

# IMPOSING THE UNDERWRITERS' DUTY OF CARE ON ART AUCTIONEERS

## I. INTRODUCTION

Few cases deal with art auctions and auctioneers.<sup>1</sup> Those that are litigated invariably concern questions of authenticity<sup>2</sup> or title,<sup>3</sup> issues which are typically raised as defenses when the auctioneer sues the buyer to collect the purchase price of goods bought at an auction.<sup>4</sup> In *Cristallina S.A. v. Christie, Manson & Woods*<sup>5</sup> ("Christie's"), the seller sued the auctioneer and sought to hold him responsible for the failed auction.

*Christie's* involved a seller who consigned eight Impressionist paintings for sale to Christie's, the internationally known auction house. The subsequent auction was a failure. The sellers sued Christie's and their auctioneer,<sup>6</sup> contending that: (1) the failed

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<sup>1</sup> See generally 2 J. MERRYMAN & E. ELSÉN, LAW, ETHICS AND THE VISUAL ARTS 505-24 (2d ed. 1987) [hereinafter MERRYMAN & ELSÉN]. See also Gerstenblith, *Picture Imperfect: Attempted Regulation of the Art Market*, 29 WM. & MARY L. REV. 501 (1988) [hereinafter Gerstenblith].

Although few cases reach trial, the general level of litigation against art merchants has increased in direct proportion to the high stakes currently involved in the art business. See Burnham, *As The Stakes in The Art World Rise, So Do Laws and Lawsuits* N.Y. Times, Feb. 15, 1987, § 2 (Arts & Leisure) at 9, col. 2.

<sup>2</sup> See *Weisz v. Parke-Bernet Galleries, Inc.*, 67 Misc. 2d 1077, 325 N.Y.S.2d 576 (Sup. Ct. 1971), *rev'd.*, 77 Misc. 2d 80, 351 N.Y.S.2d 911 (1974) (action by buyers regarding an express warranty as to the authenticity of two paintings); see also *Hahn v. Duveen*, 133 Misc. 871, 234 N.Y.S. 185 (Sup. Ct. 1929) (suit against art expert for negligent appraisal).

<sup>3</sup> *Abrams v. Sotheby Parke-Bernet, Inc.*, No. 42255-84 (Sup. Ct., N.Y. County, Aug. 24, 1984) (action by New York State Attorney General to enjoin sale of ancient Hebrew manuscripts as consignor's title to goods was in doubt). For an interesting commentary on the above case see Comment, *Why is This Sale Different From all Other Sales?* *Abrams v. Sotheby-Parke-Bernet, Inc.*, 4 CARDOZO ARTS & ENT. L.J. 139 (1985). See also *Levy Bros. & Adler, Rochester, Inc. v. Karp*, 124 Misc. 901, 209 N.Y.S. 720 (Sup. Ct. 1924).

<sup>4</sup> See generally *Thompson v. Kelley*, 101 Mass. 291, 3 Am. Rep. 353 (1869), *French v. Sotheby & Co.*, 470 P.2d 318 (Okla. 1970). In both cases the courts held that the passing of title was not material to a suit instituted by the auctioneer for the purchase price; once the hammer falls at auction the bidder is liable for the contract price. However, in *Romani v. Harris*, 255 Md. 389, 258 A.2d 187 (1969), a successful bidder was excused based on a defense that the painting she had purchased was not by the alleged artist.

*Parke-Bernet Galleries, Inc. v. Franklyn*, 31 A.D.2d 276, 297 N.Y.S.2d 151 (1969), *rev'd on other grounds*, 26 N.Y.2d 13, 256 N.E.2d 506, 26 N.Y.S.2d 337 (1970), is another example of an auctioneer suing to collect the purchase price for a sale. The buyer in this case raised the defense of lack of personal jurisdiction—having conducted his bidding over the phone—which was dismissed.

<sup>5</sup> 117 A.D.2d 284, 502 N.Y.S.2d 165 (1st Dep't 1986).

<sup>6</sup> The fact that the consignor sued the auctioneer was of itself quite unusual. See *Porter v. Wertz*, 68 A.D.2d 141, 416 N.Y.S.2d 254 (1979), *aff'd.* 53 N.Y.2d 696, 421 N.E.2d 500, 439 N.Y.S.2d 105 (1981) (owner of painting sues to recover work sold without his consent); *Art Education Press, Inc. v. Smith*, 252 A.D. 316, 299 N.Y.S. 170 (1937) (auctioneer sued by consignor for the proceeds of an auction sale). See generally Note, *Title Disputes in the Art Market: An Emerging Duty of Care for Art Merchants*, 51 GEO.

auction resulted from the auctioneer's selection of paintings that lacked auction appeal; (2) the auctioneer failed to bring materially relevant information to the seller's attention regarding the auction value of the paintings; (3) Christie's provided contradictory advice to the public regarding the presale estimates; and (4) the auctioneer recommended reserves<sup>7</sup> higher than the highest presale estimate—a violation of Christie's policy.<sup>8</sup>

Cristallina first sued Christie's in 1982. The suit was dismissed in 1985 by the State Supreme Court in Manhattan.<sup>9</sup> This ruling was modified by the Appellate Division in 1986, which cleared the obstacles to trial.<sup>10</sup> However, the case was settled in January of 1987, before the jury reached the merits of the case.<sup>11</sup>

The issue raised in the *Christie's* case was to what standard of care, if any, should an auctioneer be held. The case is important because it has established the notion that the auctioneer is more than just a seller of goods.<sup>12</sup> It introduced the concept of professional liability into the auction world, and continued the imposition of liability against those who hold themselves out as art experts, i.e., dealers and appraisers.<sup>13</sup>

In analyzing *Christie's*, this Note will focus on the issue of disclosure and how it relates to the auctioneer's performance of his duties.<sup>14</sup> Information is an integral part of maximizing the benefits of an auction, and only an informed seller can determine

WASH. L. REV. 443 (1983); R. DUFFY, ART LAW: REPRESENTING ARTISTS, DEALERS, AND COLLECTORS (1977).

<sup>7</sup> See *infra* note 28.

<sup>8</sup> *Christie's*, 117 A.D.2d at 286, 502 N.Y.S.2d at 168. For a more detailed picture of auction house policies, see Reif, *Auctions*, N.Y. Times, Aug. 2, 1985, at C23, col. 1.

Several new rules governing auction house practices were proposed by the New York City Department of Consumer Affairs in the wake of the *Christie's* litigation. See McGill, *Proposed Auction Rules Would Reveal No-Sales*, N.Y. Times, Apr. 10, 1986, at C17, col. 1; *New York City Sets Auction-Business Rules*, N.Y. Times, Oct. 24 1986, at C22, col. 6; McGill, *Sweeping Reassessment in the Auction Trade*, N.Y. Times, July 31, 1985, at A1, col. 4.

<sup>9</sup> *Cristallina S.A. v. Christie, Manson & Woods Int., Inc.*, No 82-09630 (S. Ct., N.Y. Cty., July 15, 1982).

<sup>10</sup> *Christie's*, 117 A.D.2d at 284, 502 N.Y. at 165.

<sup>11</sup> See McGill, *An Out-of-Court Settlement Reached in Christie's Case*, N.Y. Times, Jan. 22, 1987, at C20, col. 3. For an additional report on the "Cristallina Disaster" and its aftermath, see 2 MERRYMAN & ELSEN, *supra* note 1, at 507-12. See also Gerstenblith, *supra* note 1, at 533-39.

<sup>12</sup> *Christie's*, 117 A.D.2d at 290, 502 N.Y.S.2d at 172.

<sup>13</sup> E.g., *Hahn v. Duveen*, 33 Misc. 871, 234 N.Y.S. 185 (Sup. Ct. 1929).

<sup>14</sup> Disclosure is the primary objective of the 1933 and 1934 Securities Acts. Securities Act of 1933, Pub. L. No. 73-22, 48 Stat. 74 (1933) (codified as amended at 15 U.S.C. §§ 77a-77aa) (1982 & Supp. IV 1986) [hereinafter Securities Act of 1933]; Securities Exchange Act of 1934, Pub. L. No. 73-291, 48 Stat. 881 (1934) (codified as amended at 15 U.S.C. §§ 78a-78kk (1982 & Supp. IV 1986) [hereinafter Exchange Act of 1934]. The Securities and Exchange Commission (SEC) statutes were enacted "to substitute a philosophy of full disclosure for the philosophy of *caveat emptor* and thus to achieve a high standard of business ethics in the securities industry." SEC v. Capital Gains Research

whether the auctioneer is acting in his best interests.<sup>15</sup>

This Note, in addressing the issue of disclosure and the need for a freer flow of information between the parties, will analogize the role of the auctioneer to that of an underwriter. The underwriting function is similar in some ways to the mechanics of an auction sale.<sup>16</sup> In analyzing the auctioneer's role as professional,<sup>17</sup> fiduciary,<sup>18</sup> and underwriter in the art market,<sup>19</sup> this Note will suggest that the auctioneer should face similar due diligence requirements to those that the underwriter must adhere to under the 1933 Securities and Exchange Act.<sup>20</sup>

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Bureau, Inc., 375 U.S. 180, 186 (1963), *quoted in*, L. LOSS, FUNDAMENTALS OF SECURITIES REGULATION 36 (3d. ed. 1983) [hereinafter L. LOSS].

The primary purpose of both acts has been to protect the buyer of securities through disclosure before a public offering and continued disclosure after the securities have been distributed. The Securities Act of 1933 maintains its disclosure philosophy by requiring the registration with the SEC of distributions of securities. The Securities Exchange Act of 1934 transformed the static disclosure of the 1933 Act "into a philosophy of continuous disclosure through the registration of all securities traded on exchanges." L. Loss, *supra* at 39. *See also infra* notes 166-167 and accompanying text.

<sup>15</sup> This Note, in comparing the role of the auctioneer to that of an underwriter, is not necessarily analogizing the consignor to an issuer in a securities offering. The "seller" or consignor in this Note, is afforded many of the same protections available to the purchaser of stock in the securities context. The benefits that would inure to the art buying public, should this Note's proposal be adopted, are obvious and consequently will not be the focus of discussion.

Furthermore, current regulations regarding auctioneers provides some protection for the buying public. The New York City Department of Consumer Affairs Regulation facing auctioneers provides that:

[t]he auctioneer will be held responsible for the truth of any statement contained in any catalogue, advertisement, announcement, press release or other public statement made by the auctioneer relating to any auction.

City of New York, Department of Consumer Affairs, Administrative Code ch. 32, tit. B, Art. 21, reg. 1 (1987).

<sup>16</sup> Unlike the auctioneer, the underwriter does not sell directly to the public, but rather to other brokerage houses.

<sup>17</sup> *See infra* notes 74, 76 & 78 and accompanying text. New York law treats the dealer, gallery, and art auction house as "art merchants." New York's Cultural Affairs Law, which governs works of fine arts, prints, and posters, defines an art merchant as:

a person who is in the business of dealing, exclusively or non-exclusively, in works of fine art or multiples, or a person who by his occupation holds himself out as having knowledge or skill peculiar to such works, or to whom such knowledge or skill may be attributed by his employment of an agent or other intermediary who by his occupation holds himself out as having such knowledge or skill.

