CORPORATE ART COLLECTING AND FIDUCIARY DUTIES TO SHAREHOLDERS: LEGAL DUTIES AND BEST PRACTICES FOR DIRECTORS AND OFFICERS

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I. INTRODUCTION

Corporate art collecting burgeoned in the United States during the 1980s and 1990s.[1] Corporations with large fine art holdings often justify their collecting activities by announcing that the corporation's fine art enhances the workplace, motivates employees, and forges strong corporate-community ties. But the core objective of a corporation is to "create and increase wealth for its shareholders."[2] And while some art may appreciate in value if correctly acquired, if properly cared for, and if sold in the right market, the acquisition and stewardship of a large corporate fine art collection can cost many millions of dollars.

[1] CHIN-TAO WU, PRIVATISING CULTURE: CORPORATE ART INTERVENTION SINCE THE 1980S 212 (2002).

[2] ABA COMMITTEE ON CORPORATE LAWS, CORPORATE DIRECTOR'S GUIDEBOOK 11 (5th ed. 2007).

Moreover, collecting art for other than sound business purposes, utilizing improper acquisition/disposition practices, neglecting artwork in the collection, or engaging in conflict of interest transactions in connection with the corporate fine art collection, may subject the company to liability and breach fiduciary duties owed by directors to the corporation and to its shareholders.

Indeed, when corporate scandals break, corporate art collections quickly make their way into the headlines. For example, less than forty-eight hours after Lehman Brothers Holdings Inc. filed bankruptcy in September 2008, the media began to question the fate of Lehman's sizeable art collection.[3] Within days, that media attention turned to the large personal art collection of Lehman's Chief Executive Officer, Richard S. Fuld, Jr., and his wife Kathy—a trustee at the Museum of Modern Art in New York.[4]

And after Enron collapsed, and its employees learned that their pensions—which had been substantially invested in company stock—had plunged in value, the press zeroed in on the millions of dollars of corporate money spent to build Enron's corporate art collection by the company's Chief Financial Officer, Andrew Fastow, and his wife Lea—who also personally collected art—with help from curators at Houston's Museum of Fine Arts and the Menil Collection.[5] A

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[3] *See, e.g.*, W. Robinson, *Lehman's Art-Collecting Unit to be Sold,* ARTNET.COM, Sept. 17, 2008, http://www.artinfo.com/news/story/28589/lehmans-art-collects-unit-to-be-sold; Lindsay Pollock, *Hirst May Exit Corner Office as Lehman Mulls Collection's Fate,* BLOOMBERG.COM, Sept. 18, 2008.

[4] Lindsay Pollock, *Kathy Fuld, Wife of Lehman CEO, to Auction Artworks,* BLOOMBERG.COM, Sept. 26, 2008, http://www.bloomberg.com/apps/news?pid=20601088&refer=muse&sid=axNbRZlw65Ag; Carol Vogel, *Modern Drawings Head for Auction,* N.Y. TIMES, Sept. 26, 2008, at E30.

[5] *See, e.g.*, David Ebony, *Enron Collapse Impacts Art World,* ART IN AMERICA, Feb. 2002, http://findarticles.com/plarticles/mi_m1248/is_2_90/ai_82748708; Bill Murphy, *Enron's Art Hopes Just a Pipe Dream: Buying Spree Now Drawing Fire,* HOUSTON CHRON., July 29, 2002, at A1; Ben White, *Auctioning Off Symbols of '90s Executive Excess,* WASH. POST, May 11, 2003, at A10. Lea Fastow reportedly served as a trustee at the

possible conflict of interest between the Fastows and the Menil did not escape a Menil founding director who reportedly complained that Lea Fastow "sought to use the museum to increase the value of her works and to increase her social standing in Houston . . . ."[6] Then again, wealthy art collectors long have enjoyed close relationships with museums. But questions remain whether or not any potential conflicts of interest may have existed between Andrew Fastow and Enron through Fastow's personal art collecting and his corporate art collecting activities on behalf of Enron. For example: (a) did Fastow's art acquisitions for Enron build appreciation in his private art collection; (b) were artworks Fastow acquired for Enron's corporate collection sound investments or were they inferior investments to those he purchased for his personal art collection;[7] and (c) did Fastow receive discounted art prices or services for his private art collection as a result of Enron's business relationships with galleries, artists, and dealers?

Another high profile corporate case capturing press attention involved Tyco International Ltd's C.E.O. Dennis Kozlowski. When a New York grand jury indicted Kozlowski for failing to pay state taxes on his purchases of works of art by artists including Monet, Renoir, Bonheur, and LaFarge,[8] reports in the press as far away as Tapei speculated he may have used corporate funds to build his multimillion dollar private art collection.[9] Suspicions aroused, a second

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Contemporary Arts Museum and on a Museum of Fine Arts subcommittee. The Fastows' foundation, until seized by the federal government, provided philanthropic support to Houston museums.

[6] Stephen Kinzer, *Enron's Fall Reverberates in Houston's Arts World,* N.Y. TIMES, Dec. 18, 2001, at E1.

[7] *See, e.g.*, Farber v. Servan Land Co., 662 F.2d 371, 380-81 (5th Cir. 1981) (holding that a failure to give corporation first opportunity to buy parcel of land adjacent to corporate golf course breached directors' duty to corporation under doctrine of corporate opportunity).

[8] Indictment, People v. L. Dennis Kozlowski, Ind. No. 3418/02, (N.Y. Crim. Ct. 2001).

[9] Alex Berenson & Carol Vogel, *Ex-Tyco Chief is Indicted in Tax Case,* N.Y. TIMES, June 5, 2002, at C1; *see also* Ann Woolner, *Kozlowski's US*

indictment charged Kozlowski with conspiring to spend Tyco funds to acquire artwork and other expensive property for his personal use.[10] After a jury convicted Kozlowski of grand larceny for using millions of dollars in loans from the company to cover the cost of several paintings, the beleaguered Tyco auctioned off some of the works of art.[11]

One wonders why the fine art collecting activities of senior corporate executives, which impact their corporations, remain unchecked by corporate boards of directors. One answer may be the lack of statutory or decisional law and legal literature advising boards on the intersection of corporate art collecting and governance. Another may be that corporate expenditures for fine art and fine art collecting activities typically go unspecified to and unchallenged by shareholders. After all, if shareholders have no say in the multimillion dollar offices occupied by public corporations, why should they have any greater input into the multimillion dollar art collections that decorate those offices?

Corporate art collections pose unique challenges to directors charged with an "unyielding fiduciary duty to the corporation and its shareholders."[12] Although corporate insiders may not consider art in the corporate collection an investment,[13] corporate shareholders may feel otherwise. Shareholders deserve to know that when valuable fine art

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$2,200 Wastebasket, TAIPEI TIMES, Sept. 22, 2002, *available at* http:// www.taipeitimes. com/News/biz/archives/2002/09/22/169043.

[10] Indictment, People v. L. Dennis Kozlowski, Ind. No. 5259/02, "Background to the Conspiracy," at 65, *available at* http://fl1.findlaw.com/ news.findlaw.com/hdocs/docs. Kozlowski's conviction has now been affirmed. *See* People v. Kozlowski, 846 N.Y.S.2d 44 (App. Div. 2007).

[11] Phillip Boroff & Karen Freifeld, *Loot from Tyco Heads to the Auction House,* INT'L HER. TRIB., Apr. 17, 2006, *available at* http://www.ih t.com/articles/2006/04/16/bloomberg/bxart.php.

[12] Loft, Inc. v. Guth, 5 A.2d 503, 510 (Del. 1939) (holding that directors owe the corporation "undivided and unselfish loyalty").

[13] Karren Mills, *General Mills Turns Offices into Art Gallery,* OAKLAND TRIB., Aug. 12, 2003, *available at* http://findarticles.com/p/ articles/mi_qn4176/is_20030812/ai_n14558039.

assets are acquired by the company, those assets are properly purchased, acquired for sound business reasons, carefully stewarded, and disposed of consistent with the law and with best practices in corporate governance and fine art collection management. This Article examines corporate art collecting within the context of these legally mandated duties and best practices.

In this Article, we review the doctrines of primacy and corporate waste to evaluate whether corporate art collecting can maximize shareholder value or satisfy other legitimate business purposes. Corporations are advised to plan collecting activities strategically to ensure company art acquisitions align with sound business purposes justifying those purchases, and to set acquisition and collection management budgets that are reasonable and appropriate to the company's ongoing financial condition.

We begin our examination of fiduciary duties in application to corporate art collecting, exploring the duty of inquiry and fine art acquisitions. Certain market risks are discussed, which are involved in acquisitions of fine art both domestically and internationally, and this Article suggests corporations engage knowledgeable professionals to secure proper contractual documentation for art purchases made on behalf of the company. Intellectual property rights commonly associated with visual arts are reviewed in this discussion with a recommendation that corporations acquire these rights by assignment and waiver, when possible, or by suitable license.

We continue by reviewing fine art stewardship in application to directors' duty of care. Although mismanagement has long been tolerated by the courts as shielded by the business judgment rule, judicial tolerance is not boundless. Directors and officers are encouraged to establish systems for the proper care and oversight of the company's valuable art assets. This section also reviews residual legal rights that artists maintain in their works of art acquired by collectors. Rights which if not waived and if

exercised, can subject a corporation to suit should the work of art sustain damage while in the company's art collection.

We then evaluate dispositional alternatives for corporate art including resale and charitable donations. Prohibitions against self-dealing are examined in connection with any resale of corporate art, while in the context of corporate philanthropy, we review case studies in which corporations successfully made substantial charitable donations of fine art or monetary gifts in support of the arts. Finally, this Article recommends corporate agents use proper transactional documentation for all sales or gifts of art from the corporate collection.

Finally, we address the duty of loyalty in review of certain potential conflicts of interest that can arise through corporate art collecting activities. This Article recommends companies create a code of ethics and establish policies and procedures that govern their corporate fine art collections and collecting activities. A regular system to audit compliance with these policies and procedures should be established so directors and officers may exercise the proper oversight of the corporate art collection and address potential conflicts of interest or abuses as they arise.

II. FIDUCIARY DUTIES OWED TO THE CORPORATION AND CORPORATE SHAREHOLDERS

"The sentinel asleep at his post contributes nothing to the enterprise he is charged to protect."[14]

Corporate directors owe fiduciary duties to their corporations and corporate shareholders.[15] Although officers are responsible for the day-to-day operations of the corporation, corporate directors provide leadership to

[14] Francis v. United Jersey Bank, 432 A.2d 814, 822 (N.J. 1981).

[15] *See, e.g.*, Miller v. McDonald (*In re* World Health Alternatives, Inc.), 2008 Bankr. LEXIS 1012, at *34 (Bankr. D. Del. 2008) (applying Delaware law).

management, implement sound financial policy, review corporate investments at reasonable intervals, and bring a critical eye to management's activities. The law governing directors in the exercise of their fiduciary duties bears a brief restatement before we turn to its application in the corporate art collecting context.

It has been said that "[t]he best practices of corporate governance include compliance with fiduciary duties. Compliance with fiduciary duties, however, is not always enough to meet or to satisfy what is expected by the best practices of corporate governance."[16] Fiduciary duties, therefore, are but a baseline for corporate policy setting and best practices. This baseline is codified in California by Corporation Code §309(a), which provides in part:

> A director shall perform the duties of a director, including duties as a member of any committee of the board upon which the director may serve, in good faith, in a manner such director believes to be in the best interests of the corporation and its shareholders and with such care, including reasonable inquiry, as an ordinarily prudent person in a like position would use under similar circumstances.[17]

Section 309 imposes the duties of care, loyalty, and good faith on directors.[18] Like other states, California recognizes a

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[16] *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 745 (Del. Ch. 2005).

[17] CAL. CORP. CODE § 309(a) (2008).

[18] Delaware law is consistent. *See* Emerald Partners v. Berlin, 787 A.2d 85, 90 (Del. 2001) ("[D]irectors of [a] Delaware corporation have a triad of primary fiduciary duties: due care, loyalty, and good faith."). The American Bar Association's CORPORATE DIRECTOR'S GUIDEBOOK excellently summarizes these duties as requiring the director, in part, to: (a) *act in good faith*—acting honestly and dealing fairly; (b) *act in the best interests of the corporation*—avoiding acting in a self-interested manner to the corporation's detriment; (c) *act with due care*—expressing the need to pay attention, to ask questions, and to act diligently; (d) *as a person in a like position would act*—incorporating the basic attributes of common sense, practical wisdom, and informed judgment; and (e) *under similar circumstances*—depending on the circumstances and the nature of the

"judicial policy of deference to the business judgment of corporate directors in the exercise of their broad discretion in making corporate decisions."[19] This "business judgment" rule is:

> [B]ased on the premise that those to whom the management of a business organization has been entrusted, and not the courts, are best able to judge whether a particular act or transaction is helpful to the conduct of the organization's affairs or expedient for the attainment of its purposes. . . . The rule establishes a presumption that directors' decisions are based on sound business judgment, and it prohibits courts from interfering in business decisions made in good faith and in the absence of a conflict of interest.[20]

That said, the safe harbor provided by the business judgment rule can only be claimed by disinterested directors who act in good faith and in a manner attributable to a rational business purpose.[21] The rule will not shield directors if they breach their fiduciary duties, fail to make reasonable inquiries, or engage in corporate waste or

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decision to be made. *See* ABA COMMITTEE ON CORPORATE LAWS, CORPORATE DIRECTOR'S HANDBOOK 17-18, (5th ed. 2007), *available at* 62 BUS. LAW. 1479 (Aug. 2007).

