells more art than most galleries, attributing his success to his ability to undercut his competition.[105] Unlike auction houses, which cannot sell below the seller's requested price, Mr. Dina is free to sell the work for any price he wishes. And that illuminates one of the biggest problems that these usurious practices employed by art lenders and luxury pawn shops create.

VI. Bank v. Luxury Pawn Shop

While making huge profits on insanely-high interest rates, these "art lenders" are engaging in what is known as "loan-to-own" practices. They are hoping that the borrower will default on the loan, thereby allowing the lender to keep the artwork, and to subsequently sell it at auction.[106] Most lenders will only loan up to 50% of the artwork's value – if the borrower defaults, a sale at auction is a guaranteed profit, and a hefty one at that.[107] Especially since, unlike a bank, a pawnbroker is under no obligation to return the extra proceeds from a sale to the borrower.[108]

Insane interest rates aside, the extreme difference between a bank loan backed by art and a loan from an "art lender" is seen when the borrower defaults. When a borrower defaults on a bank loan, the bank is required to repossess the painting, and resell it at an auction.[109] After recovering what is owed, the bank is also required to give back any additional proceeds from the sale to the defaulting borrower.[110] Therefore, if a bank were to make a $1 million loan secured by a $10 million painting, even with interest and other fees, the defaulting borrower is likely to get back a substantial amount of money after the sale of his

$780,000).

105. Grant, *supra* note 70.

106. Ferro, *supra* note 51.

107. Arena, *supra* note 65.

108. *Id.*

109. *Using High End Artwork as Collateral for Bank Loans*, FROZEN PEA FUND (Nov. 5, 2013), http://frozenpeafund.com/using-high-end-artwork-as-collateral-for-bank-loans/.

110. U.C.C. § 9-608(b) (2011).

painting.

On the other hand, in pawn transactions, the borrower pledges an artwork in exchange for money, but he is not obligated to redeem it.[111] If the borrower is unable to pay off his loan after the time period specified by statute, the pawnbroker has the right to keep the collateral, and the borrower has no right to any excess of value that the pawnbroker acquires from the painting.[112] Therefore, if a pawnbroker were to make a $1 million loan secured by a $10 million painting, the defaulting borrower will receive nothing after the painting's sale.[113] It has been considered that most borrowers do not experience great financial loss by losing their property to pawn shops, because the value of most pawned goods is low.[114] Certainly it may not be worth the legislature's time to worry about a borrower who lost a $500 watch on a $50 dollar loan. However, when a $10 million artwork is considered, these transactions seem potentially criminal.

These art lenders are able to sell the work that is forfeited to them at far lower prices than most galleries and auction houses. Their cut-rate sales are the equivalent of selling a VCR that "fell off the back of a truck," since they are able to acquire works of art for as little as 10% of their fair market value. Paul Aitken, the CEO of *borro*, a company engaged in art lending, stated that "only 10 to 15 percent of clients default on their loans . . . ."[115] However, 10 to 15 percent of a $7 billion industry[116] is still quite high.

VII. Effects of Art-Backed Loans

The concept of using art as collateral for loans has great merit. The current economy has placed many cultural

111. *See, e.g.*, TEX. FIN. CODE ANN. § 371.170 (West 2006) ("A pledgor is not obligated to redeem pledged goods or to make a payment on a pawn transaction.").

112. Hawkins, *supra* note 71, at 1388.

113. *Id.*

114. *Id.* at 1390.

115. Ferro, *supra* note 51.

116. Michael Plummer, *The Truth About Art Financing – A Two-Tier System*, ARTVEST.COM (Apr. 4, 2012), http://artvest.com/the-truth-about-art-financing-%E2%80%93-a-two-tier-system/.

institutions in poor financial situations due to reduction in donations and government funding.[117] Art-backed loans from banks may allow institutions such as museums, opera houses, symphonies, and even cities,[118] to tap into the liquidity of what they already own, unearthing new sources of capital, while continuing to keep their prized possessions on the walls. These institutions, while struggling financially, have millions of dollars housed in their buildings in the form of paintings, sculptures, and murals. Allowing cultural institutions to access that capital through art-backed bank loans may help them, as well as their communities. As mentioned above, banks have stringent requirements that borrowers must meet, making their art-backed loans significantly less likely to default.[119] With the help of such loans, cultural institutions will be able to stay in business, and perhaps even to flourish.

In contrast, such loans from "luxury pawn shops" and "art lenders" may have drastically negative effects on individuals, the art market, and society as a whole. The effect on individuals is quite obvious: losing $10 million in the form of a painting for a $1 million loan with ultra-high interest rates is nothing short of devastating. The effect on the art market, however, is not as clearly visible. Yaron Leitner, a senior economist in the Research Department of the Philadelphia Fed, explains the problem by stating that "since the lender has an incentive to sell as quickly as possible, he may obtain less than what the collateral would normally sell for. . . . When many lenders try to sell at the same time, the market gets flooded and the price they can obtain decreases."[120] This is the exact problem the art

117. Kreder & Bauer, *supra* note 34.

118. Jeff Wattrick, *Could Kevyn Orr Use DIA Art as Collateral For Turnaround Loan?*, DEADLINE DETROIT (Sep. 5, 2013, 9:45 AM), http://www.deadlinedetroit.com/articles/6277/could_kevyn_orr_use_dia_art_as_collateral_for_turn (discussing how Detroit may have considered using the art in its Detroit Museum of Art in order to get the city out of its financial troubles).

119. FROZEN PEA FUND, *supra* note 109 ("Statistically speaking, a portfolio of loans secured against art-work at 60% collateral value will have a total default rate of approximately 2.6% . . . .").

120. Yaron Leitner, *Using Collateral to Secure Loans*, Q2 2006 FED. RES. BANK OF PHILA. BUS. REV. 9, 10 (2006), *available at* http://www.phil.frb.org/research-and-data/publications/business-review/2006/q2/br_q2-2006-2_using-collateral.pdf.

lenders create. By throwing into the market more artwork than there would typically be, and at significantly lower prices, their actions have the potential to drop the price of art as a whole. All it takes is a few Picassos selling for under $10 million to drop the artist's current going price of $100 million or more.[121] Finally, a drop in art prices may mean that more individuals would be able to own masterpieces; however, that also means that far fewer will be available for exhibiting to the general public.

VIII. Conclusion

Using art as collateral for loans was an inevitability, given the current economic climate. And, as with all new business practices, there are unscrupulous opportunists who will take advantage of the window that exists before meaningful regulation can be put into place. Damage will be done to the value of art, artworks will be forfeited, and insurmountable debts accrued, before the wheels of government turn and appropriate laws arrive. Individuals and entities with large art collections receiving liquidity in the form of bank loans are the privileged few, while those whose need drives them to swim with sharks will be bitten as long as the opportunity to do so remains.

121. Pablo Picasso currently holds numerous spots for some of the most expensive paintings ever sold, including "La Rêve," which sold for $155 million in 2013, "Nude, Green Leaves and Bust," which sold for $106.5 million in 2010, and "Garçon a la pipe," which sold for $104.1 million in 2004, just to name a few. G. Fernández, *Most Expensive Paintings Ever Sold*, ART WOLF, http://www.theartwolf.com/10_expensive.htm.