N.Y. ARTS & CULT. AFF. LAW § 11.01 (2) (McKinney Supp. 1988).

<sup>18</sup> *See infra* notes 117-21 and accompanying text.

<sup>19</sup> *See infra* notes 151-53 & 162 and accompanying text.

<sup>20</sup> Securities Act of 1933, 15 U.S.C. §§ 77a-77aa (1982). Underwriters involved in a public offering typically conduct a "due diligence" investigation to verify the information in the registration statement submitted to the SEC prior to its effectiveness. The underwriters' defense to a civil suit under section 11 of the 1933 Act, is to show that a reasonable investigation gave him reasonable grounds to believe that the registration statement did not contain a material misstatement or omission. *See* L. Loss, *supra* note 14, at 1036-39.

## II. BACKGROUND

A. *The Auction Process*

Auction houses play a critical role in the acquisition and disposition of art.<sup>21</sup> The auctions they conduct represent the liquid side of the art market and serve to establish the market value of the work of a particular artist or school.<sup>22</sup> One of the principal attractions of auctions is the likelihood of achieving prices higher than those that could be obtained through a private sale.<sup>23</sup> Naturally, there are risks,<sup>24</sup> and these risks are generally borne by the

<sup>21</sup> "Auctions are only one of the possible methods in a free market system by which goods are sold. They are, however, the most popular means of acquiring and disposing of art; . . . nearly fifty percent of art transactions are handled by this method." L. DuBOFF, *ART LAW* 53 (1984). For a comprehensive look at auctions from past to present, see DuBoff, *Auction Problems: Going, Going, Gone*, 26 CLEV. ST. L. REV. 499 (1977) [hereinafter, DuBoff, *Auction Problems*]. See generally Bender, *High Finance Makes a Bid for Art*, N.Y. Times, Feb. 3, 1985, § 3 (Business), at 1, col. 2. An estimated \$25 billion in art and collectibles are sold worldwide each year. In addition, there is a growing trend towards using art for its leveraging potential.

[Art] is being treated by some leading money center banks and smaller financial institutions as an instrument of high finance. Before the transformation is completed, a painting could become more like a house—a piece of property to be enjoyed not only for its esthetic or emotional value, but for its borrowing power.

*Id.* See also Reif, *Sotheby's Sets Record For Sales: \$1.3 Billion*, N.Y. Times, Sept. 10 1987, at C16, col. 4; Vogel, *Bargains Can Still Be Found*, N.Y. Times, Sept. 4, 1987, at C22, col. 5.

<sup>22</sup> L. DuBOFF, *ART LAW* at 53. "Dealers and collectors now examine the prices reached at the latest auction the way brokers and investors study each day's closing stock market report. . . ." Canaday, *When Is an Auction Not an Auction?*, N.Y. Times, Mar. 10, 1974 § II (Arts & Leisure), at 19, col. 1 [hereinafter *When is an Auction?*]. For a comparative and humorous analysis of the art and securities market, see Feldman, *Commodities and Art: A Delicate Relationship*, 10 COLUM. J.L. & ARTS 197 (1986) [hereinafter, Feldman]. See also Baumol, *Unnatural Value: Or Art Investment as Floating Crap Game*, 15 J. ARTS MGMT. & LAW 47 (1985).

<sup>23</sup> "[A]n auction determines what a work of art is 'worth' . . . because someone bidding against someone else was willing to pay that much for it." *When is An Auction?*, *supra* note 22, at 19, col. 1. However, in a private sale, which is negotiated between a collector and a dealer, the chances of getting true value are slim. "A dealer's business philosophy is simple—buy as low as possible, sell as high as possible," which is why, though a public auction carries risks, it's a way to realize better prices. Birmingham, *The Auction Crowd*, N.Y. Times, Mar. 6, 1977, § 6 (Magazine) at 40 [hereinafter *Auction Crowd*]. See also *infra* note 28 and accompanying text.

<sup>24</sup> Simply stated, the art work may not sell very well because of insufficient interest. The market may find the price unreasonable, or the aesthetic appeal of the piece just doesn't generate the necessary bidding. Also, the bidding might fail to meet its reserve price and thus be bought in. Many believe that this damages the work's value and makes it a tougher sell, especially if the information is leaked to the press, which can and does happen. See *Auction Crowd*, *supra* note 23, at 38. The more optimistic vision is that a painting bid up to its reserve and then bought in has established its market value without the benefit of being sold. *Id.* at 40. This becomes especially true when one realizes that it is almost impossible to tell at an auction whether a work has actually been sold and who bought it, given the policy of protecting the seller. See *When Is An Auction?* *supra* note 22, at 19; Gerstenblith, *supra* note 1, at 530. In fact, it was cynically suggested that unscrupulous types might "lay in a substantial supply of some low-priced artist's paintings, put a few of them up at progressively higher prices as bid in by accomplices, and create an expensive new reputation from the publicity." *When Is An Auction?*, *supra* note

seller.<sup>25</sup> If an auction fails, the seller must keep his goods; in the language of the auction house, the items are "bought in."<sup>26</sup>

Chapter 32, Title B, Article 21, Regulation 8 of New York City's Department of Consumer Affairs<sup>27</sup> allows sellers to set a minimum price below which their property cannot be sold. This threshold minimum is called a reserve price;<sup>28</sup> it is usually established with the advice of the auction house specialist and is only disclosed to the auction house and the consignor.<sup>29</sup> The higher the reserve price, the more likely the goods will be bought in. If the auction does not result in a sale, the seller bears the cost of failure even though the auction house might be responsible for overpricing the work or not generating sufficient interest in the sale.<sup>30</sup>

The success of an auction turns on many factors, including time, place, weather, and the level of publicity surrounding the event.<sup>31</sup> An auction house will try to attract as many bidders as possible, using all the resources at its disposal to attain that end.<sup>32</sup> However, even well-attended auctions can fail, and some of the reasons for failure can be attributed to acts committed by the auction house before the sale.

22, at 19. See also DuBoff, *Auction Problems*, *supra* note 21, at 509-11. But see Goldman, *When Items Don't Sell*, N.Y. Times, Aug. 8, 1986, at C25, col. 1.

<sup>25</sup> See *infra* note 30 and accompanying text.

<sup>26</sup> "When a lot does not sell during an auction, it is 'bought in,' i.e., it remains the property of the owner." HOW TO BUY AND SELL AT CHRISTIE'S (1987).

<sup>27</sup> If the consignor has fixed a price below which an article will not be sold, the "reserve price," the fact that the item is being sold subject to reserve must be disclosed in connection with the description of any item or items so effected in the catalogue or any other printed material published or distributed in relation to the sale.

City of New York, Department of Consumer Affairs, Administrative Code Ch. 32, tit. B, art. 21, reg. 13.a (1987)(footnote omitted).

<sup>28</sup> The "reserve price" is "the minimum price agreed upon confidentially between [the auctioneer] and the seller below which an item will not be sold, i.e., the item will be 'bought in' if the bidding does not at least reach the reserve price." HOW TO BUY AND SELL AT CHRISTIE'S (1987). See also U.C.C. 2-328 (3).

<sup>29</sup> See Feldman, *supra* note 22, at 199.

<sup>30</sup> One of the costs borne by the seller is the damage which occurs if the item is widely known and the buying public is aware of who the owner is. See DuBoff, *Auction Problems*, *supra* note 21, at 509-11.

From a securities market perspective, there is a similarity in the relationship of the issuer and underwriter. The issuer also bears the loss in the case of a public offering done under a "best efforts" arrangement. Only if the underwriting agreement is a "firm commitment" will the underwriter be responsible for failure. See *infra* note 150 and accompanying text.

<sup>31</sup> L. DUBOFF, *THE DESKBOOK OF ART LAW* 569 (1977) [hereinafter L. DUBOFF, *DESKBOOK*].

<sup>32</sup> For major auction houses, catalogues are most effective, as they are widely followed by dealers and collectors who may want to bid or simply monitor price trends. See *id.* at 568. See also *infra* note 38 and accompanying text.

Before consigning<sup>33</sup> a work for auction, the seller will generally want to know about the work of art and its appraisal value.<sup>34</sup> This information will affect the seller's decision to pursue a sale by means of an auction. One common way to conduct an appraisal is through a valuation by an auction house representative.<sup>35</sup> Many objects or works of art need to be examined personally before an accurate appraisal can be made. In addition, if a large collection is involved, the auctioneer can recommend and select the most appropriate pieces to be auctioned. A presale estimate is made by the expert based on his evaluation of the works.<sup>36</sup> The goods are then consigned to the auction house approximately three months before the auction date, where more extensive research is done before the works are catalogued.<sup>37</sup>

Catalogues are an indispensable part of the auction process.<sup>38</sup> They provide prospective buyers with information about

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<sup>33</sup> Consign is defined as: "[t]o deliver goods to a carrier to be transmitted to a designated factor . . . [t]o deposit with another to be sold, disposed of, or called for, whereby title does not pass until there is action of consignee indicating sale." BLACK'S LAW DICTIONARY (3rd ed. 1979); see also U.C.C. 2-326.

<sup>34</sup> This is one of the advantages of auction houses which underscores their importance in the market place. An auction house provides expertise and a well established marketing network to the prospective seller. An auction house's expert knowledge is reflected in the training and background of the auction specialists. The specialists' acquired skills are based on the volume of work encountered, research of past sales, prices, provenance, exhibitions, and literature. The auction house's marketing base is composed of a full in-house staff encompassing media relations, advertising, special events, customer service, catalogue preparation, and regional representation. The marketing base is geared completely towards attracting existing buyers and encouraging new ones. See Loud, *How an Auction House Works, Advantages of Sale— Auction Expertise and Marketing, in Representing Artists, Collectors & Dealers*, 611 (R. Lerner, ed. 1985) [hereinafter *Representing Artists*].

<sup>35</sup> This is not typical. Only in certain circumstances, such as an unusually large or diverse collection, or a very important collector and/or collection, will the auction house expert make an on-site visit. See SOTHEBY'S: A GUIDE TO BUYING AND SELLING AT AUCTION (1987); HOW TO BUY AND SELL AT CHRISTIE'S (1987).

<sup>36</sup> These estimates are based on the specialist's knowledge of the current art market. Other factors taken into account when appraising a work are: (1) authenticity; (2) condition; (3) rarity; (4) its historic importance; (5) size; (6) medium, i.e., actual material used in the creation of the work; (7) provenance, i.e., the history of ownership; (8) subject matter, e.g., a Rembrandt painting of a dead ox will not be as valuable as a Rembrandt painting of an attractive young girl; (9) fashion, or the intangible of current tastes; and (10) aesthetic quality, the most difficult criterion to explain. Weitmann, *The Fine Art of Appraisals*, in REPRESENTING ARTISTS, *supra* note 34, at 603-10. See also Mathias v. Commissioner, 50 T.C. 994 (1968); Mauldin v. Commissioner, 60 T.C. 749 (1973). For a more in-depth exploration of the mechanics of the appraisal process, see Homer, *Fine Art Appraisers: The Art, The Craft, and The Legal Design*, 8 COLUM. J.L. & ARTS 457 (1984) [hereinafter Homer]; Hildesley, *Fine Arts Appraisal—an Auctioneer's View*, in *Representing Artists*, *supra* note 34 at 165.