[19] Lee v. Interinsurance Exch., 50 Cal. App. 4th 694, 711 (Ct. App. 1996). This business judgment rule presumption has been applied by courts to officers as well as directors. *See, e.g.*, *In re* Munford, Inc., 98 F.3d 604, 611 (11th Cir. 1996) (applying Georgia law); *In re* Croton River Club Inc., 52 F.3d 41, 44 (2d Cir. 1995); Cede & Co. v. Technicolor, Inc., 634 A.2d 345, 361 (Del. 1993).

[20] *Lee*, 50 Cal. App. 4th at 711.

[21] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *disapproved on other grounds by* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000). Delaware courts typically define "disinterested directors" as "those directors that neither appear on both sides of the transaction nor expect to derive any personal financial benefit from it in the sense of self-dealing, as opposed to a benefit which devolves upon the corporation or all stockholders generally." Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 174 n.140 (Del. Ch. 2005), *aff'd,* 906 A.2d 114, 119 (Del. 2006) (quoting Williams v. Grier, 671 A.2d 1368, 1377 n.19 (Del. 1996)).

impermissible conflicts of interest.[22] Thus, satisfying the duty of "reasonable inquiry" is one of the preconditions to application of the business judgment rule.[23] In short, a director's decision must be informed.

The Second Circuit Court of Appeals explained these preconditions to the application of the business judgment rule as follows:

> Directors must exercise their "honest judgment in the lawful and legitimate furtherance of corporate purposes." It is not enough that directors merely be disinterested and thus not disposed to self-dealing or other indicia of a breach of the duty of loyalty. Directors are also held to a standard of due care. They must meet this standard with "conscientious fairness." For example, where their "methodologies and procedures" are "so restricted in scope, so shallow in execution, or otherwise so *pro forma* or halfhearted as to constitute a pretext or sham," then inquiry into their acts is not shielded by the business judgment rule.[24]

Underscoring the rule's limits, one California court of appeals in *Gaillard v. Natomas Co.* explained:

> [T]he rule does not immunize a director from liability in the case of his or her abdication of corporate responsibilities: " . . . when courts say that they will not interfere in matters of business judgment, it is presupposed that judgment - reasonable diligence - has in fact been exercised. A director cannot close his eyes to what is going on about him in the conduct

[22] Lee v. Interinsurance Exch. of the Automobile Club of So. Cal., 57 Cal. Rptr. 2d 798, 808 (Ct. App. 1996); *see also* Brehm v. Eisner, 746 A.2d 244 (Del. 2000).

[23] Gaillard v. Natomas Co., 208 Cal. App. 3d 1250 (Ct. App. 1989); *see also* Smith v. Van Gorkom, 488 A.2d 858, 872 (Del. 1985) (holding that the business judgment rule gives "no protection for directors who have made 'an unintelligent or unadvised judgment'").

[24] Hanson Trust PLC v. ML SCM Acquisition, Inc., 781 F.2d 264, 274 (2d Cir. 1986) (internal citations omitted).

> of the business of the corporation and have it said that he is exercising business judgment."[25]

To satisfy this duty of inquiry, directors can rely on competent information provided by corporate management, outside professionals, and board committees.[26] Failure "to establish an information and reporting system reasonably designed to provide the senior management and the board with information regarding the corporation's legal compliance and business performance" may prevent application of the business judgment rule presumption.[27]

The duties of loyalty and good faith present another set of requirements for directors. One federal bankruptcy court recently summarized Delaware law in this regard as follows:

> Numerous Delaware decisions refer to directors as trustees, and impose on directors the highest duties of loyalty, honesty, and fair dealing in all matters concerning the management of corporate assets. Furthermore, Delaware cases impose this fiduciary duty prior to, and without reference to, any misconduct by the director. "It is not always necessary for [directors] to reap a personal profit or gain a personal advantage in order for their actions in performance of their quasi trust to be successfully questioned. Trustees owe not alone the duty to refrain from profiting themselves at the expense of their beneficiaries. They owe the duty of saving their beneficiaries from loss." Thus, Delaware case law clearly identifies the fiduciary duties of a corporate director, the trust *res* (all corporate assets), and the

[25] 208 Cal. App. 3d 1250, 1263-64 (Ct. App. 1989) (internal citations omitted).

[26] CAL. CORP. CODE § 309(b) (2008).

[27] *In re* Tower Air Inc., 416 F.3d 229, 238 (3d Cir. 2005) ("Overcoming the presumptions of the business judgment rule on the merits is a near-Herculean task . . . .").

> beneficiaries of the trust (the corporation and its shareholders).[28]

Born out of this duty of loyalty and good faith is the duty of "oversight."[29] The Delaware Chancery Court described this duty as requiring boards of directors to:

> [E]xercise a good faith judgment that the corporation's information and reporting system is in concept and design adequate to assure the board that appropriate information will come to its attention in a timely manner as a matter of ordinary questions, so that it may satisfy its responsibility.[30]

Whether the duty of oversight is a proactive one—imposing on directors an affirmative duty of inquiry regardless of the circumstances—or whether it requires only "red flag" attention when circumstances present themselves, is an evolving question under the law.[31] More recent authority suggests judicial movement away from the earlier

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[28] ATR-Kim Eng Capital Partners, Inc. v. Bonilla, Case No. 07-30309 TEC, 2007 Bankr. LEXIS 3566, at *3-4 (Bankr. N.D. Cal. 2007) (citations omitted). The bankruptcy court noted that Delaware court decisions do not equate corporate directors with trustees in all respects because directors do not hold title to the property of the corporation, and they may be required to take risks with the assets they manage for the corporation. *Id.*

[29] *See, e.g.*, Stone v. Ritter, 911 A.2d 362, 368 (Del. 2006).

[30] ATR-Kim Eng, C.A. No. 489-N, 2006 Del. Ch. LEXIS 215, at *72 (Del. Ch. 2006) (*quoting In re* Caremark Int'l, Inc. Derivative Litig., 698 A.2d 959, 970 (Del. Ch. 1996)).

[31] Early Legislative Committee Comment to California's CAL. CORP. CODE § 309 (1999) noted that, in enacting the statute, "[t]here was no intention of imposing upon any director a duty to make an inquiry regardless of the circumstances." *Id.* Similarly, the 1963 holding by the Delaware Supreme Court in its landmark *Graham v. Allis-Chalmers Mfg. Co.*, interpreting Delaware law in this regard, dismissed plaintiff's theory in a shareholder derivative action that directors owed a "system of watchfulness," stating, "directors are entitled to rely on the honesty and integrity of their subordinates until something occurs to put them on suspicion that something is wrong." Graham v. Allis-Chalmers Mfg. Co., 188 A.2d 125, 130 (Del. 1963); *see also In re* Caremark Int'l Inc. Derivative Lit., 698 A.2d 959, 970 (Del. Ch. 1996).

"red flag" standard, instead requiring directors to meet their oversight duties by inquiry based upon relevant and timely information.[32]

Directors may run little risk of personal liability for asset mismanagement or neglect.[33] Each director, however, remains a guardian of corporate assets as highlighted by the decision in *ATR-Kim Eng Capital Partners, Inc. v. Bonilla*,[34] in which the Delaware Chancery court entered judgment against directors for breach of duty for their failure to monitor corporate assets, which a majority shareholder transferred to his family for no consideration.[35] The court adjudged the defendant directors "stooge[s] for [the majority

[32] *See* Sarah H. Duggin & Stephen M. Goldman, *Restoring Trust in Corporate Directors: The Disney Standard and the "New" Good Faith*, 56 AM. U. L. REV. 211 (Dec. 2006). In this connection, the American Bar Association's CORPORATE DIRECTOR'S GUIDEBOOK advises that "[e]ven when there are no red flags, directors should satisfy themselves periodically that the corporation maintains procedures that are appropriately designed to identify and manage business risks and are reasonably effective in maintaining compliance with laws and corporate policies and procedures." ABA COMMITTEE ON CORPORATE LAWS, CORPORATE DIRECTOR'S GUIDEBOOK 21 (5th ed. 2007). Notwithstanding this evolution, some courts maintain that liability for director passivity should be limited only to cases in which inattention created a high risk for public safety. *See In re* SFBC Int'l, Inc. Sec. & Derivative Litig., 495 F. Supp. 2d 477, 486 (D.N.J. 2007).

[33] Many states have enacted statutes permitting corporations, by addition of a corporate bylaw provision, to exempt directors from personal liability for monetary damages for certain breaches of fiduciary duty. *See, e.g.*, DEL. CODE ANN. tit. 8, § 102(b)(7) (2008). Delaware's statute does not permit the corporation to eliminate or limit the liability of a director: "(i) [f]or any breach of the director's duty of loyalty to the corporation or its stockholders; (ii) for acts or omissions not in good faith or which involve intentional misconduct or a knowing violation of law; (iii) under [other sections of the Delaware code]; and (iv) for any transaction from which the director derived an improper personal benefit."

[34] ATR-Kim Eng Capital Partners, Inc. v. Bonilla, 2007 Bankr. LEXIS 3566 (Bankr. N.D. Cal. Oct 16, 2007); *see also* ATR-Kim Fin. Corp. v. Araneta, C.A. No. 489-N, 2006 Del. Ch. LEXIS 215, at *76-77 (Del. Ch. Dec 21. 2006) (finding no reporting system in place, and that defendant directors never checked the status of the corporate assets; "it is no safe harbor to claim that one was a paid stooge for a controlling stockholder").

[35] *ATR-Kim Eng*, 2007 Bankr. LEXIS 3566, at *7-8.

shareholder], seeking to please him and only him, and having no regard for [defendant directors'] obligations to act loyally towards the corporation and all of its stockholders."[36] Reviewing the Chancery Court's underlying judgment, the federal bankruptcy court concluded that defendant directors' failure to preserve corporate assets was tantamount to "leaving a large amount of cash unguarded in a public place," and the "hallmark of defalcation."[37] Instead, the bankruptcy court concluded, each director owed a duty as an independent and impartial fiduciary honestly seeking to make decisions for the best interest of the corporation.[38]

Shedding light on the independence required of directors, another federal bankruptcy court explained:

> [Independence] involves an inquiry into whether the director's decision resulted from that director being *controlled* by another. A director can be controlled by another if in fact he is *dominated* by that other party, whether through close personal or familial relationship or through force of will. A director can also be controlled by another if the challenged

[36] *Id.* at *8.

[37] *Id.* at *8-9.

[38] *Id.*; *see also* Telxon Corp. v. Meyerson, 802 A.2d 257, 264 (Del. 2002) ("Directors must not only be independent, but must act independently. As this Court has previously stated in defining director independence: '[i]t is the care, attention and sense of individual responsibility to the performance of one's duties . . . that generally touches on independence.'"). Directors who are not "independent" are those "dominated or otherwise controlled by an individual or entity interested in the transaction." Benihana of Tokyo, Inc. v. Benihana, Inc., 891 A.2d 150, 174-75 (Del. Ch. 2005) (citation omitted). Such control may be proven by facts evidencing that "through personal or other relationships the directors are beholden to the controlling person" such that individual, rational business discretion would be highly unlikely. *Id.* at 175 (citation omitted). "Entrenchment, self-dealing, or financial interest" can also indicate a director lacks independence. *Id.* Personal friendship or a business relationship, alone, is not enough to find a lack of independence. Beam v. Stewart, 845 A.2d 1040, 1051-52 (Del. 2004). Delaware law requires a very strong showing of financial interest to be made before a lack of independence is established. *See Benihana,* 891 A.2d at 175-76.

> director is *beholden* to the allegedly controlling entity. A director may be considered beholden to (and thus controlled by) another when the allegedly controlling entity has the unilateral power (whether direct or indirect through control over the other decision makers), to decide whether the challenged director continues to receive a benefit, financial or otherwise, upon which the challenged director is so dependent or is of such subject material importance to him that the threatened loss of that benefit might create a reason to question whether the controlled director is able to consider the corporate merits of the challenged transaction objectively.[39]

Where a corporate art collection has been developed at sizeable expense to the company, these corporate assets must not be mismanaged or ignored. Directors must exercise independent oversight of corporate practices in connection with these valuable assets, applying standards of due care, inquiry, loyalty, and good faith. With the "eyes wide open" approach recommended by the court in *Gaillard v. Natomas*, we turn to some essentials of corporate fine art collecting and fine art collection management.

III. COLLECTING ART FOR THE CORPORATION: DETERMINING PROPER BUSINESS PURPOSES

A. Corporate Art Collections and the Doctrine of "Waste"

Is all corporate art collecting a "waste" of corporate assets? This question generally can be answered in the negative even for corporations the core business purposes of which have nothing to do with fine art.[40] This conclusion

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[39] *In re* Robotic Vision Sys., Inc., 2007 Bankr. LEXIS 2982, at *12-14 (Bankr. D.N.H. 2007) (quoting Orman v. Cullman, 794 A.2d 5, 23 (Del. Ch. 2002)).

[40] Note, however, that small public companies with highly valued art collections may draw scrutiny from the Securities and Exchange

presumes, however, that some proper business purpose exists for the corporation to collect art.