<sup>37</sup> L. DUBOFF, *DESKBOOK*, *supra* note 31, at 568.

<sup>38</sup> The catalogue serves a function similar to that of a preliminary prospectus for the securities market, which is sent to prospective purchasers, providing information about an upcoming sale, and often giving an approximate price range. Both the issuer and underwriter face some liability as to this information, though not to the same degree as

an upcoming sale and list an estimated price at which the auctioneer expects the items to sell. Catalogues also provide collectors with insight about price trends and current values.<sup>39</sup>

The marketing process imparts most of the costs of a failed auction to the consignor. The auctioneer may suffer the loss of a commission and slight public embarrassment, but the consignor faces much greater damage. Apart from out-of-pocket expenses incidental to the auctioning process,<sup>40</sup> the consignor faces potential damage to the value of his property if knowledge of the failed auction becomes public.<sup>41</sup> The consignor will also be unable to immediately resell the work at auction, and at this point the negative publicity generated is likely to preclude a private sale.<sup>42</sup>

### B. *The Facts of Christie's*

Cristallina<sup>43</sup> contacted Christie's about selling several Impressionist paintings from Cristallina's collection.<sup>44</sup> David Bathurst, then president of Christie's, met with Cristallina representative Dimitry Jodidio in Geneva, and after inspecting a group of paintings, recommended eight of them for auction.<sup>45</sup> Bathurst prepared a memorandum to demonstrate the advantage of a public auction as opposed to a private sale.<sup>46</sup> Jodidio claimed that Bathurst played down the estimated price that a private sale would bring and focused on the highest auction figures from the range of prices provided.<sup>47</sup> Based on Bathurst's advice, Jodidio agreed to a public auction. Christie's publicized the sale

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with an offering prospectus, which is directly connected to the sale. *See also infra* note 155 and accompanying text.

<sup>39</sup> *See supra* notes 22 and 32 and accompanying text.

<sup>40</sup> *E.g.*, insurance costs for shipping works to auction house, shipping costs and cataloguing expenses. *See* HOW TO BUY AND SELL AT CHRISTIE'S (1987).

<sup>41</sup> *See supra* notes 24-26 and accompanying text. This problem is further compounded by the recent statutory requirement that the auctioneer must announce at the sale that an item has been "bought in." *See* City of New York, Department of Consumer Affairs, Administrative Code ch. 32, tit. B, art. 21, reg. 20 (1987).

<sup>42</sup> Another possible factor in the failure of an auction is the potential for insider trading by the auctioneer in collusion with a "ring" of buyers.

<sup>43</sup> The main business of Cristallina, a Panamanian corporation, was the purchase and sale of works of art. Jodidio was the principal shareholder of Cristallina and the owner of the French art auction magazine *Connaissance des Arts*. Brief for Defendants-Respondents at 8, *Christie's*, 117 A.D.2d 284, 502 N.Y.S.2d 164 (1986).

<sup>44</sup> *Id.* at 286.

<sup>45</sup> *Christie's*, 117 A.D.2d at 286, 502 N.Y.S.2d at 167.

<sup>46</sup> *Id.* Another similarity between the art and securities markets is that, under Regulation D of the 1933 Act, some securities may be sold through a private process, facilitated by the underwriter. 17 C.F.R. § 230.501-506 (1986).

<sup>47</sup> *Id.* Bathurst also described the auction sales which had occurred in the spring and fall of 1980, demonstrating how spirited bidding at an auction during a strong market could yield higher prices than would be expected in a private sale.

through the media and the collectors' network, and also produced a color catalogue of the paintings.<sup>48</sup>

Prior to cataloguing the paintings, Bathurst recommended total reserves for the paintings and wrote a memo which listed an assigned reserve for each painting.<sup>49</sup> The reserves were contingent upon a later meeting between Bathurst and Jodidio, where the final price would be set just prior to auction. There was also an understanding that Bathurst's estimate was subject to the vagaries of the marketplace.<sup>50</sup>

Subsequent to the meeting in Geneva, Christopher Burge, then head of Christie's Impressionist Painting Department, agreed with Bathurst's valuation of the works, but disagreed as to their auction appeal.<sup>51</sup> Burge strongly believed that the subject matter of many of the paintings would make them difficult to sell, irrespective of the true value they carried.<sup>52</sup> Burge's opinion was never reported to Jodidio.<sup>53</sup>

At the time Burge was consulted, the paintings were not yet catalogued and no public announcements of the sale had been made. At this point, the sale could have been cancelled without lowering the value of the paintings.<sup>54</sup>

Before an auction, Christie's advises potential purchasers of the high and low presale price estimates for each painting. These estimates reflect the auction house's appraised value of a work and are generally accepted by the public as the approximate market value of the paintings.

Christie's first publicly released estimates were substantially lower than the original price that Bathurst quoted to Jodidio.<sup>55</sup> The high estimate was also lower than the original recommended reserves.<sup>56</sup> In releasing these estimates, Christie's "violated its long-standing policy, stated in every catalogue which it published, not to set reserves higher than the announced presale es-

<sup>48</sup> *Id.* at 287, 502 N.Y.S.2d at 168.

<sup>49</sup> *Id.*

<sup>50</sup> *Id.*

<sup>51</sup> *Id.* "Although he did not change his view as to their value . . . he believed [that] irrespective of their true value, [they] would be 'difficult' to sell at auction since 'a prettier picture will be easier to sell than a tough picture, even though the tough picture is important.'" *Id.*

<sup>52</sup> *Id.* at 288, 502 N.Y.S.2d at 168.

<sup>53</sup> *Id.* "For example, Burge considered the Cezanne to be a 'tough picture' while Bathurst predicted proceeds as high as \$3,200,000, a figure which Burge dismissed as 'unobtainable.'" *Id.*

<sup>54</sup> *Id.*

<sup>55</sup> *Id.* at 289, 502 N.Y.S.2d at 169.

<sup>56</sup> *Id.*



timates."<sup>57</sup> Ideally, reserves should be set at around eighty percent of the published estimates. Neither the estimates quoted to the public nor any specific high or low presale estimate was ever quoted to Jodidio.<sup>58</sup>

Eight days after the first release, Christie's issued new price estimates which were even lower than the prices they previously released.<sup>59</sup> Thus, one week before the auction, Christie's was advising the bidding public that the paintings were not worth as much as previously stated.<sup>60</sup>

Jodidio and Bathurst met one last time before the auction to finalize the setting of reserve prices. The reserves were approximately the same as Bathurst had initially recommended after their first meeting, which was still higher than the presale estimates released to the public.<sup>61</sup> Furthermore, Bathurst failed to advise Jodidio about the earlier public releases of the lower presale estimates.<sup>62</sup> Jodidio agreed to the higher reserves, still believing that the presale estimates were the ones they had originally agreed upon.<sup>63</sup>

The auction was conducted during one of the busiest and most lucrative weeks for auction houses.<sup>64</sup> It was well advertised and there was a sell-out crowd at the auction.<sup>65</sup> Despite this, only

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<sup>57</sup> *Id.* at 288, 502 N.Y.S.2d at 169. A 1987 amendment to the New York City Department of Consumer Affairs Law regulating auctioneers now provides that [i]n no event shall the reserve price for any lot exceed the maximum estimated value of the lot as published in any catalogue or other printed material distributed by the Auctioneer.

City of New York, Department of Consumer Affairs, Administrative Code ch. 32, tit. B, art. 21, reg. 23 (1987).

<sup>58</sup> *Id.* at 289, 502 N.Y.S.2d at 169.

<sup>59</sup> On May 12, 1981, Christie's public relations officer, who received her information from Burge, wrote to CBS in connection with her promotional activities for the upcoming auction, stating that Christie's expected to receive between \$5,000,000 and \$9,000,000 for the paintings. Thus eight days after its May 4th quote setting forth the high and low estimates [at \$6,250,000 and \$10,000,000] and only one week before the auction, Christie's was advising the media that the paintings were worth even less than the estimates quoted on May 4th. *Id.*

<sup>60</sup> *Id.* at 289, 502 N.Y.S.2d at 169. Prior to auction, the confidentiality as to whom the consignor of the works was may have been breached. Many rumors circulated within the art community questioning the ownership of the paintings and Jodidio's name came up more than once. Cristallina alleged that this may have contributed to questions about the title and ownership of the paintings. An inter-office telex between Geneva and New York suggested that Bathurst had notice of the rumors, but Jodidio was once again kept in the dark. *Id.* See also N.Y. Times, May 15, 1981, at C1, col. 6.

<sup>61</sup> *Christie's*, 117 A.D.2d at 291, 502 N.Y.S.2d at 170.

<sup>62</sup> *Id.*

<sup>63</sup> *Id.*

<sup>64</sup> *Id.*

<sup>65</sup> See Reif, *Art Records Set in May*, N.Y. Times, June 7, 1981, § 2 (Arts and Leisure), at 33. During the month of May, record prices were obtained at auctions conducted by Christie's and Sotheby's. Sotheby's enjoyed record sales during the week of the Cristallina auction.

one of the eight paintings was sold.<sup>66</sup>

Although the court in *Christie's* held that an auctioneer cannot be a guarantor of prices,<sup>67</sup> nor be required to predict the results of a sale,<sup>68</sup> it did find that an auctioneer could be "held to a standard of care commensurate with the special skill which is the norm in the locality for that kind of work."<sup>69</sup> In modifying the trial court's dismissal, the Appellate Division gave the consignor—Cristallina—the opportunity to try the issues of whether the auctioneer: (1) was professionally negligent; (2) had breached a fiduciary duty to the consignor; or (3) by his actions, had breached the contract between the two.<sup>70</sup>

### III. THE AUCTIONEER AS PROFESSIONAL

#### A. Industry Standards

Sellers choose a particular auction house because of its perceived ability to perform the tasks related to conducting an auction. A particular auction house may have a special reputation within the community, created by ongoing representations as to its fitness and skill.<sup>71</sup>

Once a contractual relationship is formed, the consignor is entitled to rely upon the auctioneer's judgment and integrity.<sup>72</sup> The seller may also rely on the auction house not to deviate from its standard practices for the promotion and sale of works of art. In short, the seller is relying on the existence of industry standards.<sup>73</sup> Among auction houses, Christie's and Sotheby's are the dominant forces. Consequently, their in-house practices represent the standard of care for the industry.

For example, the auction house's policy in *Christie's* of not

<sup>66</sup> *Christie's*, 117 A.D.2d at 291, 502 N.Y.S.2d at 170.

<sup>67</sup> *Id.* at 294, 502 N.Y.S.2d at 172.

<sup>68</sup> *Id.* See also *CPC Int'l, Inc. v. McKesson Corp.*, 120 A.D.2d 221, 507 N.Y.S.2d 984 (1st Dep't 1986), *modified*, 70 N.Y.2d 268, 519 N.Y.S.2d 804 (1987) (statement that a business will yield large profits is promissory and a matter of opinion).

<sup>69</sup> "[S]ufficient [evidence had] been shown to present a factual question as to whether Christie's and Bathurst acted in a manner commensurate with their skill and expertise." *Christie's*, 117 A.D.2d at 294, 502 N.Y.S.2d at 172.

<sup>70</sup> *Id.*

<sup>71</sup> See RESTATEMENT (SECOND) OF TORTS § 299A comment c (1965) [hereinafter RESTATEMENT] (liability would rest on the skill which the professional represents himself to have and not on his actual possession of the skill or whether the task requires the use of the skill).

<sup>72</sup> See *id.* at comment d (if the professional does not make a special representation and makes it clear that he does not possess special skill, he is required to exercise only the skill which he represents he has).

<sup>73</sup> An industry standard is a practice peculiar to the particular industry—such as the auction business—which has been followed with regularity. 1 R. ANDERSON, UNIFORM COMMERCIAL CODE § 2-103:31.

recommending reserves higher than the highest presale estimate would constitute an industry norm.<sup>74</sup> A reasonable man entering into a transaction with an auction house would expect the auctioneer to adhere to industry norms in the conduct of a sale.<sup>75</sup>

### B. *The Standard of Care*

Auctioneers, like other professionals, can be charged with malpractice.<sup>76</sup> A person who is hired as an expert in a particular trade or profession is expected to conduct himself in a reasonable manner, consistent with the requisite skill and knowledge of his trade or profession.<sup>77</sup> The auctioneer separates himself from other professionals and nonprofessionals in the use both of his skills as an appraiser and his knowledge of the art market.<sup>78</sup> The failure to use or incorporate the tools of his profession in the selection of paintings for auction would be negligent and would violate the "standards of best efforts."<sup>79</sup>

The standard of care for professionals goes beyond the general requirement of knowledge and skill<sup>80</sup> and involves two additional elements.<sup>81</sup> The first element is described as the use of reasonable judgment, or a professional's "exercise [of] his own best judgment."<sup>82</sup> The second element deals with "the professional's use of due care in exercising his skill and knowledge."<sup>83</sup> This means that while an auctioneer may not be liable for a mistaken appraisal, or an error in judgment when planning and exe-

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<sup>74</sup> See Reif, *How to Bid at an Auction*, N.Y. Times, July 26, 1985, at C23, col. 10.

<sup>75</sup> See U.C.C. § 2-103(1)(b): "'Good faith' in the case of a merchant means honesty in fact and the observance of reasonable commercial standards of fair dealing in the trade." See also Levie, *Trade Usage and Custom Under the Common Law and the Uniform Commercial Code*, 40 N.Y.U. L. REV. 1101, 1108 (1965).

<sup>76</sup> See RESTATEMENT, *supra* note 71, at § 299A comment b. "Professional negligence is now commonly called malpractice." W. PROSSER, J. WADE & V. SCHWARTZ, TORTS: CASES AND MATERIALS 187 n.5 (7th ed. 1982) [hereinafter, PROSSER, WADE & SCHWARTZ]. The auctioneer will be held to the uniform standards applicable to art experts. Whether or not he is held liable for negligence can be determined from the use of that standard. This standard has been articulated as "the knowledge, training and skill (or ability and competence) of an ordinary member of the profession in good standing." *Id.*, n.2.

<sup>77</sup> See *id.*, notes 2, 3.

<sup>78</sup> See generally *Hahn v. Duveen*, 133 Misc. 871, 875, 234 N.Y.S. 185, 190 (Sup. Ct. 1929): "An expert is no better than his knowledge . . . his opinion is better by just so much as he has intelligently considered the subject." See also *supra* notes 35-37.

<sup>79</sup> See *infra* notes 126-132 and accompanying text.

<sup>80</sup> E.g., *Hodges v. Carter*, 239 N.C. 517, 80 S.E.2d 144, 146 (1954). "[A professional] who acts in good faith and in an honest belief that his advice and acts are well founded and in the best interest of his client is not answerable for a mere error of judgment or for a mistake . . . [for] which reasonable doubt may be entertained by well-informed [professionals]." *Id.*

<sup>81</sup> PROSSER, WADE & SCHWARTZ, *supra* note 76, at 191 n.2.

<sup>82</sup> *Id.*

<sup>83</sup> *Id.* at 192 n.4.

cutting a sale, he may be liable for negligence if he fails to obtain the requisite data on which to exercise his trained discretion.<sup>84</sup>

The divergent opinions of Burge and Bathurst about the paintings cast doubt upon Bathurst's expertise as an auctioneer and increase the probability that Bathurst was negligent.<sup>85</sup> When Bathurst assessed the value of the artworks and recommended the reserves, he may not have incorporated all the factors that one would reasonably expect an auction expert to consider.<sup>86</sup>

### C. *Negligent Misrepresentation*

In the auction context, negligence can occur at the appraisal stage, where the actual value of the work as well as its auction appeal is determined. Negligence at this stage has a direct and adverse impact on the presale estimates that determine the work's potential value at auction and the reserves recommended by the auctioneer. The reserve amount is an important factor in determining whether or not the paintings are ultimately sold. When the auctioneer inaccurately assesses the value of a work because of a defective application of his skills, he becomes liable for negligent misrepresentation.<sup>87</sup>

To make a negligent misrepresentation, the auctioneer must be unaware that he is making a false statement. This becomes

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<sup>84</sup> The auction expert can be held liable based on the following four categories of negligence [which] can result from not having knowledge or not applying it. In the first case, the expert does not possess the minimal knowledge necessary. The expert may be totally oblivious to this lack of knowledge or may be aware that he or she does not have the requisite knowledge, so that the expert's deficiency can be conscious or inadvertent.

In another case, the expert has only what he or she perceives to be knowledge. This "knowledge" really only amounts to "belief" because it is faulty, outdated, or distorted. It even could be said that defective knowledge is equivalent to no knowledge. Again, the expert can be either aware or unaware that the knowledge he or she possesses is defective or distorted.

In a third situation, the expert may neglect to apply his or her knowledge intentionally because of sloth or malice, or inadvertently because of forgetfulness or distraction [or perhaps because of a conflict of interest].

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Finally, in the fourth type of case the expert has proper knowledge but applies it badly. For example, the expert can fail to draw the right conclusions from comparative analyses [of similar works and their auction price history] or conduct a scientific test carelessly. Once again, defective application of the knowledge may be either conscious or inadvertent.

Karlen, *Fakes, Forgeries and Expert Opinions*, 16 J. ARTS MGMT. & LAW 5, 9-10 (1986) [hereinafter Karlen].

<sup>85</sup> Bathurst may have been grossly negligent for not using adequate research procedures in the initial appraisal. See Homer, *supra* note 36, at 504.

<sup>86</sup> See *id.* at 500-05.

<sup>87</sup> See *infra* note 88-90.

possible when the auction expert does not possess the skill and expertise commensurate with other experts in his field,<sup>88</sup> it presents the most persuasive justification for holding the auctioneer liable.<sup>89</sup>

The elements of the tort of negligent misrepresentation are the making of a 1) false 2) material 3) representation 4) to another person 5) without a reasonable belief that the representation is true, such that 6) another person reasonably relies upon the representation and is 7) induced 8) to act in a manner which causes him injury.<sup>90</sup>

In *Christie's*, Bathurst's failure to disclose material facts to Jodidio constitutes misrepresentation.<sup>91</sup> The auctioneer who makes a statement and subsequently acquires new information which makes the prior statement false or misleading has a duty to disclose the new information to the seller who the auctioneer knows is acting on the basis of the original statement.<sup>92</sup> Consequently, an auctioneer's silence<sup>93</sup> or failure to disclose facts<sup>94</sup> of which he has

<sup>88</sup> See Edgerton, *Negligence, Inadvertence, and Indifference: The Relation of Mental States to Negligence*, 39 HARV. L. REV. 849, 855-58 (1926); Note, *Tort Liability for Negligent Misrepresentation*, 81 U. PA. L. REV. 435 (1933).

<sup>89</sup> See generally W. PROSSER, *HANDBOOK OF THE LAW OF TORTS*, 699-714 (4th ed. 1971) [hereinafter PROSSER]. See also Green, *Innocent Misrepresentation*, 19 VA. L. REV. 242 (1932).

<sup>90</sup> Karlen, *supra* note 84, at 8. In order to hold the auctioneer liable for negligent or intentional misrepresentation, *scienter* or *mens rea* would have to be established. See also *id.* at 26 n.69, depicting a diagram for the tort of negligent misrepresentation (citing J. BENTHAM, *AN INTRODUCTION TO THE PRINCIPLES OF MORALS AND LEGISLATION*, 67-78 (1780)). The diagram is used to evaluate culpability by analyzing 1) the conduct of the actor, 2) the circumstances of the conduct, and 3) the results or harm of the conduct, with the corresponding *mens rea* for each category.

<sup>91</sup> [T]here is still no common law liability in deceit for complete nondisclosure as distinguished from a half-truth, unless the one party to a business transaction "by concealment or other action intentionally prevents the other from acquiring material information," or the one party is under a duty to the other to exercise reasonable care to disclose the matter in question "because of a fiduciary or other similar relation of trust and confidence between them."

L. Loss, *supra* note 14, at 812.

<sup>92</sup> See PROSSER, *supra* note 89, at 697. There is "a duty of disclosure in cases where the defendant has special knowledge, or means of knowledge, not open to the plaintiff, and is aware that the plaintiff is acting under a misapprehension as to facts which would be of importance to him, and would probably affect his decision." *Id.* A misrepresentation can involve misleading words or acts, or nondisclosure of known facts. See Keeton, *Fraud, Concealment and Non-Disclosure*, 15 TEX. L. REV. 1 (1936). "[T]he failure to disclose the existence of something which the other person has reason to believe would be disclosed" is misrepresentation. *Id.* at 1-2. See also Kronman, *Mistake, Disclosure, Information, and the Law of Contracts*, 7 J. LEGAL STUD. 1, 16-18 (1978).

<sup>93</sup> Where there is a duty to speak, an affirmative misrepresentation is not needed. This is sometimes referred to as constructive fraud. *Daves v. Lawyers Surety Corp.*, 459 S.W.2d 655, 657 (Tex. Civ. App. 1970); *Jackson v. Seymour*, 193 Va. 735, 71 S.E.2d 181-85 (1952).