"Waste" is a cause of action that alleges corporate officers or directors have engaged in a transaction through which the corporation received consideration no reasonable person would find adequate. Claims of "waste" typically arise when there is an expenditure of corporate funds or a disposition of corporate assets for which no consideration is received in exchange, and for which there is no rational business purpose.[41] As waste claims allege injury to the corporation, they can be asserted only by the corporation or by corporate shareholders in a derivative suit.[42]

Successful claims of waste are rare and usually relate to the "unconscionable case where directors irrationally squander or give away corporate assets."[43] Indeed, courts have set an extremely high bar to establish a claim of waste. As adopted by the Delaware Supreme Court:

> If, however, there is *any substantial* consideration received by the corporation, and if there is a *good faith judgment* that in the circumstances the transaction is worthwhile, there should be no finding of waste, even if the fact finder would conclude *ex post* that the transaction was unreasonably risky. Any other rule would deter corporate boards from the optimal rational acceptance of risk, for reasons explained elsewhere. Courts are ill-fitted to attempt to weigh the "adequacy" of consideration under the

Commission. *See* Release No. 34-41110, 1999 SEC LEXIS 409, at *172 (Feb. 25, 1999).

[41] 1 PRINCIPLES OF CORPORATE GOVERNANCE: ANALYSIS AND RECOMMENDATIONS § 1.42 (1994).

[42] Hillman v. Webley, No. 95-1513, 1996 U.S. App. LEXIS 25702, at *31 (10th Cir. 1996).

[43] *In re* Walt Disney Co. Derivative Litig., 907 A.2d 693, 748-49 (Del. Ch. 2005).

> waste standard or, *ex post,* to judge appropriate degrees of business risk.[44]

Even with this high threshold of proof required to establish corporate waste, excessive corporate spending on the arts has not always been sanctioned by the courts. In *Cox Enterprises, Inc. v. News-Journal Corp.* the court found defendant News-Journal Corporation ("NJC") engaged in "waste" through its excessive spending in support of arts and culture.[45] In reaching its holding, the court found the individual defendants had used the corporation "to indulge their personal interests in the arts."[46] NJC's contributions to support various cultural activities had exceeded deductible amounts permitted by tax laws, and NJC's counsel had warned management that the company's contributions to the arts could not "be justified in terms of promotional consideration [or] as reasonable corporate philanthropy," as they equaled "twice the industry average" and had a material adverse effect on profits.[47]

Although the court in *Cox Enterprises* did not create a bright line test for corporate expenditures in support of arts and culture, it cautioned that there are limits. Contributions must be kept within a reasonable range and tied to legitimate business purposes. By analogy, corporations are advised to articulate legitimate business purposes for collecting fine art and to set reasonable limits on expenditures for acquiring and stewarding fine art in the corporate art collection. Let us examine certain business purposes that may serve in some part to justify corporate art collecting.

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[44] Lewis v. Vogelstein, 699 A.2d 327, 336 (Del. Ch. 1997), *cited approvingly in* Brehm v. Eisner, 746 A.2d 244, 263 (Del. 2000).

[45] Cox Enters. v. News-Journal Corp., 469 F. Supp. 2d 1094 (M.D. Fla. 2006), *aff'd* 510 F.3d 1350 (11th Cir. 2007).

[46] *Id.* at 1110-11.

[47] *Id.* at 1098.

B. Shareholder Primacy: Corporate Collecting of Investment Grade Fine Art

Profit maximization for the benefit of shareholders is a norm in law and economics.[48] While the vitality of "primacy," which this norm is called, has been debated in this era of control contests and executive compensation, the norm remains a beacon in matters of corporate purpose and governance. Simply stated, primacy recognizes a fiduciary duty imposed on directors to further shareholder interests by maximizing shareholder profits, subject to inconsistent legal obligations upon them, and within the discretion permitted them by the business judgment rule.

Corporate fine art collecting has escaped the primacy debate. Indeed, little has been written as to whether large-scale art collections of publicly traded companies—such as JPMorgan Chase's collection of over 30,000 objects of art by artists including Milton Avery, Jean-Michel Basquiat, Jenny Holzer, Cindy Sherman and Jeff Koons, or the more modest General Mills art collection with 2000 works of art by artists including Jim Dine, Jasper Johns, and Roy Lichtenstein—comport with this profit maximization norm. There is also an absence of statutory and decisional law on the subject. The lack of discourse about corporate art collecting, however, should not be interpreted to suggest the practice is inconsistent with shareholder interests or prohibited by law.[49]

To be sure, corporate philanthropy in support of the arts is nothing new. Take for example Altria Group, which until 2007 owned Phillip Morris USA. For decades, Altria gifted millions of dollars to arts organizations in the United States, even housing a branch of the Whitney Museum of American Art at Altria's Park Avenue headquarters in New York City.

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[48] *See, e.g.*, Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest,* 80 N.Y.U. L. REV. 733, 735-39 (2005).

[49] *See, e.g.*, Unocal Corp. v. Mesa Petroleum Co., 493 A.2d 946, 957 (Del. 1985) ("Merely because the General Corporation Law is silent as to a specific matter does not mean that it is prohibited.").

As the company spun off Phillip Morris and moved its headquarters from the U.S. to Switzerland, arts groups in Manhattan struggled to find new benefactors to replace Altria's generous support.[50] There can be no doubt that Altria's redirection of profits to support arts and culture, notwithstanding how it may have earned those profits, contributed to the public good.

Corporate art collecting, like corporate funding of the arts, is both commonplace and can contribute to the public good. One way to view the scope of corporate art collecting in the United States is to look at it through the microcosm of losses of corporate art that occurred in lower Manhattan from the terrorist attacks on 9/11. Appropriately overshadowed by the loss of life on that day, the value of corporate art destroyed on 9/11 exceeded more than $100 million, according to insurer Chubb.[51] Felled collections included Cantor Fitzgerald's "Museum in the Sky," with its unsurpassed Rodin sculpture and drawing collection, as well as the many works lost by Silverstein Properties including a mobile by Alexander Calder and a tapestry by Joan Miro. The attacks also destroyed site-specific works of art commissioned by the port authorities of New York and New Jersey.[52]

State corporate laws encourage corporate philanthropy, including philanthropic support of the arts.[53] Federal tax

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[50] Andrew Martin, *As a Corporation Leaves Town, Grants for the Arts Go With It*, N.Y. TIMES, Oct. 8, 2007, http://www.nytimes.com/2007/10/08/business/media/08altria.html.

[51] Beverly Schreiber Jacoby, *A Year After September 11: Art Collecting in an Age of Uncertainty*, CHUBB COLLECTORS, Sept. 3, 2002, http://www.chubbcollectors.com/Vacnews/index.jsp?form=2&ArticleId=86.

[52] *Id.*

[53] To this end, the Delaware Code empowers corporations to make donations for the public welfare or for charitable, scientific, or educational purposes. DEL. CODE ANN. tit. 8, § 122(9) (2008); *see also* CAL. CORP. CODE § 207(e) (2008) (permitting corporations to "[m]ake donations, regardless of specific corporate benefit, for the public welfare or for community fund, hospital, charitable, educational, scientific, civic or similar purposes").

law, too, promotes charitable donations by corporations.[54] Corporate art collecting, however, is not expressly sanctioned by these statutory laws.

Decisional law lends only indirect guidance to corporations in the context of their corporate art collecting activities. Delaware courts in two decisions upheld a vote by the board of directors for Occidental Petroleum Corporation to fund development of the Armand Hammer Museum of Art and Cultural Center to house the large art collection of Occidental's founder and chairman of the board, Dr. Armand Hammer. In reaching their decisions, the courts never mentioned the primacy doctrine.[55] Instead, finding no corporate "waste," the Chancery Court presumed application of the business judgment rule to shield the directors' vote to fund the museum's development where the donation fell "within the range of reasonableness" of the company's overall resources, and where the company would receive good will and other benefits from the expenditures.[56]

These decisions suggest that the doctrine of primacy in the context of corporate support for the arts is either not a relevant consideration or has been supplanted by the legal extremes of the doctrine of "waste." Whether courts will begin to consider "primacy" in evaluating corporate art collecting activities in the future remains to be seen. To determine if art collecting can satisfy primacy, one must look to art as an investment class of assets.[57]

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[54] *See* 26 U.S.C. § 170(a)(2) (2008).

[55] *See* Sullivan v. Hammer, 1990 Del. Ch. LEXIS 119 (1990); Kahn v. Sullivan, 594 A.2d 48 (Del. 1991).

[56] *Sullivan,* 1990 Del. Ch. LEXIS at *19.

[57] Primacy can take many forms. *See, e.g.*, Melvin Aron Eisenberg, *Corporate Conduct that Does Not Maximize Shareholder Gain: Legal Conduct, Ethical Conduct, the Penumbra Effect, Reciprocity, the Prisoner's Dilemma, Sheep's Clothing, Social Conduct, and Disclosure,* 28 STETSON L. REV. 1, 14-17 (1998). Where corporate-owned fine art assets can appropriately be characterized to serve the same or similar purposes as other ordinary business expenses, such as advertising, or gain economic benefit for the corporation, it should to some extent enjoy treatment as a profit-maximizing activity, rather than a non-maximizing activity.

1. Art as an Investment

Like debates surrounding primacy, the profitability of collecting art also has been debated. Somewhat optimistic on the subject are Professors Michael Moses and Jianping Mei from the Stern School of Business who founded the Mei/Moses Fine Arts Index, which tracks paired auction purchases and sales of art from 1875 to the present, and then compares those results to the S&P 500 and other investment markers. The Artasanasset.com website, home of the Mei/Moses family of indices, summarizes the performance of art investments as follows:

> In general arts relative performance is based on the historical time period under consideration. For example over the last fifty years the Mei Moses® all art index has slightly underperformed stocks. It has significantly underperformed stocks for the last 25 years and has slightly outperformed stocks for the last ten years and significantly outperformed stocks over the last five years.[58]

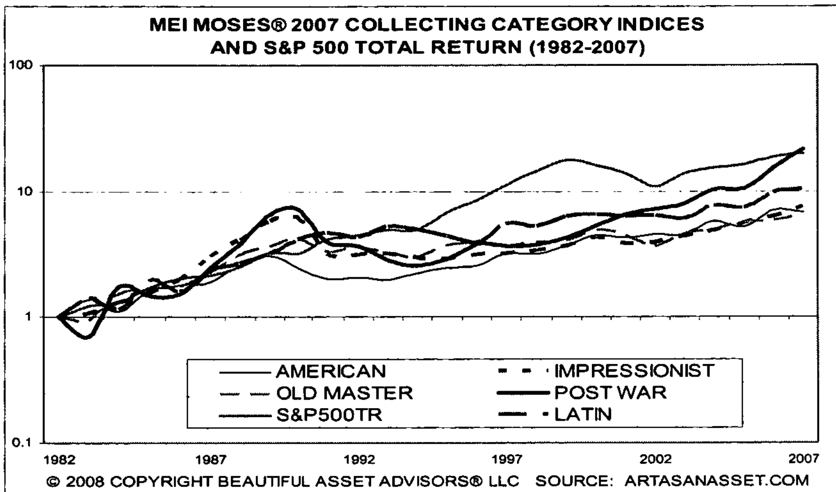
The Artasanasset.com website notes that art assets suffer from higher volatility and lower liquidity than most other financial assets, but that the lack of correlation of art assets to other asset classes may render art investments a potential vehicle for portfolio diversification.[59] On these latter points, Professors Moses and Mei apparently agree with Belgian cultural economist Victor A. Ginsburg who generally has held a more sanguine view of art as an investment,

[58] *See* Jianping Mei & Michael Moses, *The Investment and Asset Potential of Art*, ARTASANASSET.COM, http://www.artasanasset.com/main/artinvesting.php (last visited Mar. 9, 2009). The author gratefully acknowledges Professor Michael Moses for permission to include market information and the following chart from ARTASANASSET.COM in this Article.

[59] *Id.*

concluding that art offers lower returns than other classes of financial assets, proves more risky, and is less liquid.[60]

Within the broader art market, certain submarkets outperform other submarkets at various points of time. The Mei/Moses indices visually capture some of these performance differences over the past twenty-five years:[61]



Because performance differences exist at various times for fine art submarkets, timing the resale of fine art for the right market can be key to maximizing art values. In 2007, for example, old master paintings waned while sales of Chinese contemporary art went wild. Sales for contemporary art had never been more robust. According to Bloomberg.com, Christie's International auction sales rose 25% thanks to contemporary art sales, with the company's overall 2007 auction and private sales of art totaling a

[60] Victor A. Ginsburgh, *Art Markets*, *in* A HANDBOOK OF CULTURAL ECONOMICS, 40 (Ruth Towse ed., 2003).

[61] Reprinted with permission of Professor Michael Moses and ARTASANASSET.COM.

reported $6.1 billion.[62] Sotheby's operating revenues for the nine months ending September 30, 2007, ended almost 50% above the prior period, topping out at $572 million.[63]

Not all classes of art found the 2007 auction picture rosy, however. While Andy Warhol's *Green Car Crash (Green Burning Car I)* sold in May 2007 for a record $71.7 million,[64] and Edward Weston's photograph *Nautilus* set an auction record for the photographer of $1.1 million,[65] Impressionist works, including a key work by Vincent Van Gogh offered by Sotheby's, either did not sell at all or returned underwhelming prices. Shares of Sotheby's stock, which had been riding well above the S&P 500 and the Dow for the first part of the year, fell in November 2007 due, in part, to its disappointing Modern and Impressionist sales.[66] This disparity in contemporary versus Impressionist art sales in 2007 bespeaks the volatility and time sensitivity of the art market, in general, and of its relative submarkets in particular.