<sup>94</sup> A party to a contract who conceals a fact which he is bound to disclose is liable for

knowledge *during* his relationship with the seller is actionable as misrepresentation.<sup>95</sup>

#### D. *Fraudulent Misrepresentation*

Fraudulent misrepresentation<sup>96</sup> constitutes the most extreme form of possible wrongful conduct by the auctioneer.<sup>97</sup> The tort of fraudulent misrepresentation is premised on the idea that in certain settings, statements of value can be taken as representations of an existing fact.<sup>98</sup> For instance, an auctioneer would be making a fraudulent misrepresentation if, despite his anticipation that the substance of his predictions would not be realized, he knowingly rendered an untruthful opinion about the value of a painting.<sup>99</sup> Such a misrepresentation would also occur if the auctioneer recklessly evaluated the worth of a painting.<sup>100</sup>

It is difficult to believe that the consignor in *Christie's* could have justifiably relied<sup>101</sup> upon a prediction made in February of what would happen in May. The art market, like other commodities markets, is influenced by many factors and is thus subject to change. Many variables beyond an auctioneer's control undermine the reliability of price predictions. In addition, it would be difficult to classify *Christie's* wide-ranging predictions of future

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fraud. *See, e.g.*, *Simpson Timber Co. v. Palmberg Constr. Co.*, 377 F.2d 380, 385 (9th Cir. 1967): "[O]nce a duty to disclose has arisen, suppression of a material fact is tantamount to an affirmative misrepresentation." The key factor for liability "[w]hen an allegation of fraud is based upon nondisclosure [is that] there can be no fraud absent a duty to speak." *Chiarella v. United States*, 445 U.S. 222, 235 (1980).

<sup>95</sup> A party seeking redress for a purported fraud must prove that defendant made a misrepresentation in the form of a statement, an act, or silence. *113-14 Owners Corp. v. Gertz*, 123 A.D.2d 850, 507 N.Y.S.2d 641 (2d Dep't 1986).

<sup>96</sup> *See* RESTATEMENT, *supra* note 71, §§ 525-30. *See also* *Channel Master Corp. v. Aluminum Ltd. Sales*, 4 N.Y.2d 403, 151 N.E.2d 833, 176 N.Y.S.2d 259 (1958).

To maintain an action based on fraudulent representations, whether it be for the rescission of a contract or, . . . in tort for damages, it is sufficient to show that the defendant knowingly uttered a falsehood intending to deprive the plaintiff of a benefit and that the plaintiff was thereby deceived and damaged.

*Id.* at 407, 151 N.E.2d at 835, 176 N.Y.S.2d at 262.

<sup>97</sup> This Note does not focus on the element of fraud involving statements, nor does the Note assume that the auctioneer would deliberately deceive a consignor to further the auctioneer's own interests or those of a third party through misleading statements or nondisclosure.

<sup>98</sup> *Gross v. State Cooperage Export Crating & Shipping Co.*, 32 A.D.2d 540, 299 N.Y.S.2d 773, 774 (1969) (under certain circumstances an expression of opinion, including an estimation of value may be fraudulently uttered); *Channel Master Corp. v. Aluminum Ltd. Sales*, 4 N.Y.2d at 407, 151 N.E.2d at 835, 176 N.Y.S.2d at 262; *Hickey v. Morrell*, 102 N.Y. 454, 463, 7 N.E.2d 321, 335 (1886).

<sup>99</sup> *See e.g.*, *Chase Manhattan Bank v. Perla*, 65 A.D.2d 207, 210, 411 N.Y.S.2d 66, 68 (1978).

<sup>100</sup> *See* *Karlen*, *supra* note 84, at 26 n.69. *See generally* PROSSER, *supra* note 89, at 684; RESTATEMENT, *supra* note 71, § 526.

<sup>101</sup> *See infra* notes 104 & 105 and accompanying text.

prices as representations of fact. Accordingly, the auction estimates given by the Christie's expert in February should merely be viewed as an attempt to measure the market for paintings at an auction sale three months in the future.<sup>102</sup>

It is, therefore, unlikely that the February prediction alone would be sufficient to hold the auctioneer liable in this case.<sup>103</sup> Furthermore, the knowledge of the consignor-collector closely approximates that of the auctioneer, making it even more difficult to establish justifiable reliance.<sup>104</sup> Since reliance is one of the traditional elements of deceit,<sup>105</sup> it seems implausible that Christie's could be held liable for actual statements made to the consignor in this case.

#### IV. THE AUCTIONEER AS FIDUCIARY

##### A. Generally

As an appraiser of fine art,<sup>106</sup> the auctioneer has the knowledge and ability to estimate the fair market value of a piece of art.<sup>107</sup> In selling property for another party, he acts as the agent<sup>108</sup> of the seller.<sup>109</sup> Thus, the auctioneer's rights and liabili-

<sup>102</sup> See *CPC Int'l, Inc.*, 120 A.D.2d at 230, 507 N.Y.S.2d at 989. See also Brief for Defendant at 36-37 *Cristallina v. Christie, Manson & Woods, Int'l Inc.* 117 A.D.2d 284, 502 N.Y.S.2d 165 (1986).

<sup>103</sup> See *supra* note 84 and accompanying text (explaining the grounds on which to base an auctioneer's liability). See also Defendant's Trial Memorandum at 35, *Christie's*, 117 A.D.2d 284, 502 N.Y.S.2d 165, which states that the consignor in *Christie's* could not base a "fraudulent misrepresentation claim on Christie's pre-consignment estimates since its wide-ranging predictions of possible future prices are in no sense representations of fact. Rather, as assessments of value . . . they are simply non-actionable opinions." *Id.* (citations omitted).

<sup>104</sup> For the consignor there might be a question of justifiable reliance. For instance, "[o]ne who fraudulently makes a misrepresentation of fact, opinion, intention or law for the purpose of inducing another to act or to refrain from action in reliance upon it, is subject to liability to the other in deceit for pecuniary loss caused to him by his *justifiable reliance* upon the misrepresentation." RESTATEMENT, *supra* note 71, § 525 (emphasis added). Should an art dealer claim justifiable reliance on the statements of someone whose expertise is only slightly greater than his own?

<sup>105</sup> The traditional elements of deceit are 1) an untrue representation of a 2) material 3) fact where the 4) defendant knew it was not truthful (*scienter* or *mens rea*) but made the statement anyway for the purpose of inducing the plaintiff to rely on it and 5) the plaintiff did *justifiably* rely on it and 6) suffered a loss as a result. See PROSSER, *supra* note 89, at 684. The missing element in the consignor's action against the auctioneer is justifiable reliance.

<sup>106</sup> For an explanation of the term appraiser, see Homer, *supra* note 36, at 462-74.

<sup>107</sup> See *supra* note 36 and accompanying text.

<sup>108</sup> "Agency is the fiduciary relationship between two persons in which one person (the agent) acts for or represents another (the principal) in dealings with third persons." J. PAUST, R. UPP & J. SHERRY, *BUSINESS LAW* 200 (4th ed. 1984) [hereinafter *BUSINESS LAW*].

<sup>109</sup> See 3 R. ANDERSON, *UNIFORM COMMERCIAL CODE* § 2-328:12 (3d ed. 1983) (auctioneer acting for a seller is himself not a seller).

ties, absent an applicable statute, are governed by general agency law principles.<sup>110</sup> In performing his duties, the auctioneer is under an obligation not to attempt the impossible or impracticable.<sup>111</sup> If it reasonably appears to the auctioneer that the results to which both parties originally contracted will be unattainable, the auctioneer should discontinue servicing the consignor.<sup>112</sup>

The auctioneer has a fiduciary<sup>113</sup> duty to act in good faith<sup>114</sup> for the benefit of his consignor throughout their relationship.<sup>115</sup> Moreover, the auctioneer has a duty to use his best efforts<sup>116</sup> in procuring the desired ends of the contract.<sup>117</sup> He is also bound by the principles of agency to keep the consignor informed of all materially relevant facts<sup>118</sup> so that the seller can protect his own

<sup>110</sup> See generally 7 N.Y. JUR. 2D *Auctions & Auctioneers* § § 9, 28 & 32 (1980).

<sup>111</sup> See BUSINESS LAW, *supra* note 108, at 220: "The agent owes a duty not to continue to render service that subjects the principal to risk of expense if it reasonably appears to the agent to be impossible or impracticable to accomplish the objects of the principal and if the agent cannot communicate with the principal."

<sup>112</sup> See RESTATEMENT (SECOND) OF AGENCY § 384 (1958). This obligation is particularly relevant to the determination of presale estimates and reserves. Despite the disclaimers that presale estimates are only a guide for buyers and sellers, these estimates can cause much reliance and some expectation on the seller's part.

<sup>113</sup> An agent is a fiduciary and owes a duty of good faith and candor to his principal. The relationship is one of trust. See J. DAWSON, W. HARVEY & S. HENDERSON, *CASES AND COMMENT ON CONTRACTS* 175-6 (4th ed. 1982).

A "fiduciary" relationship is one whose successful functioning requires a high degree of candor and reliability between the participants. . . . The standards of disclosure and disinterestedness are not the same in all fiduciary relationships, and often the requirements are one-sided in the sense that higher standards are imposed on one participant than on the other. . . .

. . . . The principal requirement is one of full disclosure of all elements that have a bearing on the subject matter or terms of the bargain made. This means, however, that any transaction between the parties . . . will be closely examined to be sure that there was full disclosure. . . .

*Id.*

<sup>114</sup> *Blonsky v. Allstate Ins. Co.*, 128 Misc. 2d 981, 982, 491 N.Y.S.2d 895, 897 (Sup. Ct. 1985) ("agent is required to exercise good faith, reasonable diligence and such skill as is ordinarily possessed by persons . . . engaged in the same business"). See also 7 N.Y. JUR. 2D *Auctions and Auctioneers* § 28 (1980). "[T]he auctioneer is under a duty to exercise ordinary care and skill in the performance of his duties and is responsible for his failure to do so." *Id.*

<sup>115</sup> See, e.g., *In re Premier Container Corp.*, 95 Misc. 2d 859, 866, 408 N.Y.S.2d 725, 729 (Sup. Ct. 1978) (in making a sale, an auctioneer must act in the interest of his principal); *Elco Shoe Mfg. v. Sisk*, 260 N.Y. 100, 103-04, 183 N.E. 191, 192 (1932) (an agent owes primary loyalty to his principal).

<sup>116</sup> *Griffin & Evans Cosmetic Mktg. v. Madeleine Mono Ltd.*, 73 A.D.2d 957, 424 N.Y.S.2d 269, 270 (Sup. Ct. 1980) ("[u]nderlying an agency contract . . . is the implied good faith obligation that the agent use his best efforts to promote the principal's product" *Id.*).

<sup>117</sup> See *Wood v. Lucy, Lady Duff-Gordon*, 222 N.Y. 88, 118 N.E. 214 (1917) (failure of an agent to use best efforts to promote the principal's product constitutes breach of an agency contract). See also *Chajet Design Group, Inc. v. Warner/Lauren Ltd.*, 106 Misc. 2d 159, 162, 431 N.Y.S.2d 275, 277-78 (1980) (designer had duty to use best efforts to produce design best suited to needs of client in keeping with the intent of the contract).