With the global economic decline, auction results in 2008 proved more disappointing with works by Warhol and other artists, which had experienced substantial gains in 2007, losing ground in 2008. But even in good economic times, the art market can prove highly unpredictable. Take for example Sotheby's auction of the *Guennol Lioness* in December 2007. Estimated to sell between $14 million to $18 million, the small sculpture sold for an astounding three

[62] Linda Sandler, *Christie's 2007 Auctions Rise 25%, Boosted by Contemporary Art*, BLOOMBERG.COM (Jan. 18, 2008), *available at* http://www.williamverdult.com/home/2008/1/19/christies-2007-auctions-rise-25-boosted-by-contemporary-art.html.

[63] Sotheby's, Current Report (Form 8-K) (Nov. 14, 2007).

[64] Sandler, *supra* note 62.

[65] Daryl Lang, *$1.1 Million Weston Sets Artist's Record At Sotheby's*, PDNONLINE, Oct. 23, 2007, http://www.pdnonline.com/pdn/newswire/article_display.jsp?vnu_content_id=1003661941.

[66] Earnings and income press release issued by Sotheby's on November 9, 2007 with its 8-K for the quarter ended September 30, 2007.

times the estimate, bringing in $57.16 million.[67] Meanwhile, a copy of the Magna Carta, touted in Sotheby's pre-auction press release as "[a]rguably, the most famous single document in existence," sold only at the lowest end of its estimate.[68]

It should be remembered that only a fraction of art becomes valuable enough for resale on the secondary market. To hope for any return, collectors must therefore acquire art with resale potential.[69] Resale potential requires the existence of a market for the particular artist's body of work. Markets are made by those who collect the artist's works of art; i.e., which prominent collectors and notable museums collect the artist. For example, if key collectors Vicki and Kent Logan or the San Francisco Museum of Modern Art collect Takashi Murakami (as they both do), the resale potential and prices of Murakami's art will be positively impacted.

Whether a corporation should plan to collect investment grade fine art depends on whether, and to what extent, the corporation has the necessary resources and expertise to acquire and steward investment grade fine art, and should be carefully evaluated by corporate advisors.

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[67] Compare earnings and income press release issued by Sotheby's on November 9, 2007 with Form 8-K for the quarter ended September 30, 2007 (estimated price) with reported sales results in *Lion Sculpture gets Record Price,* BBC NEWS, Dec. 6, 2007, http://news.bbc.co.uk/2/hi/middle_east/7130337.stm.

[68] Compare earnings and income press release issued by Sotheby's on November 9, 2007 with its 8-K for the quarter ended September 30, 2007 (estimated price) with C. Michaud, *Magna Carta Fetches $21.3 Million at Sotheby's Auction,* REUTERS, Dec. 19, 2007, http://www.reuters.com/article/oddlyEnoughNews/idUSHAR95284120071219.

[69] Some corporations, on the other hand, collect works by emerging or mid-career artists with little or no secondary market potential. Beyond the enjoyment of these artistic images by corporate employees and the fostering of the local arts scene—both legitimate goals—any return of investment on this art, let alone any return on investment, is unlikely.

2. Resources and Expertise to Acquire Investment Grade Fine Art

Several corporations have taken the step to collect investment grade fine art. Consider the collection of UBS, which acquired Paine Webber in 2000 along with its world-class art collection that Donald Marron, Chairman of the Board for PaineWebber, began collecting in the early 1970s. Today, the collection is one of the most acclaimed in the country with works by artists including Jasper Johns, Roy Lichtenstein, Anselm Kiefer, Robert Rauschenberg, Lucian Freud, and Ed Ruscha. So impressive is the collection that UBS loans its works of art to museums. Any successful collector will tell you it is no accident Marron managed to amass such a large-scale collection of valuable art for the company. It took time, resources, and expertise to acquire works of art with appreciation potential in the secondary market.

Corporate officers and directors, while not guarantors of their efforts on behalf of the corporation,[70] nonetheless must consider whether the corporation has, or can obtain, the necessary resources and expertise to acquire investment grade fine art. Knowing what the corporation can afford to collect is a key to developing a sound corporate collection strategy. Few companies can afford the hundred million dollar price tag for the Van Gogh painting that makes its way into the market. Instead, contemporary art may be more affordable, with prints and photography generally less expensive than paintings or sculpture.[71] Having identified an art budget (which must anticipate costs of stewardship), companies that wish to buy investment grade fine art may need to engage a fine art consultant/connoisseur who knows

[70] Biren v. Equality Emergency Med. Group., Inc., 102 Cal. App. 4th 125, 136 (2002) (a director will not be liable for mistake in business judgment, which is made in good faith and in what he/she believes to be in the best interest of the corporation).

[71] Prints by an artist may offer smaller returns on resale than paintings by the artist.

the art market and who can discern a "better" deal from a "good" deal to make the right fine art purchases for the corporate collection. Few corporate employees, officers, or directors are trained or skilled in these pursuits.

A personal lesson may be illustrative here. As a young lawyer at a law firm in the 1990s, the author served on a committee to acquire art for the firm's new west coast offices. None of the lawyers on the committee possessed the requisite expertise to buy investment grade fine art, so the firm engaged a fine arts consultant. With little debate, and no real strategic plan for collecting, the committee adopted the consultant's acquisition recommendations, spending a sizable amount of money on the firm's art collection.

Did the committee make good purchases? The consultant recommended works by well-known California artists, and the committee liked the works acquired (even if some of our colleagues did not). But the full committee lacked the training and expertise to know whether the consultant had presented the best available works by each artist, or whether works by other artists may have been more suitable or a better buy for the firm.

Did the firm buy the works at favorable prices? The works purchased for the collection fit within the firm's generous art budget. But the committee did little to test the consultant's recommended acquisition prices. The committee certainly did not check auction records (online now) to see if the price to be paid for each work fell within an appropriate range for similar works by the artist, or whether each artist had a robust secondary market for his/her works.

Did the committee make any bad buys? We commissioned a large mixed media work from an artist who had been collected, as it turned out, by only a few collectors. The resale potential for this unique and expensive work evaporated as the artist's market waned. The lesson here is to be wary of collecting art where demand for the artist's

works rests only with a small group of collectors if appreciation is a primary goal for the collection.[72]

To our firm's credit, it reached out to a trained consultant to help select works for the firm's art collection, which almost certainly enhanced the overall value of the collection. The importance of due diligence in engaging the right consultant and in scrutinizing their recommendations cannot be overstated. Stumbling into the acquisition process without proper advice can waste corporate funds and build a collection with little resale or gifting potential.

C. Other Business Purposes Promoted by Corporate Art Collecting

In the context of corporate art collecting, other business purposes beyond investment or appreciation may provide justification for corporate art collecting. Indeed, "[a] board of directors enjoys a presumption of sound business judgment, and its decisions will not be disturbed if they can be attributed to any rational business purpose."[73] And in making corporate decisions, the laws in more than half the states permit directors to consider the interests of constituencies other than shareholders, including employees and the communities in which the company operates, so long as real benefits accrue to shareholders.[74]

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[72] Consider Charles Saatchi's consumption in the 1980s of works by artist Julian Schnabel. The young artist became an overnight star after Saatchi bought Schnabel's works *en masse*. But when Saatchi offloaded Schnabel's works a few years later, the market reacted. *See* Grace Glueck, *A Leading Art Collectors is Selling, and the Market Wonders Why*, N.Y. TIMES, Nov. 23, 1989, http://query.nytimes.com/gst/fullpage.html?res=950DE1D91339F930A15752C1A96F948260# (noting Saatchi's sale of fifteen of Schnabel's works).

[73] Sinclair Oil Corp. v. Levien, 280 A.2d 717, 720 (Del. 1971).

[74] Revlon, Inc. v. Macandrews & Forbes Holdings, 506 A.2d 173, 182 (Del. 1986); *see also* CONN. GEN. STAT. ANN. § 33-756(d); N.Y. BUS. CORP. LAW § 717(b); OHIO REV. CODE ANN. § 1701.59(E). Much has been written regarding the tension between shareholder interests and the interests of these other constituencies. *See* Timothy L. Fort, *The Corporation as Mediating Institution: An Efficacious Synthesis of Stakeholder Theory and*

Art in the workplace can motivate corporate employees, entertain visitors, decorate facilities, and strengthen community ties to the corporation. The cultural and historical contribution made to the public by large corporate art collections in the United States cannot be overlooked; art gifted or loaned by corporations to museums strengthens these public institutions and provides the public with greater access to fine art. Purchasing art also supports artists who depend on collectors to fuel their creative machines.

JPMorgan Chase has offered similar justifications for its collection, which David Rockefeller, then President of the Chase Manhattan Bank, began to collect in the 1950s.[75] In conjunction with Chase's exhibition of works of art from its corporate collection in partnership with the Dubai International Financial Centre, the director of Chase's collection, Lisa Erf, told reporters Chase's art collection represents key corporate values including creativity, originality, innovation, and diversity and, as a "cultural investment," creates a humanizing and engaging environment for employees and visitors.[76] Erf noted that corporate art also serves a functional purpose as interior decoration while demonstrating the firm's commitment to

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Corporate Constituency Statutes, 73 NOTRE DAME L. REV. 173 (1997); Einer Elhauge, *Sacrificing Corporate Profits in the Public Interest,* 80 N.Y.U. L. REV. 733 (2005).

[75] One can visit JPMorgan Chase's corporate art collection at the corporate website where the art collection is showcased alongside its philanthropic activities. The company's strategy of listing the corporate art collection on its website under the umbrella of "Community Partnerships" is no accident. Associating its world class collection with the company's philanthropic activities may, in some small way, afford the company freedom in developing, maintaining, and disposing of its multimillion dollar fine art asset. JPMorgan Chase: The JPMorgan Chase Collection, http://www.jpmorganchase.com/cm/cs?pagename=Chase/Href&urlname=jpmc/community/grants/art/collection (last visited Mar. 9, 2009).

[76] K. Fernandez, *Art Collections Demonstrate Key Corporate Values*, EMIRATES BUSINESS 24/7 (Mar. 8, 2008), *available at* http://www.business 24-7.ae/articles/ 2007/1/pages/346321042008.aspx.

social responsibility and broadening awareness about contemporary art.[77]

Another corporate giant, Citigroup, reported that the mission of its art collection had been "to decorate the offices in a way that set a comfortable and conservative tone for business."[78] When Citigroup's office space in Seven World Trade Center collapsed on the morning of 9/11, it destroyed more than 1113 works of art from its collection including English and American antique furniture, Asian porcelains, prints by Alex Katz, Jim Dine, Jacob Lawrence, and Romare Bearden, and paintings by Louis Bouche, John Heliker, and William Thon, among others.[79] Shareholders may debate whether Asian porcelains and expensive paintings are really necessary to set a "comfortable and conservative tone for business."[80] Proper collection planning can ensure this debate will not arise or, if it does, that shareholder questions can be satisfactorily answered.

Indeed, strategic planning is a useful tool to identify why a corporation is collecting, what types of works will best meet corporate goals, and how best to achieve collection objectives while assessing the resources necessary to acquire and steward the corporate art collection. This strategic plan should periodically be reviewed to evaluate whether original business justifications for collecting art remain or have changed, whether works of art acquired for the collection align with these business purposes, and whether works of art

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[77] *Id.*

[78] Suzanne F. W. Lemakis, *The Art Lost by Citigroup on 9/11*, IFAR, Feb. 28, 2002, *available at* http://ifar.org/upload/pdffile19470e62bc7da96 ifar_911citi.pdf.

[79] *Id.*

[80] Reportedly, one of the most deeply missed works destroyed in Citigroup's collection on 9/11 was a large mural from a wallpaper factory created by an unknown designer. *Id.* That this unattributed work of art held such significance for Citigroup's workforce highlights the importance of art in the workplace while underscoring the fact that works by emerging artists rather than more costly works by known artists may satisfy corporate goals.

should be acquired or removed from inventory to meet corporate collection goals.

IV. ART ACQUISITIONS AND THE DUTY OF INQUIRY

As discussed in Part II of this Article, the duty of inquiry is a prerequisite to application of the business judgment rule, requiring directors to inform themselves of all material information reasonably available and, having done so, to act with requisite care in the discharge of their duties.[81] In the context of collecting art, satisfying the duty of inquiry requires more than just knowing *that* the company is acquiring art. Companies would not think of buying valuable technology or other expensive assets without evaluating the suitability and pricing of the asset, and without getting proper purchase agreements in place. Art acquisitions warrant equivalent inquiries and documentation. Moreover, the intrinsic value of art rests not just on the value of the particular object acquired—whether it be a painting, print, sculpture, or photograph—but also on the value of the object's intangibles.[82] These intangibles include perfected title in the work of art, its authenticity, the completeness of its provenance, lawful import/export clearances for the object if created or bought outside the country, and intellectual property rights in the work of art. Utilizing transactional documentation informed by the law of the art market, which properly captures the full value of the fine art acquired, including the intrinsic value of its intangibles, is essential to these corporate purchases.

[81] Aronson v. Lewis, 473 A.2d 805, 812 (Del. 1984), *disapproved on other grounds in* Brehm v. Eisner, 746 A.2d 244, 254 (Del. 2000).