<sup>118</sup> A material fact is one which a "reasonable man would attach importance to its



interests.<sup>119</sup>

The obligations that an auctioneer incurs toward a consignor begin at the moment the consignor expresses an interest in selling his artwork. The encounter begins as a simple status relationship,<sup>120</sup> under which the auctioneer has a partial monopoly over the means for satisfying the needs of the consignor. This relationship may eventually evolve into a contractual, and then a fiduciary relationship.<sup>121</sup>

In the contractual relationship,<sup>122</sup> the auctioneer enjoys a superior bargaining position to the extent that the percentage rate of remuneration is not negotiable. The consignor's primary purpose for entering the relationship may be for profit, or for the purpose of liquifying his holdings. The position of the parties makes it necessary and reasonable for the consignor to place his

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existence or nonexistence in determining his choice of action in the transaction in question." RESTATEMENT, *supra* note 71, § 538 (2)(a). This definition was cited by the court in *SEC v. Texas Gulf Sulphur Co.*, 401 F.2d 833, 849 (2d Cir.), *cert. denied*, 394 U.S. 976 (1968) which then added, "[t]his, of course, encompasses any fact . . . which in reasonable and objective contemplation *might* affect . . . value." See also *Shores v. Sklar*, 647 F.2d 462, 468 (5th Cir. 1981), *cert. denied*, 459 U.S. 1102 (1983).

As an agent, the auctioneer has a duty to disclose information that may affect the consignor's interests, i.e., information the agent possesses or receives notice of. By extension, the auctioneer also has an obligation to truthfully assess the value of a consignor's paintings and to inform him of any factors that may affect the auction value of the work. The failure to disclose can be viewed as fraud, or as a violation of the auctioneer's duty of good faith performance. See RESTATEMENT (SECOND) OF CONTRACTS § 161 (1979); 12 S. WILLISTON, A TREATISE ON THE LAW OF CONTRACTS § 1498 (3d rev. ed. 1970).

<sup>119</sup> See *Miles v. Perpetual Savings & Loan Co.*, 58 Ohio St. 2d 93, 388 N.E.2d 1364 (1979). When a breach of that duty occurs, the consignor has a cause of action in contract or tort. See, e.g., *Griffin & Evans*, 73 A.D.2d at 957 424 N.Y.S.2d at 269; *Brown v. Poritzky*, 35 A.D.2d 1007, 1008, 318 N.Y.S.2d 551, 553 (2d Dep't 1970), *aff'd*, 30 N.Y.2d 289 (1972). The auction house will be held liable for damages caused by such a breach under the doctrine of *respondeat superior*. See, e.g., *Mirto v. News-Journal Co.*, 123 A.2d 863 (1956).

<sup>120</sup> The relationship between the auctioneer and the consignor may be viewed in terms of status, contract and fiduciary relations. In a status relationship, one party has full or partial monopoly over the means for satisfying the needs of the other party. Parties to a contract determine their own needs and bargain to obtain them. Like the status relationship, one party to a fiduciary relationship is dependent on the other. However, a fiduciary — the auctioneer — rarely has a monopoly over the entrustor's — the consignor's — needs. See Frankel, *Fiduciary Law*, 71 CALIF. L. REV. 795, 798-99 (1983) [hereinafter Frankel].

<sup>121</sup> The fiduciary relationship appears to be the most appropriate vehicle for analyzing the auctioneer-consignor relationship. It encompasses both the status and contractual elements that are found in the auctioneer-consignor relationship. An important feature of this relationship is that the auctioneer serves as a substitute for the consignor in order to benefit the consignor. See *id.* at 808.

<sup>122</sup> A consignor will want an auctioneer to act for him on matters within the auctioneer's expertise. The relationship may be classified as contractual or may fall into a status category because the consignor is unable to conduct an auction for himself. See, e.g., *United States v. Whiting Pools, Inc.*, 462 U.S. 198 (1981) (agency concept entails a fiduciary relationship arising out of an express or implied contract between the principal and the agent); Frankel, *supra* note 120, at 808.

trust and confidence in the judgment and ability of the auctioneer.<sup>123</sup> However, the means of remuneration for the auctioneer's efforts in selling the artwork may cause him to frustrate the consignor's enjoyment of his contract rights. Because of the status of the parties, the auctioneer is immediately in danger of committing a bad faith breach once a contractual relationship is assumed.<sup>124</sup>

### B. *Bad Faith*

Courts have recognized that in every contract there is an implied covenant of good faith and fair dealing that neither party will do anything which injures the right of the other to receive the benefits of the agreement.<sup>125</sup> "This covenant not only imposes upon each contracting party the duty to refrain from doing anything which would render performance of the contract impossible by an act of his own, but also the duty to do everything that the contract presupposes that he will do to accomplish its purpose."<sup>126</sup>

In the case of an auctioneer, the duty to perform in good faith applies to the auctioneer's discretionary power to execute

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<sup>123</sup> The other important feature of a fiduciary deals with the delegation of power. See Seavey, *The Rationale of Agency*, 29 YALE L.J. 859, 860-61 (1920). A fiduciary obtains power in order to facilitate the performance of his functions. This leads to the problem of potential abuses of power and the inherent dilemmas faced by a consignor in a fiduciary situation.

Although the auctioneer must be entrusted with power in order to perform, possession of power creates a risk that he will misuse it and injure the consignor. The consignor can lessen his exposure to this risk by reducing delegated power. However, this hampers the performance of the auctioneer and, consequently, may reduce the expected benefits from the relationship.

A consignor who gives his auctioneer selling discretion benefits from the auctioneer's expertise and diligent observation of the market, but also becomes vulnerable to neglect or self-dealing. If the consignor makes the selling decisions himself, he is no longer in danger of abuse of power, but loses the benefit of the auctioneer's services and expertise. See Frankel, *supra* note 120, at 809-10.

<sup>124</sup> The consignor's vulnerability stems from the structure and nature of the fiduciary relationship. The delegated power that allows the auctioneer to benefit the consignor also enables the auctioneer to injure him, "because the purpose for which the [auctioneer] is allowed to use his delegated power is narrower than the purposes for which he is capable of using that power." *Id.* at 810. The end result of these sometimes conflicting purposes is a bad faith breach on the part of the fiduciary. This defines, to a large degree, the legal results of the auctioneer's conduct in *Christie's*.

<sup>125</sup> *Collard v. Incorporated Village of Flower Hill*, 75 A.D.2d 631, 427 N.Y.S.2d 301 (2d Dep't), *aff'd*, 52 N.Y.2d 594, 421 N.E.2d 818, 439 N.Y.S.2d 326 (1980) (implied covenant of fair dealing and good faith is breached only where one party to a contract seeks to prevent performance or withhold its benefits). See also *Kirke La Shelle Co. v. Paul Armstrong Co.*, 263 N.Y. 79, 188 N.E. 163 (1933).

<sup>126</sup> *Colwell Co. v. Hubert*, 248 Cal. App. 2d 567, 575, 56 Cal. Rptr. 753, 759 (1967) (citations omitted). See also *Caceci v. Di Canio Constr. Corp.*, 72 N.Y.2d 52, 526 N.E.2d 266, 530 N.Y.S.2d 771 (1988); *Kalisch-Jarcho, Inc. v. City of New York*, 58 N.Y.2d 377, 448 N.E.2d 413, 461 N.Y.S.2d 746 (1983).

the contract and control the consignor's anticipated benefit.<sup>127</sup> The auctioneer performs in good faith when he exercises discretion for any purpose within the reasonable contemplation of the parties, and in bad faith when his discretion is used, for example, to capture foregone opportunities.<sup>128</sup>

In *Christie's*, the auctioneer's failure to inform the consignor of the materially differing opinions as to the auction appeal of his paintings and continuing with the sale were not in the best interests of Cristallina. Bathurst may have acted in bad faith<sup>129</sup> because Cristallina had a clear opportunity at that point to withdraw the items from sale without any adverse publicity, since no announcements of the impending sale had yet been made.

This concept of bad faith performance was further articulated in a recent article, which stated:

[T]he tort of bad faith breach of contract should be limited to contracts where (1) one of the parties to the contract enjoys a superior bargaining position to the extent that it is able to dictate the terms of the contract; (2) the purpose of the weaker party in entering into the contract is not primarily to profit, but rather to obtain financial security or peace of mind; (3) the relationship of the parties is such that the weaker party reasonably and justifiably places its trust and confidence in the larger entity; and (4) there is conduct on the part of the stronger con-

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<sup>127</sup> See Burton, *Breach of Contract and The Common Law Duty to Perform in Good Faith*, 94 HARV. L. REV. 369, 373 (1980).

<sup>128</sup> If the consignor gives discretion to the auctioneer to perform on object A (which is in the consignor's interests), and the auctioneer, while performing on object A decides to act simultaneously on object B (his own interests) and consequently harms the consignor, he acts in bad faith.

Economists sometimes refer to this problem as the potential for "opportunistic behaviour." The potential for opportunism exists when the relationship between the parties is not clearly defined, or when the terms of the contract "are costly to enforce and when the wealth of one . . . [party] can be affected significantly by the behaviour of" the other. Liebler, *1984 Economic Review of Antitrust Developments: Horizontal Restrictions, Efficiency, and The Per Se Rule*, 33 UCLA L. REV. 1019, 1022 (1984).

To a potential victim [of opportunistic behaviour], a person must have made some kind of commitment of specialized wealth to the other party in such a way that the other party's behaviour affects the first person's subsequent wealth. The specializer is then *not in a position to say*, "No matter what you do, I can go elsewhere to associate with someone else and be just as well off there as I am with you. If you try cheating, I can leave with my wealth at no loss."

*Id.* at 1023, quoting, A. ALCHIAN & W. ALLEN, *EXCHANGE & PRODUCTION: COMPETITION, COORDINATION & CONTROL* 170 (1983).

<sup>129</sup> See 7 N.Y. JUR.2D *Auctions and Auctioneers* § 32 (1980).

The nature and extent of the auctioneer's liability to the seller depend upon the terms of the particular contract existing between them. For a failure to live up to the terms thereof . . . he is answerable in damages. . . . He is also personally responsible for any loss that is a consequence of his failure to use ordinary care and skill in the performance of the duties confided to him.

*Id.* (citations omitted).

tracting party indicating an intent to frustrate the weaker party's enjoyment of its contract rights.<sup>130</sup>

When applied to the facts of *Christie's*, this test suggests a finding that Christie's was liable for a bad faith breach of its contract with Cristallina.<sup>131</sup> The fact that auction reserves were not adjusted downward to be consistent with the revision of presale estimates raised the probability that the objectives of a contract between the auctioneer and the consignor would not be fulfilled. Furthermore, releasing contradictory information to the public about presale estimates was bound to frustrate the purpose for which the auctioneer's services were contracted.

An auctioneer who does not follow the standards for commercial reasonableness within his industry when performing a contract commits a breach of his duty.<sup>132</sup> An additional breach occurs if he fails to make an honest disclosure to his consignor.<sup>133</sup> This not only constitutes a bad faith breach on his part, but taken in the context of his relationship with his consignor, it is a breach of the fiduciary duty owed to the seller.