[82] William Landes & Daniel Levine, *Economic Analysis of Art Law*, *in* HANDBOOK OF THE ECONOMICS OF ART AND CULTURE 25 (V.A. Ginsburgh & D. Thronsby eds., 2006), *available at* http://www.hertig.ethz.ch/LE_2007_files/Papers/Landes_Art_Law_2007.pdf.

Directors must provide oversight to ensure a system is in place for the company to make proper art acquisitions.

Many federal laws are applicable to art market transactions. For example, federal consumer protection laws including the Truth-in-Lending Act, the Magnuson-Moss Warranty Act, and the Federal Trade Commission Act,[83] intellectual property laws including the Copyright Act and the Visual Artists' Rights Act,[84] as well as the Lanham Act,[85] may apply to purchases and sales of fine arts. The Uniform Commercial Code also applies to art transactions, and many states have enacted specialty laws regulating transactions among collectors, art dealers, galleries, artists, and auctioneers. These laws vary in scope from state to state, with California and New York having the most rigorous sets of laws. In California, for example, statutory laws govern matters including fine art consignments, sales of multiples, auctions and auctioneers, and royalty rights of artists.[86] New York's civil statutes provide authenticity protections for purchasers, while its penal laws criminally punish those who make or alter an object to appear as if it has rarity, antiquity, or a source or authorship it does not actually have.[87]

Utilizing proper written purchase agreements can add an essential layer of protection for corporate art buyers. Without proper transactional documentation, corporations may be unable to maximize the price of corporate art upon its resale, or to document full insurance value if a work of art from the collection is damaged or lost, or to fend off claims or demands by third-parties in connection with the work of art. A representative sample of provisions that may be

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[83] *See, e.g.*, 15 U.S.C. §§ 45, 1601-11, 1631-35, 2301-05 (2008).

[84] *See* 17 U.S.C. §§ 101-1330, 106A (2008).

[85] *See* 15 U.S.C. §§ 1051-52, 1115-27 (2008).

[86] *See, e.g.*, CAL. CIV. CODE §§ 986, 1738-38.9, 1740-45.5, 1812.600-12.608 (2008).

[87] *See, e.g.*, N.Y. ARTS & CULT. AFF. LAW § 13.01 and N.Y. PENAL LAW § 170.45 (2008).

appropriate for inclusion in an art purchase agreement includes those that:[88]

- obtain representations, warranties and indemnifications to guarantee the authenticity of the work and to perfect title;

- comply with import/export requirements if the artist created the work abroad or the work is being acquired from a foreign country;

- acquire by assignment, license, waiver, and/or release intellectual property rights, artists' moral rights, and publicity rights attendant to the work of art;

- warrant the condition of the work of art and that the work has not been previously damaged and/or repaired;

- ensure that limits are placed on the ability of the artist to expand editions of multiples beyond set numbers of prints or sculptures in a series;

- document the provenance of the work of art to establish the chain of title and to enhance value by noting notable collectors or museums as prior owners; and

- set proper risk of loss and insurance terms in the event the work of art is damaged or lost in transit to the corporation from the gallery.

Let us discuss the utility of a few of these provisions. The value of a work of art depends on its authenticity. A work of art by Andy Warhol is worth what the market will pay for a Warhol only if the work truly is a Warhol. Authenticity

[88] Readers are encouraged to consult with knowledgeable professionals including a knowledgeable art lawyer. This Article does not constitute legal advice and does not discuss all risks, legal precedent, or contractual terms and conditions applicable to art transactions.

disputes prove costly as questions of fact predominate, necessitating a trial wherein dueling experts seek to persuade the court whether or not the work is authentic.[89] Even after judicial determination that a work of art is authentic, a cloud can remain over the artwork's marketability and value. Contractual representations and warranties of authenticity along with proper indemnifications for a return of value, litigation costs, and attorneys' fees can protect buyers and facilitate an early resolution of any dispute over the genuineness of the object.

Contractual representations and warranties also can provide assurances that the seller is able to transfer good and marketable title free of liens, encumbrances, debt, and third-party claims. A cautionary tale in this regard is offered by the case of collector Marilyn Alsdorf who, along with her husband, purchased Pablo Picasso's *Femme en Blanc* in 1975 from an upscale New York gallery for $375,000.[90] Over the next twenty-five years galleries in Paris and Los Angeles handled the painting, none apparently raising concerns about its provenance. In 2002, college student Thomas Bennigson filed suit against Alsdorf, claiming ownership of the painting that he asserted had been confiscated by Nazis from his grandmother during World War II. Three lawsuits in two states later, including one filed by the U.S.

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[89] *See, e.g.*, Greenberg Gallery, Inc. v. Patricia Bauman, 817 F. Supp. 167 (D.D.C. 1993).

[90] The facts of these events are detailed in two cases: U.S. v. One Oil Painting Entitled "Femme En Blanc", 362 F. Supp. 2d 1175 (C.D. Cal. 2005); Alsdorf v. Benningson, 2004 U.S. Dist. LEXIS 24696 (N.D. Ill. 2004). Bennigson filed a California action against Alsdorf in state court on December 19, 2002. Alsdorf successfully quashed service of summons for lack of personal jurisdiction in that action. The California Court of Appeals affirmed the ruling in 2004. *See* http://www.courtinfo.ca.gov/opinions/revnppub/B168200.DOC. In July 2004, the California Supreme Court granted Bennigson's petition for review of the decision. Meanwhile in September 2004, Alsdorf sued for declaratory relief and to quiet title against Bennigson in the district court in Illinois. In October 2004, the government filed a civil forfeiture action for return of the painting, and in March 2005, the district court denied Alsdorf's motions to dismiss the action or to transfer it to the district court in Illinois.

government, Alsdorf reportedly paid Bennigson over $6 million for the painting she had long ago purchased from reputable dealers.[91]

Provenance due diligence and marketable title warranties in purchase agreements are important even when collecting modern and contemporary art. One need only watch the paper to see artworks recently reported missing or stolen. As the case of Warhol's *Red Elvis* bears out, ownership disputes to defend or assert one's title to a valuable work of art can be hard fought.[92] Provenance and marketable title contractual warranties return real value in the art market in which no system for recordation of title exists and title insurance remains novel.

Equally important are documented import/export clearances if the work has been created abroad or acquired from a foreign seller. Lawful export from a foreign country and import into the United States can be essential to preventing a later seizure or forfeiture of an acquired work of art. A complex network of domestic and international laws, conventions, treaties, and EU directives govern both ownership and global transport of art and antiquities. Many foreign countries have adopted broadly defined cultural property laws under which art and antiquities remain the property of the state or, at a minimum, require government authorization before export. These laws can extend protections beyond archaeological objects and antiquities to even more modern works of art. Art dealers may not understand the breadth and scope of these foreign laws, and as demonstrated by recent repatriation demands made by Italy, Greece, China, and Peru, claims for art repatriation

[91] For news about the settlement of the litigation between Bennigson and Alsdorf, see Press Release, Burris & Schoenberg LLP, Litigation over Picasso Painting Settled Out Of Court, http://www.bslaw.net/news/050809.html (last visited Mar. 9, 2009). Burris & Schoenberg LLP was the law firm that represented Bennigson.

[92] Lindholm v. Brant, 925 A.2d 1048 (Conn. 2007) (the litigation lasted five years until the Connecticut Supreme Court quieted title to the painting).

may lie dormant for decades before being asserted with the assistance of the U.S. departments of State and Homeland Security.

Another group of important contractual provisions are those necessary to secure intellectual property rights in art. Some suggest that the value of intellectual property rights in a work of art may be more valuable than the work of art itself.[93] Acquiring ownership of the work of art does not equate to acquiring ownership of the intellectual property rights in that work of art.

One set of these rights is called, "artists' rights" or "moral rights," derived from the French law concept of *droit moral.* Artists' rights are codified by the Visual Artists' Rights Act ("VARA"),[94] and by state laws such as California's Art Preservation Act.[95] Foreign nations also have enacted *droit moral* laws. The existence and scope of artists' rights vary from state to state, state law to federal law, and country to country. Unless properly waived where the law permits, artists' rights leave the collector at risk of suit by an artist whose work is damaged while owned by the collector.[96]

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[93] Landes & Levine, *supra* note 82, at 25.

[94] 17 U.S.C. § 106A (2008).

[95] CAL. CIV. CODE § 987-89 (2008).

[96] 17 U.S.C. § 106A(e) provides:

> (1) The rights conferred by subsection (a) may not be transferred, but those rights may be waived if the author expressly agrees to such waiver in a written instrument signed by the author. Such instrument shall specifically identify the work, and uses of that work, to which the waiver applies, and the waiver shall apply only to the work and uses so identified. In the case of a joint work prepared by two or more authors, a waiver of rights under this paragraph made by one such author waives such rights for all such authors.
>
> (2) Ownership of the rights conferred by subsection (a) with respect to a work of visual art is distinct from ownership of any copy of that work, or of a copyright or any exclusive right under a copyright in that work. Transfer of ownership of any copy of a work of visual art, or of a

Yahoo! faced just this situation after landscapers on the corporate campus clipped Sharon Louden's installation, *Reflecting Tips, 2001.*[97] No corporation wants to see an accident happen to artwork in its collection but, if one does happen, it does not want to be sued.

Copyrights represent another set of intellectual property rights in fine art. Without an assignment or license of the copyrights in a work of art, a collector may not photograph, reproduce, or otherwise create a derivative work from an acquired work of art without infringing the artist's copyrights. For example, if a company produces a commercial brochure with a photograph of an interior corporate hallway, and that photograph captures a work of art on a corporate wall, the corporation may be subject to an infringement suit unless it has acquired the right to reproduce the image by proper license or copyright assignment. Moreover, if the work of art reproduced in the corporate brochure displays the likeness of a person, that person may have a claim for violation of his/her publicity rights, absent an appropriate release.

Museum trained consultants engaged by corporations may be hesitant to negotiate for assignment to the corporation and waiver of the artist's intellectual property rights when acquiring works of art. Their reluctance stems from a long-standing tradition existing between museums and artists that permit artists to maintain their intellectual

> copyright or any exclusive right under a copyright, shall not constitute a waiver of the rights conferred by subsection (a). Except as may otherwise be agreed by the author in a written instrument signed by the author, a waiver of the rights conferred by subsection (a) with respect to a work of visual art shall not constitute a transfer of ownership of any copy of that work or of ownership of a copyright or of any exclusive right under a copyright in that work.

[97] Louden sued Yahoo! Inc. in the federal district court in California in October 2007. The parties later dismissed the action with prejudice in December 2007. *See* case docket at http://docs.justia.com/cases/federal/district-courts/California/candce/4:2007cv05053/196378/1.

property rights in a work of art. Individual collectors generally have not challenged this tradition. The better course for corporations, however, may be to acquire these rights, when possible, so to maximize object value and to minimize the risk of infringement suits.

Finally, acquisitions of art from foreign sellers require knowledge of foreign laws and their interplay with international conventions such as the 1980 United Nations Convention on Contracts for the International Sale of Goods, and the Berne Convention, among others. Contract requirements, letters of credit for fund transfers, consignments, conflict of law issues, dispute resolution mechanisms, risk of loss presumptions, and intellectual property rights, represent just some of the complex issues involved in international purchases/sales of art for which foreign law may apply. Failing to utilize documentation that appropriately addresses these international laws and conventions can leave the corporation with a failed art purchase, or worse, an international dispute and foreign judgment against the company.

V. MANAGING THE CORPORATE ART COLLECTION

The duty of care owed by directors to the corporation has been described by one federal court as follows:

> Under Delaware law, the fiduciary duty of due care requires that directors "'use that amount of care which ordinarily careful and prudent men would use in similar circumstances,' and 'consider all material information reasonably available' in making business decisions, and that deficiencies in the directors' process are actionable only if the directors' actions are grossly negligent." "Liability for a director's breach of the duty of care may arise in two contexts." The duty of care may be breached by either "(1) director action or nonaction following from an 'ill-advised or negligent' board decision, or (2) from "an *unconsidered failure of the board to act* in circumstances in which due attention would,

> arguably, have prevented the loss." In short, "the duty of care requires a director, when making a business decision, to proceed with a 'critical eye' by acting in an informed and deliberate manner."[98]

Directors often rely on management for the day-to-day care of corporate assets. The holding in *ATR-Kim Eng Capital Partners, Inc. v. Bonilla* teaches, however, that directors remain guardians charged with protecting and preserving corporate assets. In this connection, directors must serve as "active monitors of corporate performance."[99]

During the boom of corporate art collecting in the 1980s and 1990s, corporations often employed professional staff including curators and registrars to build and manage their fine art collections. Annual labor costs for this staff easily can run into six figures for a sizeable collection. When the boom quieted, some companies trimmed back art spending, downsized their in-house collection staff, or turned to private art consulting firms to outsource necessary collection management functions. Some companies, alternatively, simply left their fine art unattended in corporate corridors.

Fine art is our cultural heritage. The proper stewardship of fine art can be both time consuming and costly. Proper corporate management of art assets is essential to preserve asset value.

A. Fine Art Stewardship

The proper stewardship of art in a corporate collection requires preventative and restorative care by professionals

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[98] Nelson v. Repository Techs., Inc. (*In re* Repository Techs. Inc.), 381 B.R. 852, 869 (Bankr. N.D. Ill. 2008) (internal citations omitted); see also 1-15 *Delaware Corporation Law and Practice,* "The Standard of Care," § 15.06 (2007), which notes that advising directors whether specific conduct falls below or above the fiduciary duty of care can prove challenging as some jurisdictions articulate tests that present a sheer "negligence" standard while others talk in terms of "gross negligence" or "reckless indifference."