The court in *Christie's* stated,

[a]s an agent, Christie's had a fiduciary duty to act in the utmost good faith and in the interest of Cristallina, its principal, throughout their relationship. . . . When a breach of that duty occurs, the agent is liable for damages caused to the principal, whether the cause of action is based on contract . . . or on negligence . . . .<sup>134</sup>

The conduct of the Christie's auctioneer was not in the best interests of the consignor from the beginning of their relationship. The acts of the auctioneer made it difficult to fulfill the purpose of their contract, and as such, constituted a bad faith breach for which there is liability in tort or in contract.<sup>135</sup>

<sup>130</sup> Louderback & Jurika, *Standards for Limiting the Tort of Bad Faith Breach of Contract*, 16 U.S.F. L. REV. 187, 189 (1982).

<sup>131</sup> See *supra* notes 121-22. (Note 119 addresses the bargaining position of the consignor vis-a-vis the Auctioneer, and this satisfies the first part of the test. Note 122 describes the consignor's motivation for entering into a contractual relationship with the auctioneer which fulfills the second part of the test. It also explains why the consignor is justified in placing its trust in the Auctioneer in accordance with the requirements of the third part of the test.)

<sup>132</sup> See *supra* note 72.

<sup>133</sup> See *supra* notes 89-93 and accompanying text.

<sup>134</sup> *Cristallina S.A. v. Christie, Manson & Woods Int'l, Inc.*, 117 A.D.2d 284,290, 502 N.Y.S.2d 165, 171 (1986) (citations omitted).

<sup>135</sup> See *Ajax Hardware Mfg. Corp. v. Industrial Plants Corp.*, 569 F.2d 181 (2d Cir. 1977) (negligent performance of a contract may give rise to a claim sounding in tort as well as for breach of contract).

## V. THE AUCTIONEER AS UNDERWRITER

Best efforts for the auctioneer would, at a minimum, involve generating interest for the items offered for sale by the consignor through advertising, using the auction house's logistical network on behalf of its client and compiling a catalogue for distribution.<sup>136</sup> The most effective auctioneer would, because of his skill and industry, be able to garner the best possible price for his consignor.<sup>137</sup> Unfortunately, the dynamics of the auctioneer-consignor relationship may not lead to such results.

A. *Conflicts*

Auctioneers operate under a conflict of interest when they sell under a best efforts arrangement. The interest of the auctioneer is to maximize gross profits,<sup>138</sup> while the interest of the consignor is to maximize net profits.<sup>139</sup> An inherent conflict exists because of the way the auctioneer is rewarded for his efforts. The auctioneer's fees depend on the degree of success he achieves in garnering the most money he can for the commodity he is promoting.<sup>140</sup> In short, his fees are based on his performance.<sup>141</sup>

In theory, performance based fees ought to eliminate any possible injury to the consignor that might occur from conflicts of interest, because he will compensate the auctioneer only if he

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<sup>136</sup> Compare this with the facts of *Zilg v. Prentice-Hall, Inc.*, 717 F.2d 671 (2d Cir.) 466 U.S. 938 (1983), where a writer sued his publisher claiming that it had not tried hard enough to promote his book. The court found that the publisher had a good faith duty to promote the book, not a duty to use its best efforts. The court concluded that the defendant had met this duty.

<sup>137</sup> This ideal behavior on the part of an auctioneer, or most other performers under a best efforts arrangement, is tempered by the reality that "[o]nce the initial obligation is fulfilled, all that is required is a good faith business judgement." *Id.* at 680. See also *Van Valkenburgh, Nooger & Neville, Inc. v. Hayden Publishing Co.*, 30 N.Y.2d 34, 330 N.Y.S.2d 329 (1972).

<sup>138</sup> See *In re Fisher Bookbinding Co.*, 119 Misc. 2d 763, 465 N.Y.S.2d 428 (1983). "It is part of the auction business or profession to obtain the greatest possible amount of money for that which is auctioned. It is of personal monetary benefit to the auctioneer, as well as his duty to his client, that he do so." *Id.* at 767, 465 N.Y.S.2d at 432, quoted in Defendant's Trial Memorandum, *Cristallina, S.A. v. Christie, Manson & Woods Int'l, Inc.* 117 A.D.2d 284, 502 N.Y.S. 2d 165 (1986).

<sup>139</sup> See Farnsworth, *On Trying to Keep One's Promises: The Duty Of Best Efforts in Contract Law*, 46 U. PITT. L. REV. 1, 10 (1984) [hereinafter Farnsworth]. Although the auctioneer-consignor conflict is the sharpest under such conditions, it is the payment incentive that gives rise to the implied duty of best efforts.

<sup>140</sup> See Farnsworth, *supra* note 139, at 10-12.

<sup>141</sup> See Goetz & Scott, *Principles of Relational Contracts*, 67 VA. L. REV. 1089 (1981) (a theoretical discussion of conflicts of interest in agent-principal and fiduciary type relationships with best efforts arrangements). [hereinafter Goetz & Scott]

receives the benefit for which he bargained.<sup>142</sup> However, such a fee structure, which more or less guarantees best efforts, also encourages risk taking on the part of the auctioneer.<sup>143</sup> Because the auctioneer's fees are measured as a percentage of the consignor's gross intake, with only the seller disproportionately bearing the risk of loss resulting from a no-sale, the auctioneer may make riskier business decisions in order to increase his potential fee.<sup>144</sup> As long as this behavior does not openly harm the consignor, the conflict remains hidden.<sup>145</sup>

The reasons the consignor is rarely damaged by such risk taking relates to the nature of the art auction market itself and the strong selling positions of the few major auction houses within the market. While there is some competition between the auction houses to attract well known works of art, the true competition exists at the auctions themselves.<sup>146</sup> Through its monopolistic position, an auction house influences the market through its role as a price regulator and through setting the stan-

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<sup>142</sup> There is a presumption that a contractual obligation to use best efforts may possibly solve the problems that a commission-based relationship creates. *See id.* at 1119-26.

<sup>143</sup> *See id.* The courts have had difficulty balancing the interests of the auctioneer and seller, and in defining which situations are "symptomatic of a best efforts violation." *Id.* at 1125. *See also supra* notes 121-22 and accompanying text.

<sup>144</sup> Goetz & Scott, *supra* note 139, at 1119-26. Another source of conflict for the auctioneer is the fact that he receives a buyers premium in addition to a sellers commission. *See HOW TO BUY AND SELL AT CHRISTIE'S* (1987). The buyer's premium is levied irrespective of the outcome of the sale. In the case of a failed auction, the seller theoretically would have to pay the premium for having the article bought in. *Id.* *See also* F. FELDMAN & S. WEIL, *ART LAW: RIGHTS AND LIABILITIES OF CREATORS* 192 (1986). *See also* White, *Putting Your Possessions On The Block*, N.Y. Times, June 14, 1987, § 3 (Business), at 11.

Additionally, the auctioneer gets a buyer's premium regardless of whether the sale is privately arranged or by public auction. This increases the potential for risk taking faced by an auctioneer—even if he makes a bad decision, he still receives some form of compensation for his efforts. In essence, there is less incentive for the auctioneer to look out for the consignor's interests and more for him to cater to his own (i.e., increasing profits via higher commissions from the sale).

<sup>145</sup> For a fuller explanation of this proposition and its effect on the agent principal relationship, *see* Note, *Auctioning New Issues of Corporate Securities*, 71 VA. L. REV. 1381, 1389-91 (1985). [hereinafter Note].

<sup>146</sup> An auction, like a stock exchange, approximates the model for perfect competition. Four basic conditions must exist for perfect competition: (1) there must be many buyers and sellers in the market; (2) the product must be homogeneous; (3) buyers and sellers must have complete knowledge of market conditions, and (4) buyers and sellers must be able to react quickly to news of market conditions. *See* J. GWARTNEY, *ECONOMICS, PRIVATE AND PUBLIC CHOICE* 342 (1976) [hereinafter Gwartney].

Imperfect competition describes the market structure of the auction business. An "imperfect competitor" is *anyone who buys or sells a good in large enough quantities to be able to affect the price of that good.* P. SAMUELSON, *ECONOMICS* 47 (10th Ed. 1976).

True competition emphasizes price competition which is what occurs at the auctions themselves. The competition that exists between the auction houses is called nonprice competition. Nonprice competition involves aspects such as service, honesty, convenience, quality and reliability. "This nonprice competition may be just as intense as the price competition of [the] hypothetical purely competitive model." GWARTNEY, *supra* note 146 at 342.

dards by which the participants in the art market conduct business.<sup>147</sup> This role allows it to set prices which the buying public accepts, to some degree, as indicative of the true value of the works being offered.<sup>148</sup> In sum, because only a few auction houses dominate the marketplace, consignors will rarely question the price that is set for a work, and, consequently, the conflict remains hidden.

The market position of the auctioneer allows him to gauge the potential price of a work in much the same manner that an underwriter<sup>149</sup> at a brokerage firm prices a newly issued security. The auctioneer is faced with the same performance pressures that an underwriter has under a best efforts or firm commitment selling arrangement.<sup>150</sup> This means that the same downward pricing pressures which influence the underwriter<sup>151</sup> will affect the auctioneer. These forces influence the underwriter to price the new security conservatively. Invariably, if the security is un-

<sup>147</sup> See Klein, Crawford & Alchian, *Vertical Integration, Appropriable Rents and the Competitive Contracting Process*, 21 J. LAW & ECON. 297, 299 (1978).

We can use monopoly terminology to refer to the phenomenon we are discussing as long as we recognize that we are not referring to the usual monopoly created by government restrictions on entry or referring to a single supplier or even highly concentrated supply. . . . [M]onopoly power, better labeled "market power," is pervasive. Because of transaction and mobility costs, "market power" will exist in many situations not commonly called monopolies. There may be many potential suppliers of a particular asset to a particular user but once the investment in the asset is made, the asset may be so specialized to a particular user that monopoly or monopsony market power, or both, is created.

*Id.* See also *supra* notes 121-22 and accompanying text.

<sup>148</sup> But see *Warhol Cookie Jars Sell For \$247,830*, N.Y. Times, Apr. 25, 1988, at C18, col. 4. The jars had been estimated to sell at auction for, at most, \$250 each, but actually sold for between \$1,980 and \$2,310. A personal friend of Warhol's was the buyer, and price was apparently no object in remembering the late pop artist.

<sup>149</sup> Section 2 (11) of the Securities Act of 1933, defines an underwriter as any person who [a] has purchased from an issuer with a view to, or [b] offers or sells for an issuer in connection with, the distribution of any security, or [c] participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but [d] such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission.

15 U.S.C. § 77b (11) (1982).

<sup>150</sup> See Note, *supra* note 145, at 1390.