[99] Buckley v. O'Hanlon, 2007 U.S. Dist. LEXIS 22211, at *16 (D. Del. 2007) (citing *In re* Caremark Int'l, 698 A.2d 959 (Del. Ch. 1996)).

trained in conservation and collection management best practices. Works of art in corporate hallways where visitors, employees, and other unsupervised guests roam free are vulnerable to damage and destruction, and a siren for theft.[100] Even careful collectors have accidents. When major art collector and Las Vegas casino magnate, Steve Wynn, inadvertently stuck his elbow through a Picasso painting he owned, Wynn reportedly lost both a pending opportunity to sell the painting for $139 million, and an estimated $85,000.00 to repair the damaged work of art.[101]

Even absent accidents, artistic materials are inherently fugitive, and atmospheric and environmental conditions may damage art. Because works on paper, prints, and photographs can fade and irreparably discolor, they must be installed out of direct light and regularly rotated from display. Dust and grime, smoke, or water may damage the surfaces of art, necessitating attention by a conservator. Cleaning and repair of works of art by other than highly skilled professional art conservators can cause further damage to fine art and diminish its value.[102] Custodial employees require specialized training to protect corporate art, and movement and improper art installation by inexperienced workers can harm fragile works. Moreover, as Yahoo! learned, outdoor sculptures need protection not only from the elements, but also from landscape gardeners.

As discussed, above, artists retain the legal right of integrity to prevent damage to their works of visual art in collections unless the artwork is a "work made for hire" or

[100] The FBI estimates art theft to be a six billion dollar per year business. *See* Federal Bureau of Investigations—Art Theft Program, http://www.fbi.gov/hq/cid/arttheft/arttheft.htm (last visited Mar. 9, 2009).

[101] *See Casino Mogul's Picasso Is On The Mend: Steve Wynn Accidentally Poked Hole In 'Le Reve'; He Puts Restoration Cost At $85,000*, Feb. 15, 2009, http://www.cbsnews.com/stories/2006/11/14/national/main2179786.shtml.

[102] *See, e.g.*, Joyce Hill Stoner, *The Debate over Cleaning Paintings: How Much is Too Much?*, 5 IFAR Journal 3 (2002).

the artist has waived his/her artist's rights. In this connection, the federal VARA statute provides:

> . . . the author of a work of visual art–
>
> (3) Shall have the right–
>
> (A) to prevent any intentional distortion, mutilation, or other modification of that work which would be prejudicial to his or her honor or reputation, and any intentional distortion, mutilation, or modification of that work is a violation of that right, and
>
> (B) to prevent any destruction of a work of recognized stature, and any intentional or grossly negligent destruction of that work is a violation of that right.[103]

Not all damage to a work of visual art is actionable under VARA. The statute applies to intentional distortions, mutilations, and modifications to visual art that are prejudicial to an artist's honor or reputation, and to any intentional or grossly negligent destruction of a work of visual art of recognized stature. VARA excludes modifications, mutilations, or distortions resulting from the passage of time or the inherent nature of the materials, as well as those resulting from conservation or public presentation unless caused by gross negligence.[104]

Artists and authors have proven quite creative in suing under a myriad of legal theories, including VARA, when their artistic creations have been modified, damaged or distorted.[105] For example, in *Gillam v. American*

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[103] 17 U.S.C. § 106A(a)(3)(A)-(B) (2008).

[104] 17 U.S.C. § 106A(c) (2008). Gross negligence is something greater than simple negligence.

[105] In Louden's lawsuit against Yahoo!, for example, Louden alleged causes of action for breach of contract, violation of the federal Visual Artists' Rights Act (17 U.S.C. § 106A), desecration of fine art under CAL. CIV. CODE § 987, conversion, negligence, unfair competition, and emotional distress. *See* Complaint, Louden v. Yahoo, Case 4:07-cv-05053-SBA (N.D.

Broadcasting Cos., a federal court of appeals held that Monty Python episodes edited for television broadcast by ABC impaired the integrity of the author's work and misrepresented to the public a caricature of the artists' talents.[106] Finding that a valid cause of action likely could be stated under the Lanham Act by the author, the court issued a preliminary injunction to prevent repetition of the broadcast prior to final determination of the issues.[107]

In *Flack v. Friends of Queen Catherine Inc.*, fine artist Audrey Flack sued a foundry that had stored outdoors the clay maquette she had created for her sculpture of Queen Catherine.[108] Flack alleged the foundry's actions caused damage to her maquette and violated VARA. On the foundry's motion to dismiss, the court ruled the clay maquette was a "work of visual art" under VARA. The court rejected Flack's claims over erosion of the maquette, which the court determined could be repaired, and which fell within VARA's exceptions for modifications due to the passage of time and the inherent nature of materials. The court upheld Flack's remaining VARA claims based upon defendant's resculpting of the maquette.[109]

In *Leonardo v. United States*, artist Elaine Leonardo sued after works of art she loaned to the American Cultural Center in Brussels, Belgium, were destroyed in storage at a warehouse.[110] Leonardo argued the federal government violated her right to integrity under VARA by depriving her of her right to prevent her works from being destroyed.[111] In

Cal. Oct. 1, 2007), *available at* http://docs.justia.com/cases/federal/district-courts/California/candce/4:2007cv05053/196378/1.

[106] Gillam v. Am. Broadcasting Cos., 538 F.2d 14 (2d Cir. 1976).

[107] *Id.* at 30. The court also held that "unauthorized changes in the work that are so extensive as to impair the integrity of the original work constitute copyright infringement." See the discussion in Melville Nimmer, 3-8D NIMMER ON COPYRIGHT § 8D.04.

[108] Flack v. Friends of Queen Catherine Inc., 139 F. Supp. 2d 526, 528 (S.D.N.Y. 2001).

[109] *Id.* at 540.

[110] Leonardo v. United States, 55 Fed. Cl. 344 (Cl. Ct. 2003).

[111] *Id.* at 353.

granting summary judgment to the government, the court ruled that destruction of the art took place in Belgium and, accordingly, the court lacked jurisdiction to entertain her claims.[112]

Leonardo's case underscores another important collection reminder—the need for proper loan agreements and insurance when lending works of art from the corporate collection to museums or other borrowers. Loaning art materially increases its risk of loss and damage. Before lending works of art from the company's collection even to established museums, the company should secure proper loan agreements, nail-to-nail insurance, and periodic condition reports to permit full recompense for any damage to, or loss of, the object while on loan.

Indeed, given the potential for damage or loss to fine art, companies may wish to consider obtaining specialized fine art insurance for their collections, and to periodically update insurance valuations to account for inflation and appreciation. Steve Wynn's ability to recover the full diminution in value for his damaged Picasso painting—insured through Lloyd's of London—depended upon whether he had updated coverage values closer to the $139 million he recently had been offered for the painting, or whether coverage values remained closer to the approximate $48 million he originally paid for the painting.

B. Document Retention in Collection Management

Best practices in collection management also require proper record retention. Registrar records for well-managed art collections include acquisition and disposition records, inventory records, transactional documentation, provenance histories, financial records, condition reports, conservation and treatment documentation, insurance policies and claims, import/export permits, valuations and appraisals, deeds of gifts, photographs of works of art in the collection, object loan documentation, intellectual property assignments or

[112] *Id.* at 354.

licenses, and any other documentation related to individual works of art, and to the collection as a whole. Periodic collection audits may identify gaps in documentation needed for the collection.

Electronic storage of digitized copies of collection records, or offsite retention of a duplicate copy of records is essential to enable information recovery in the event of a catastrophe. Citigroup lost not only its fine art but also its art archival records on 9/11.[113] Contingency planning for both the corporate art and collection records represents a sound practice to protect the corporation's investment in the face of an unexpected disaster. Several software tools are now commercially available to facilitate electronic storage of key collection information.

VI. DISPOSITIONS OF CORPORATE ART AND SHAREHOLDER INTERESTS

Another issue facing corporate fine art collectors is how to permanently remove works of art from their collections. Museums refer to this process as "deaccessioning art." Due to scandals that erupted during the 1970s and '80s, anyone coming from the non-profit sector is sensitive to the rigors of new rules governing deaccessioning activities by museums and other organizations that hold a public trust.[114] The unique ethical concerns facing museums when deaccessioning art are not present for the private individual collector who enjoys the freedom to decide when and why to sell art from his/her collection. In the corporate context, removal of fine art from the corporate art collection generally allows for two primary options—resale or gifting of the art.[115]

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[113] Lemakis, *supra* note 78.

[114] *See generally,* Patty Gerstenblith, *Acquisition and Deacquisition of Museum Collections and the Fiduciary Obligations of Museums to the Public*, 11 CARDOZO J. INT'L & COMP. L. 409 (2003).

[115] Discarding or destroying a "work of visual art" from the corporate collection may be inconsistent with state and federal moral rights laws including VARA. Collectors occasionally may be able to trade works of art

A. Sales of Art

1. Sales to Corporate Insiders

One way to remove art from corporate inventory is to sell it. Sales of art to company insiders can prove ripe with potential conflicts of interest and require safeguards to prevent self-dealing. One such situation arose in connection with a closely held media-buying company, Mediators, Inc., the directors and shareholders of which company—the Manneys—were avid art collectors.[116] The Manneys spent millions of dollars on expensive artwork for the corporation in the 1970s and early 1980s as the company prospered.[117] When business slowed, the couple borrowed millions more to permit the company to continue acquiring art.[118]

By the late 1980s, hard times had fallen upon the company and its financial strength had waned. The Manneys personally borrowed $12 million to buy back the collection from the company at prices they had paid for the works of art when they originally acquired them for the company.[119] In the meantime, however, the art had appreciated in value.[120] Upon the company's insolvency, its creditor committee sued the Manneys for breach of fiduciary duty for both depleting corporate assets to buy the art on behalf of the company in the first instance, and for self-dealing in buying back the art at prices unfair to the company.[121]

The *Mediators* case underscores the importance of setting corporate policy to impose strict controls to prevent self-dealing in asset exchanges between the corporation and corporate insiders. To ensure the corporation receives fair

from their collections for other works of art held by artists, galleries, or dealers.

[116] *In re* Mediators, Inc., 190 B.R. 515, 519 (Bankr. S.D.N.Y. 1995).

[117] *Id.*

[118] *Id.*

[119] *Id.*

[120] *Id.*

[121] *Id.* at 521.

market value for its artworks, a current appraisal or appraisals by qualified appraisers should be obtained before any exchange occurs. Proper transaction documentation and a disinterested review by directors of any internal transactions would be essential to protect corporate interests.

2. Market Sales of Corporate Art

A better option for the corporation is to consign works of art from the corporate collection for sale through an auction house, art dealer, or gallery. Any of the larger auction houses such as Christie's, Sotheby's, or Bonham and Butterfield are willing to visit collections to determine whether works can be sold at auction and what estimated prices the works may bring. Several corporations auctioned large portions of their collections in the late 1990s, including IBM, which had a strong collection of 19th and 20th century American masters.[122] Works from IBM's collection of 300 paintings, drawings, and prints that went on the block reportedly brought in approximately $31 million in 1994.[123] Whether any block sale of multiple works from a corporate collection will discount prices or, inversely, stimulate interest among buyers and drive up prices, should be discussed by corporate advisors in consult with art market professionals.

Auction sales promote transparency because, absent fraud or manipulation, a public auction realizes fair market value.[124] Depending upon the anticipated value of works to be sold, auction houses competitively often reduce or waive

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[122] Carol Vogel, *For Sale: Corporate America's Big Blue Period*, N.Y. TIMES, Apr. 23, 1995, http://query.nytimes.com/gst/fullpage.html?res=990CE4DD1F3DF930A15757C0A963958260.

[123] Carol Vogel, *Inside Art*, N.Y. TIMES, Sept. 8, 1995, http://query.nytimes.com/gst/fullpage.html?res=9405EEDA1639F93BA25755C0A9629C8B63.

[124] Clay v. Sotheby's Chicago, Inc., 257 F. Supp. 2d 973, 981 (S.D. Ohio 2003) (agreeing that absent fraud, collusion, or other clandestine wrongdoing, sale by auction represents fair market price).

entirely their commissions, fees, and costs to sellers.[125] Whether an auction house, gallery, or dealer acts as a fiduciary to the seller of art depends on the jurisdiction in which the sale occurs, the circumstances of the sale, and any contractual arrangement between the parties.[126] California's Civil Code, like similar laws in other states, also imposes legal duties on auctioneers and auction companies to:

> (a) follow all lawful requests of the owner or consignor of the goods being sold at auction with regard to the sale of those goods;
>
> (b) perform his or her duties so that the highest or most favorable offer made by a member of his or her audience is accepted, except to the extent that any item or sale is offered with reserve or subject to confirmation;
>
> (c) truthfully represent the goods to be auctioned;
>
> (d) otherwise perform his or her duties in accordance with the laws of this state.[127]

Corporate agents charged with selling fine art from the corporate collection should be familiar with these and other laws that govern art market transactions. They should also be aware of any terms and conditions of sale standard to the auction house, gallery or dealer, often found in sales catalogs. All such terms and conditions of sale are negotiable.

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[125] Private dealers or galleries will also negotiate commissions or fees for selling consigned art.

[126] *Compare* Thomas, Lord of Shalford v. Shelley's Jewelry, 127 F. Supp. 2d 779, 784-85 (W.D.N.C. 2000) (holding that consignment agreement under North Carolina law did not create fiduciary duty) *with* Cristallina S. A. v. Christie, Manson & Woods International, Inc., 117 A.D.2d 284, 293-94 (App. Div. N.Y. 1986) (holding that fiduciary duty existed and that it was a question of fact whether Christie's breached its fiduciary duty).

[127] CAL. CIV. CODE § 1812.605 (2008).

Finally, when consigning works of art for sale through an intermediary, it is important to consider perfecting a security interest in conformity with Article 9 of the U.C.C. or other state law equivalent, in the event the intermediary becomes insolvent while holding the corporation's artwork. With a proper consignment agreement and a perfected security interest, the corporation, rather than the intermediary's creditors, stands the better chance of recovering the work of art through judicial bankruptcy proceedings.

3. Oversight of Collection Inventory in Relationship to the Market to Maximize Resale Values of Art

Market timing is an imprecise science; yet maximizing returns when reselling art can depend on then-existing conditions of the market. One can see market timing sensitivity, for example, in the case of Pierre-Auguste Renoir's *A Young Woman Bathing,* which sold in 1997 for $11.3 million, but fell out of favor in the next seven years to sell in 2004 for a disappointing $7.3 million. Failing to take advantage of favorable market conditions to sell works of art from the collection can diminish returns and leave works of art that have substantially appreciated at greater risk in the workplace. Maximizing returns requires active oversight of the inventory of the corporation's art collection as well as trends in the art market by trained and dedicated corporate staff or fine arts consultants.

It is worth noting that directors and officers have been sued for failing to take reasonable steps to maximize corporate revenues and asset values. For example, in the *Tower Air, Inc.* case,[128] the trustee of a bankrupt airline sued corporate directors and officers, claiming they drove the company into insolvency by indifference and egregious decision-making.[129] The complaint alleged the airline's

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[128] *In re* Tower Air, Inc., 416 F.3d 229 (3d Cir. 2005).

[129] *Id.* at 232.

Chairman of the Board and Chief Executive Officer, along with co-directors, failed "to ensure that used passenger tickets were processed for payment from credit card companies and other third parties" during a period when the airline needed cash.[130] Unprocessed tickets valued at one million dollars were found in the airline's offices when it filed for bankruptcy.[131] Failure to process those tickets, the complaint alleged, "hurt Tower Air's cash flow and impeded its ability to pay creditors."[132] On appeal, the court reversed the judgment of the district court, which had dismissed the trustee's claims.[133] Although *dicta* in the decision questioned whether plaintiff could ultimately prevail on his claims alleging the failure by directors and officers to create a system of oversight for the proper processing of tickets, the case nonetheless highlights the risk of suit against corporate directors that exists when corporate assets are not properly managed to maximize profits.

Proper oversight of inventory in a corporate art collection in relation to trends in the art market can enable works from the collection to be sold in more favorable markets and to capture maximum returns. Directors and officers may want to establish systems for this type of review and/or ensure that corporate consultants charged with managing the art collection have such systems in place.

B. Gifting Works of Art and Corporate Philanthropy

Another way to dispose of works of art from a corporate collection is by gifting them to a museum or other qualified charitable organization. Early decisional law in California held that corporate directors had no authority to give away property of the corporation.[134] Today, however, corporate laws in states including California permit corporations to

[130] *Id.* at 233.

[131] *Id.*

[132] *Id.*

[133] *Id.* at 242.

[134] Crane v. French, 39 Cal. App. 2d 642, 656 (Ct. App. 1940).

engage in philanthropy without shareholder reprisals, while tax laws provide tax deductions for corporate gifts and donations to qualifying charitable organizations.

The boundaries of corporate philanthropy have been critically discussed.[135] Good corporate citizenship must be balanced against shareholder interests. Yet while scholars debate the limits of corporate philanthropy, courts and, in some cases, shareholders seem little concerned with large-scale corporate philanthropy. Two cases are worth examining in more detail.

1. Occidental Petroleum—The Armand Hammer Museum

Shareholders initiated three civil actions against Occidental Petroleum Corporation in 1989 after the company's board of directors (the "Board") voted to approve an expenditure of more than $85 million to build a museum to house the art collection of Occidental's Chief Executive Officer and Chairman of the Board, Dr. Armand Hammer, and to fund an annuity for museum operations.[136] At the time of the board's vote, Occidental had 495,000 shareholders, $20 billion in assets, and pre-tax earnings of $574 million.[137]

Occidental's Board established a special committee to study a commissioned report, which detailed the project's impact on Occidental's financial condition.[138] Individuals on the special committee included the venerable Albert Gore—father of Vice President Al Gore—a former United States Congressman and Senator in his own right, as well as an

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[135] *See, e.g.*, MILTON FRIEDMAN, CAPITALISM AND FREEDOM 133 (1962) (arguing that the business of business is to make money for shareholders); *see also* Victor Brudney & Alan Ferrell, *Corporate Speech and Citizenship: Corporate Charitable Giving,* 69 U. CHI. L. REV. 1191 (2002); Jayne Barnard, *Corporate Philanthropy, Executives, Pet Charities, and the Agency Problem,* 41 N.Y. L. SCH. L. REV. 1147 (1997).

[136] Kahn v. Sullivan., 594 A.2d 48 (Del. 1991) (recounting the proceedings and findings of the Chancery Court).

[137] *Id.* at 51.

[138] *Id.* at 53.

F.B.I. agent and executive officers from several other corporations.[139] Lawyers and accountants from nationally recognized firms advised the Board and the special committee about the project.[140]

The report revealed that the project would provide several benefits to the company including public recognition for establishing the museum where Armand Hammer's sizable art collection, valued at between $300 and $400 million upon his death in 1990, could be seen by the public.[141] Under the proposal, moreover, Occidental would enjoy use of the museum and its parking structure, and it would have ongoing representation on the museum's board of trustees.[142]

On recommendation of the special committee, Occidental's Board unanimously approved the project, whereupon the company announced it to shareholders in a proxy statement for the annual meeting set for May 26, 1989.[143] With the announcement, shareholder lawsuits began to roll in.[144] The Board met over the summer to review additional information about the project and to consider the lawsuits. The Board engaged outside independent counsel with no connection to Occidental to review the project and shareholder complaints.[145] Meanwhile, the corporation and parties to one of the lawsuits hammered out a proposed stipulated settlement whereby additional requirements for the proposed project evolved; the museum building would be named the "Occidental Petroleum Cultural Center Building," and Occidental would enjoy perpetual corporate sponsorship status at the museum.[146] Further, Occidental would limit

[139] *Id.* at 53-54.
[140] *Id.*
[141] *Id.* at 54.
[142] *Id.*
[143] *Id.* at 55.
[144] *Id.*
[145] *Id.* at 56.
[146] *Id.* at 56-57.

subsequent charitable donations, and it would cap future expenditures on the museum's construction at $50 million.[147]

Shareholders objected to the proposed settlement, citing conflicts of interest by the Board and a lack of independence on the part of Occidental's special committee.[148] Represented by counsel, shareholders deposed key board members and obtained written discovery responses from the company.[149] Shareholders argued that Occidental's Board had been grossly negligent in failing to fully consider all material information about the project including the value of the art collection, how much of the art had been purchased with corporate funds, the tax consequences of the project, and the cost to Occidental in granting the museum free rent for several years.[150] An alleged lack of directorial independence along with the Board's gross negligence in analyzing the proposal, according to shareholders, defeated any application of the business judgment rule to shield the board's decision to approve the project.[151]

The Chancery Court rejected shareholder arguments, holding that the business judgment rule would apply to shield the Board's vote, which had been based on the special committee's review and which, in turn, had been free from Dr. Hammer's control.[152] In dismissing shareholder "waste" claims, the court recognized that Delaware statutory law authorized charitable donations to be made by corporations.[153] Reasoning that not every corporate

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[147] *Id.*

[148] *Id.*

[149] *Id.* at 59-61.

[150] *Id.*

[151] *Id.*

[152] *Id.* at 60.

[153] *Id.*; *see also* DEL. CODE ANN. tit. 8, § 122(9) (2008), which permits corporations to, "[m]ake donations for the public welfare or for charitable, scientific or educational purposes, and in time of war or other national emergency in aid thereof." Gifts of corporate assets not authorized by Section 122(9) require unanimous stockholder approval under Delaware Corporate law. Taussig v. Wellington Fund, Inc., 187 F. Supp. 179, 212 (D. Del. 1960).

charitable gift constituted a valid corporate action, the court noted that statutory language placed no limits on the size of charitable gifts although decisional law limited gifts to "reasonable corporate gifts of a charitable or educational nature."[154] In weighing the reasonableness of this particular gift, the court looked for guidance to relevant provisions of the tax code pertaining to corporate gifts.[155] The court held

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[154] Kahn v. Sullivan, 594 A.2d 48, 61 (Del. 1991) (citing Theodora Holding Corp. v. Henderson, 257 A.2d 398, 405 (Del. Ch. 1969)).

[155] Tax laws now limit corporate tax deductions for charitable donations to ten percent of the company's taxable income in the taxable year of the gift, with deduction carryovers allowed in five subsequent taxable years should the corporation's charitable donation deductions exceed this limit. In this connection, 26 U.S.C. § 170(2) provides:

> (A) In general. Any contribution made by a corporation in a taxable year (hereinafter in this paragraph referred to as the "contribution year") in excess of the amount deductible for such year under subsection (b)(2)(A) shall be deductible for each of the 5 succeeding taxable years in order of time, but only to the extent of the lesser of the two following amounts: (i) the excess of the maximum amount deductible for such succeeding taxable year under subsection (b)(2)(A) over the sum of the contributions made in such year plus the aggregate of the excess contributions which were made in taxable years before the contribution year and which are deductible under this subparagraph for such succeeding taxable year; or (ii) in the case of the first succeeding taxable year, the amount of such excess contribution, and in the case of the second, third, fourth, or fifth succeeding taxable year, the portion of such excess contribution not deductible under this subparagraph for any taxable year intervening between the contribution year and such succeeding taxable year.
>
> (B) Special rule for net operating loss carryovers. For purposes of subparagraph (A), the excess of—
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> > (i) the contributions made by a corporation in a taxable year to which this section applies, over
> >
> > (ii) the amount deductible in such year under the limitation in subsection (b)(2)(A),

as a matter of law that objecting shareholders likely could not prove "waste," taking into consideration Occidental's net income and the tax benefits afforded to the company by the project.[156]

Reviewing the propriety of the proposed settlement of the shareholder lawsuits, the court determined that the settlement: (1) reinforced and assured Occidental's identification with the affairs of the museum by naming the museum building after Occidental; (2) called for immediate transfer of Hammer's art collection to the museum, which reinforced the charitable nature of the project; (3) imposed meaningful controls on expenditures for the construction of the museum; (4) placed meaningful restrictions on future corporate donations; (5) restored to Occidental an equitable portion of any appreciation in the real estate should the museum relinquish its occupancy or transfer the property for value; and (6) guaranteed the collection would remain in Los Angeles for the enjoyment of the American public.[157] The court looked suspiciously, however, on Occidental's attempts to quantify values for these benefits[158] and, having before expressed displeasure with settlement efforts,[159] the court found the final settlement to be only slightly improved—"meager" but "adequate if only barely so."[160] On review, the

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> shall be reduced to the extent that such excess reduces taxable income (as computed for purposes of the second sentence of section 172(b)(2) and increases a net operating loss carryover under section 172 to a succeeding taxable year.

Congress raised this ten percent cap on taxable income (computed with adjustments) from five percent by the passage of the Economic Recovery Tax Act of 1981. The legislative history of the 1981 Act suggests Congress hoped corporate charitable contributions might be stimulated by the increased cap.

[156] *Kahn,* 594 A.2d at 61.

[157] *Id.* at 62.

[158] *Id.*

[159] *Id.* at 58.

[160] *Id.* at 63.

Delaware Supreme Court affirmed the Chancery Court decision, upholding the settlement.[161]

The museum's current website still references Occidental:

> The Armand Hammer Museum of Art and Culture Center (AHMACC) opened to the public in November 1990. Founded by Dr. Armand Hammer, former Chairman of Occidental Petroleum Corporation, the Museum was designed by architect Edward Larrabee Barnes. Financed by Occidental, the Museum was built adjacent to the Corporation's international headquarters in Westwood. At that time, the Museum featured galleries for Dr. Hammer's collections — old master paintings and drawings, and a collection of works on paper by Honore Daumier and his contemporaries — as well as galleries for traveling exhibitions. Dr. Hammer died in December 1990, three weeks after the opening of the Museum. Upon his death, all construction was halted and the building was never completed, leaving many spaces unfinished — most importantly, the 300-seat theater on the courtyard level.[162]

Several lessons come from the decisions in the Occidental case. First, corporations with sizable pre-tax financial strength are permitted to make relatively sizeable gifts in support of the arts. Shareholders may object, but with little promise of preventing these gifts, assuming the corporate board has followed proper procedures to approve the transactions. In Occidental's case, those procedures included: (1) securing reputable professional advisors including lawyers and accountants; (2) evaluating board independence on questions surrounding the transaction and, where necessary, forming an independent special committee of the board with disinterested counsel to review the proposed gift; (3) commissioning reports and accessing other available material information in order that the board could

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[161] *Id.*

[162] Hammer Museum, About the Hammer—Hammer Museum, http://hammer.ucla.edu/about/index.html (last visited Mar. 9, 2009).

assess the financial impact and tax aspects of the transaction, as well as any benefits to the company and to the public that reasonably may flow from the gift/expenditure; and (4) making any required disclosures to shareholders.