In a firm commitment offering, the underwriter bears the risk that investors may not buy the securities. Underpricing the issue, however, reduces this risk. In a best efforts arrangement, compensating the underwriter by a commission prevents the underwriter from capturing all of the marginal economic gains created by raising the price and expending additional effort to sell the securities to investors. Therefore, the underwriter has an incentive to underprice the issue, making it easier to sell the securities and to earn the commissions. *Id.*

<sup>151</sup> *Id.*

derpriced, market forces via oversubscription<sup>152</sup> or significant price increases in the aftermarket<sup>153</sup> will bid up the price of the issue to its true market value. A similar phenomenon will occur at an auction if a painting is underpriced. However, this occurrence would not cure the problem in *Christie's*, since the problem was not conservative pricing but the work's lack of auction appeal.<sup>154</sup>

Christie's market position allows it to set and regulate the base prices for goods being auctioned. Its presale estimates are generally accepted as approximating true value. Art owners disinterested in selling, but curious about the value of their holdings, will generally call on an auction house. The same general techniques used for an appraisal are applied by the auctioneer to provide presale estimates.<sup>155</sup> Similarly, Christie's dominant market position gives it the power to set the standards by which the industry is judged. Because of its influence, it epitomizes the reasonably prudent auctioneer. Thus, when Christie's released presale estimates in which the higher of these estimates was lower than the reserves, it was not only violating its own policy, but industry standards as well.

The strength of Christie's market power may have substantially affected the auction's outcome. Because of its original authoritative statement as to the value of the paintings, Christie's later revision of its own pricing estimates may have had a negative impact on the bidding public. The second set of publicly released estimates was an erosion of its own authoritative prior statement as to value. This overt contradiction and apparent self-doubt by an authority may have caused serious questions about the worth of the paintings.

### B. *Due Diligence and Best Efforts*

Section 11 of the Securities Act of 1933<sup>156</sup> imposes liability

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<sup>152</sup> *Id.*

<sup>153</sup> *Id.*

<sup>154</sup> *Cristallina, S.A. v. Christie, Manson & Woods Int'l, Inc.*, 117 A.D.2d 284, 287-88, 502 N.Y.S.2d 165, 168 (1986).

<sup>155</sup> See *supra* note 36 and accompanying text.

<sup>156</sup> Securities Act of 1933, § 11(a), 15 U.S.C. § 77k (1982). The general purpose of the 1933 Act is to provide investors with material information concerning securities offered for public sale and prohibit misrepresentation, deceit, and other fraudulent acts and practices.

Before the public offering of securities, a registration statement must be filed with the Securities and Exchange Commission. The purpose of registration is to provide disclosure to investors of relevant information with which they may determine whether to purchase the security. In order for investors to make an informed decision, they must



on statutory underwriters for any untrue statement or omission of a material fact in a registration statement.<sup>157</sup> The statute permits recovery against the underwriter in order to protect investors against misstatements by the company issuing the securities.<sup>158</sup> The effect of this liability is to improve the quality and accuracy of disclosure in the registration statement.<sup>159</sup> This places the burden on the underwriter to diligently ensure that the registration statements are true, which is why an underwriter involved in a public offering will conduct a "due diligence" investigation of the issuing company to verify the information in the registration statement. Such procedure is part of the best efforts that an underwriter exerts when dealing with a new issue. Diligence in all aspects of a transaction is necessarily a part of best efforts.<sup>160</sup>

Similarly, the auctioneer is under a common law duty "to use reasonable efforts to give his principal information which is relevant to affairs entrusted to him and which, as the agent has notice, the principal would desire to have."<sup>161</sup> However, the difference between the auctioneer's liability and the under-

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have information that will realistically allow them to appraise the securities being offered.

Factors such as whether the price or other terms of the securities are fair must be assessed by the investor himself in light of the disclosures provided. If the facts have been fully and accurately presented, the investor assumes the risks that are involved in the purchase of the securities. See L. Loss, *supra* note 14, at 92-96.

<sup>157</sup> Securities Act of 1933, § 11(a), 15 U.S.C. § 77k (1982). Liability is imposed for any untrue statement of material fact or any omission to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading. See *id.*; Note, *supra* note 145, at 1396.

<sup>158</sup> Section 11(a) imposes liability on statutory underwriters and other participants in the registration process for any untrue statement or omission of a material fact in a registration statement. 15 U.S.C. 77k.

If an investor suffers a loss in the purchase of a registered security, the law provides him with important recovery rights if he can prove there was incomplete or inaccurate disclosure of material facts in the registration statement. If the investor proves his case, the issuing company, the underwriters and the sellers of the securities would be liable to the purchaser for any losses sustained. See L. Loss, *supra* note 14, at 92-96.

In the art market, regulation of the purchase and sale of artworks sold by dealers and auctioneers would provide similar protection for the art investor.

The compilation and dissemination of catalogues by the auctioneer for instance, should be analogized to the preparation of a Registration Statement by the securities underwriter. Similarly, the pre-filing activities of the underwriter can be compared with the pre-auction efforts made by an auctioneer to generate interest in the sale.

If the auctioneer faces statutory liability from the public for inaccurate statements regarding works of art for sale, the diligence exercised by an auction house in investigating the title, provenance, and true worth of the work can only be increased.

<sup>159</sup> See Note, *supra* note 145, at 1396 n.90.

<sup>160</sup> See Farnsworth, *supra* note 139, at 8. See also Note, *Best Efforts As Diligence Insurance: In Defense of "Profit Uber Alles,"* 86 COLUM. L. REV. 1728, 1738-39 (1986) [hereinafter *Diligence Insurance*].

<sup>161</sup> RESTATEMENT (SECOND) OF AGENCY § 381 (1958).

writer's is that the plaintiff in a civil suit can make out a *prima facie* case against the underwriter by establishing the existence of a material misstatement or omission.<sup>162</sup> A consignor suing an auctioneer would have to prove reliance on the misstatement, or establish *mens rea*<sup>163</sup> on the part of the defendant to recover under common law principles of agency.<sup>164</sup> Consequently, the consignor must carry a heavier burden.<sup>165</sup>

The efficacy of an auctioneer's service to his consignor

is promoted by getting information of changed circumstances to the market as quickly as possible. . . . In some cases, the individuals who supply information have obtained it by a deliberate search. . . . A securities analyst, for example, acquires information about a particular corporation in a deliberate fashion—by carefully studying evidence of its economic performance.<sup>166</sup>

The analyst is then under a statutory duty to disclose the information under the 1933 Act.<sup>167</sup> Similarly, the auctioneer must conduct a deliberate investigation into the background, title and provenance of a work in order to accurately determine its value.

One could analogize the registration process for a securities offering to the pre-auction dealings between consignor and auctioneer.<sup>168</sup> In some instances, as in *Christie's*, representations as to value and any persuasive positions taken by the agent are in writing. The contents of the document would be subject to change based on any

<sup>162</sup> See Note, *supra* note 145, at 1397 n.92.

<sup>163</sup> See *supra* note 90 and accompanying text.

<sup>164</sup> Cf. Bulloch, *Fraud Liability Under Agency Principles: A New Approach*, 27 WM. & MARY L. REV. 301, 312-14 (1986).

<sup>165</sup> See *supra* notes 84, 90, 97, 104 & 105 and accompanying text.

A plaintiff in this case would also be able to recover damages from the defendant for any economic injury which came about as a result of the misstatements. See Note, *The Measure of Damages Under Section 10(b) and Rule 10b-5*, 46 MD. L. REV. 1266 (1987).

<sup>166</sup> Kronman, *Mistake, Disclosure, Information and the Law of Contracts*, 7 J. LEGAL STUD. 1, 13 (1978). See Gilson & Kraakman, *The Mechanisms of Market Efficiency*, 70 VA. L. REV. 549, 592-609 (1984) [hereinafter Gilson & Kraakman].

<sup>167</sup> See D. RATNER, SECURITIES REGULATION 33-39 (3d ed. 1988). The analyst is required to disclose newly unearthed information under the continuous disclosure policy of the Securities and Exchange Act of 1934 (15 U.S.C. § 78a-kk (1982)). In 1982, the Securities and Exchange Commission integrated the 1933 and 1934 Acts disclosure requirements with the adoption of an "integrated disclosure system." This permits most of "the information required in the registration statement to be incorporated by reference to the issuer's 1934 Act filings. . . ." *Id.* at 36. In essence, the 1933 Act registration process is more closely supplemented by the 1934 Act's periodic disclosure requirements. See also Gilson & Kraakman, *supra*, note 166 at 601; Fox, *Shelf Registration, Integrated Disclosure, and Underwriter Due Diligence: An Economic Analysis*, 70 VA. L. REV. 1005, 1006 n.5 (1984); Folk, *Civil Liabilities Under the Federal Securities Acts: The BarChris Case*, 55 VA. L. REV. 1, 52-56 (1969).

<sup>168</sup> See *supra* note 157 and accompanying text.

new information resulting from market fluctuation. The auctioneer would then be required to keep the consignor informed on an ongoing basis of any material changes which might affect their relationship, or affect the consignor's decision to proceed with the auction.

Statutory disclosure requirements similar to those faced by underwriters, with their concomitant liabilities, would improve the efforts that an auctioneer uses on his client's behalf.<sup>169</sup> The diligence required of best efforts at the initial stages of the auctioneer-consignor relationship can have a material effect on the outcome of the sale.<sup>170</sup> A more affirmative disclosure policy should be part of the reasonable skill and care used by an auctioneer when serving a client.

Thus, due diligence for the auctioneer would constitute: an accurate appraisal of the commodity being offered for sale, which would involve utilizing all the skill and acumen of a reasonably proficient auction expert; a truthful opinion as to value which would err on the conservative side; and continual disclosure to his consignor regarding any material changes that may affect the disposition of his property, or any business decisions regarding the sale which he believes are appropriate.

## VI. CONCLUSION

While an auctioneer is not a guarantor of auction prices, and does not guarantee that items offered at auction will be sold, he is still responsible for any acts or omissions that may affect the outcome of a sale.<sup>171</sup> Consequently, a requirement that the auctioneer act as an underwriter in diligently investigating, acquiring, and supplying information about a prospective sale is critical.<sup>172</sup> The imposition of a due diligence standard on the auctioneer is necessary not just for the consignor's sake, but also for the auctioneer's rebuttal of any presumptions of negligence or impropriety.

The due diligence and disclosure principles of section 11 of the Securities Act of 1933<sup>173</sup> should be applied to the auction market.<sup>174</sup> Auctioneers and consignors would benefit from the imposition of clear standards which would guide the expectations

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<sup>169</sup> See Gilson & Kraakman, *supra* note 166, at 600-01.

<sup>170</sup> See *Diligence Insurance*, *supra* note 160, at 1732, 1738.

<sup>171</sup> *Cristallina S.A. v. Christie, Manson & Woods Int'l, Inc.*, 117 A.D.2d 284, 293-94, 502 N.Y.S.2d, 165, 172 (1986).

<sup>172</sup> See generally, Kronman, *supra* note 166.

<sup>173</sup> See *supra* note 157 and accompanying text.

<sup>174</sup> See *supra* note 158 & 167 and accompanying text.

of consignors and provide the auctioneer with minimum performance criteria.<sup>175</sup> In addition to safeguarding the consignor's interests, the imposition of potential liability on auctioneers should improve the diligence exercised in their appraisals and assure best efforts in fulfilling their duties.

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<sup>175</sup> See Gilson & Kraakman, *supra* note 166, at 598 n.145.