With proper inquiry and the proper exercise of the fiduciary duties demanded of directors, statutory laws permitting corporate philanthropy and the business judgment rule can shield reasonable expenditures in connection with the arts in the event of shareholder litigation. But how can companies prevent shareholder actions in connection with large charitable gifts? The following case may be illustrative.

2. Sara Lee Corporation—The Millennium Gift

In 1999 and 2000, Sara Lee Corporation made its "Millennium Gift" (the "Gift" or "Sara Lee's Gift"), through which the company donated to museums around the world fifty-two of the finest works of art from the corporate art collection including paintings and sculptures by Monet, Moore, Degas, Leger, Matisse, Gauguin, and Pissarro.[163] James Wood, then President and Director of the Chicago Art Institute, which received twelve of the fifty-two works from Sara Lee, reportedly told the press it was extremely rare for a corporation to donate a collection of this scale, quality, and

[163] *See* RICHARD R. BRETTEL & NATALIE H. LEE, MONET TO MOORE: THE MILLENIUM GIFT OF SARA LEE CORPORATION (1999) (detailing the works of art gifted as they toured museums in Singapore, the National Gallery of Australia, the North Carolina Museum in Raleigh, the Portland Art Museum, and the Art Institute of Chicago before being relocated to their new final homes. The catalog includes stories about the collecting activities of the company's founder, Nathan Cummings, and provides an exhibition history of the works of art, which had been shown at major museums including the Louvre in Paris and the National Gallery in Washington D.C. Richard Brettell, author of the catalog and one of the corporation's art advisors on the Millennium Gift, is a Ph.D. and an authority on Impressionism and French painting of the 19th and early 20th century).

historical importance to public art museums.[164] Notably, Sara Lee's Chief Executive Officer and Chairman of the Board, John Bryan, who orchestrated the Gift, had served as Vice Chairman of the Art Institute's board of trustees.[165] The Gift coincided with Bryan's plan to retire as C.E.O. from Sara Lee Corporation.[166]

Bryan had acquired many of the works of art for the corporation in the 1980s from the company's founder, Nathan Cummings, who had been an avid collector.[167] A 2004 interview quotes Bryan as saying the art he had acquired for Sara Lee's corporate art collection had appreciated in value almost six to eight times from its original acquisition price.[168] At Bryan's insistence, the corporation began to explore the idea of gifting all or part of its art collection under various scenarios.[169] Counseled by a panel of "corporate financial analysts, tax advisors, lawyers,

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[164] Dana Miccuci, *Donations Mix Philanthropy with Publicity and Tax Breaks: The Corporate Art Giveaway*, INT'L HERALD TRIB., Apr. 24, 1999, at 10, *available at* http://www.iht.com/articles/1999/04/24/rphil.t.php?page=1.

[165] Sara Lee Corp., Preliminary Proxy Statement (Form pre 14A), at 6 (Oct. 29, 1998).

[166] The Gift also paralleled a major corporate restructuring of the company discussed at some length in Sara Lee Corporation's 10-K for the year ending July 1, 1998. According to this filing, the restructuring resulted from a change in the corporation's "strategic direction," "precipitated by fundamental changes in the economic environment." According to a 1997 press release by the company announcing the $1.6 billion restructuring program, the three year program was anticipated to result in a 1998 after-tax charge estimated in 1997 to be around $1.6 billion related to the sale and write-down of assets unnecessary to the restructured company. The corporate announcement of the company's overhaul caused its stock price to climb. *See* Jennifer Steinhauer, *Sara Lee Announces a Big Revamping, and Stock Climbs*, N.Y. TIMES, Sept. 16, 1997, at D4.

[167] BRETTEL & LEE, *supra* note 163, at xiv.

[168] Lynne Jeter, *Bryan Offers Insight on Business, Art, Giving Back: A Mississippi Business Journal Q&A*, MISS BUS. J., Apr. 12-18, 2004, at 1, *available at* http://goliath.ecnext.com/coms2/gi_0199-264709/ Bryan-offers-insight-on-business.html#abstract.

[169] BRETTELL & LEE, *supra* note 163, at xix.

and corporate affairs specialists," proposals were presented to the corporation's board of directors who reportedly "voted unanimously" to gift works to American museums.[170] Later, the Board determined to make gifts of works to fifteen museums in twelve other countries.[171] Recipient museums were chosen for their interest in the particular art donated, as well as for their location in areas where the corporation conducted business operations.[172]

Beginning in June 1998, the press published information regarding the company's intention to make the Gift. The company apparently never publicly disclosed the fair market value of the artworks included in the Gift, although news reports estimated their value to be around $100 million dollars.[173] When *New York Times'* reporter Judith Dobrzynski questioned Bryan on the cost to the company in making the Gift, Bryan reportedly said only that the cost was "very modest—a few million dollars," describing it as, "the difference between the after-tax value of the collection if [Sara Lee] sold it and the positive cash flow from the tax deduction [Sara Lee] can take."[174]

Sara Lee's Gift generated much fanfare and media attention. Timed with President Clinton's Millennium Gift to America, the Gift garnered Sara Lee Corporation this country's National Medal of Arts for its patronage to the arts. A corporate brochure published by the company following the Gift, shows Bryan standing alongside President

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[170] *Id.*

[171] *Id.*

[172] *Id.* at xix-xx; *see also* Press Release, Sara Lee Corp., Giving, at 2 (Oct. 1999), *available at* http://www.saraleefoundation.org/history/giving_1999.pdf (statement by C. Steven McMillan, Sara Lee Corporation's then-president and chief operating officer. In 2002, McMillan was a participating member of the Committee to Encourage Corporate Philanthropy, founded in 1999 by Paul Newman. McMillan succeeded Bryan as C.E.O. of the Sara Lee Corporation.).

[173] Judith Dobrzynski, *Sara Lee is Donating Impressionist Art to 20 U.S. Museums*, N.Y. TIMES, Jun. 3, 1998, at E1.

[174] *Id.*

and Mrs. Clinton,[175] and quotes him comparing fine art with the "ultimate in brand names," emphasizing the strong associative value between Sara Lee Corporation and the quality of celebrated artists Pissarro, Picasso, and Degas.[176] With an obvious eye to gaining shareholder approval for the unprecedented gift of corporate fine art, Bryan is quoted as saying:

> The arts are the best expression of quality that humankind can offer. We think that our involvement with the arts expresses our commitment to quality at all levels of our company's operations and that we are serving the interests of the corporation and our shareholders by helping to strengthen the central values of society through our support of the arts.[177]

Sara Lee's 10-K for the year ending July 2000 reiterates the company's commitment to primacy, announcing, "Sara Lee's primary purpose is to create long-term shareholder value."[178] Yet no shareholder apparently has sued Sara Lee over the Gift or over the company's other philanthropic activities. Shareholders did file a class action lawsuit against the company in 2003, but the class action complaint

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[175] Sara Lee Corp., *Celebrating the Art of Giving: Sara Lee Corporation*, June 1999, *available at* http://www.saraleefoundation.org/history/nmabrochure.pdf.

[176] *Id.*

[177] *Id.* This company brochure highlights millions of dollars the corporation had gifted to the Chicago Art Institute and the Museum of Contemporary Art in Chicago to fund museum programs, operations, and exhibitions. It is unclear from the brochure whether or not Sara Lee Corporation provided charitable support to the Chicago Art Institute during the time when Bryan—on the board of Sara Lee Corporation—also occupied a seat on the museum's board of trustees. Bryan, who was instrumental in developing the art collection for Sara Lee Corporation, is also a private fine art and decorative arts collector. *See* Gina Bazer, *The Simple Life: Living On a Farm Can Do Wonders for One's Imagination,* CHI. HOME & GARDEN, Nov.-Dec. 2007, *available at* http://www.chicagohomemag.com/Chicago-Home/November-December-2007/The-Simple-Life.

[178] Sara Lee Corp., Annual Report (Form 10-K), at 1 (Sept. 29, 2000).

did not address the Gift.[179] While stockholder proposals repeatedly have requested greater disclosures about Sara Lee's corporate philanthropy practices, the company has successfully opposed those proposals, maintaining that greater disclosure would not be in shareholders' best interests and would cause undue expense.[180]

What conclusions can be drawn from shareholder silence in response to Sara Lee's Gift? First, the company has a long-standing, well-documented, robust program of philanthropy. A 2008 report by the Congressional Research Service identified Sara Lee Corporation as among leading

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[179] *In re* Sara Lee Corp. Sec. Litig., 2006 U.S. Dist. LEXIS 50777 (N.D. Ill. 2006) (judgment on the pleadings was entered for Sara Lee Corporation in the case in 2006 as plaintiffs had failed to plead "loss causation").

[180] *See, e.g.*, Sara Lee Corp., Notice of the 2001 Annual Meeting of Stockholders (Form 14-A), (Sept. 21, 2001); Sara Lee Corp., Notice of the 2004 Annual Meeting of Stockholders (Form 14-A) (Sept. 22, 2004). Just before announcing the Gift, Sara Lee apparently had communicated with the Securities and Exchange Commission in opposition to proposed legislation that sought to require greater shareholder disclosures about corporate charitable contributions. *See* Letter to Jonathan G. Katz, Secretary, Securities and Exchange Commission by Chief Counsel and Assistant Secretary to Sara Lee Corporation, R. Henry Kleeman (Dec. 15, 1997), *available at* http://www.sec.gov/rules/proposed/s72597/kleeman 1.txt. In 2007, Congressman Paul Gillmor reintroduced the Corporate Charitable Disclosure Act, which would have amended the Securities and Exchange Act of 1934 to require disclosure of: (1) corporate charitable contributions the value of which exceeded contributions made by the issuer during the previous year to any nonprofit organization of which a director, officer, or controlling person of the issuer (or a spouse) was a director or trustee (insider affiliated charity); (2) the name of such nonprofit organization and the value of the contribution; (3) the total value of contributions made by the issuer to nonprofit organizations during its previous fiscal year; and (4) the organization name and the value of contributions if the value to any one organization exceeds the amount designated by Securities and Exchange Commission rule. Like Gilmor's predecessor bills on the subject, this bill never made it out of committee. *See generally*, Paul E. Gillmor & Christopher M. Bremer, *Disclosure of Corporate Charitable Contributions as a Matter of Shareholder Accountability*, 54 BUS. LAW 1007 (1999).

corporate contributors to charitable causes.[181] The corporation has a highly publicized, separate foundation established in 1981 to serve as its philanthropic arm.[182] The company's vibrant and public charitable history is part of the total mix of information available to the market, and investors know or reasonably should know that a portion of the company's pre-tax income will be paid out to charitable causes.[183]

Next, the Gift afforded the company excellent publicity at a time when the corporate image needed promotion.[184] This publicity extended beyond U.S. borders and into the global community as international museums trumpeted their selection by the company to receive art from the Gift. Some

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[181] *See* Pamela J. Jackson, *Charitable Contributions of Food Inventory: Proposals for Change*, CRS Report for Congress (Jan. 16, 2008), *available at* http://www.nationalaglawcenter.org/assets/crs/RL31097.pdf (Jackson is a Specialist in Public Finance with the Government and Finance Division. The report shows Sara Lee making charitable contributions of 3.3% of its profits—high on the overall list of corporations—but below other food companies including Kroger, Safeway, General Mills, and Kellogg).

[182] *See* SARA LEE CORP., GIVING, at 2 (1998-1999), *available at* http://www.saraleefoundation.org/history/giving_1999.pdf. Although the Foundation has a separate board of directors, it remains the role of the Sara Lee Corporation's Corporate Governance, Nominating, and Policy Committee to approve the annual operating and contributions budget of the Sara Lee Foundation.

[183] *See id.* at 4. Sara Lee Corporation's annual philanthropic report alerts investors that it is the corporation's policy to contribute at least 2% of its annual U.S. pretax income in the form of cash and product donations to nonprofit organizations that meet company giving initiatives.

[184] In December 1998, the company announced the recall of millions of pounds of hot dogs and deli meats thought to have been contaminated with the listeria bacteria. The contaminated meat allegedly was blamed for consumer illnesses and, by 2001, the company reportedly had settled several civil lawsuits related to the tainted meat and pled guilty to a misdemeanor charge for distribution of the meat, agreeing to pay a fine of $200,000 and to spend $3 million on food-safety research. David Barboza, *Sara Lee Corp. Pleads Guilty In Meat Case*, N.Y. TIMES, June 23, 2001, *available at* http://query.nytimes.com/gst/fullpage.html?res=9F0CE1D91530F930A15755C0A9679C8B63&scp=2&sq=sara+lee+June+23%2C+2001&st=nyt.#.

shareholders appreciate corporate "good citizenship" of this kind and, for those less enthusiastic about corporate give-aways, the Gift can be rationalized in this vein as an expense for advertising and corporate promotion tied to profit maximization.

Finally, the Gift made good business sense for the company, which had been undergoing programs to reduce asset levels and to restructure.[185] Beyond whatever tax deduction the company received for the Gift, removing these valuable works of art from the company's inventory streamlined unessential corporate assets and eliminated annual expenses required to care for and protect the artworks. But why not sell the works and realize sales proceeds for the company and its shareholders? Advisors may have warned that a public sell-off of these valuable art assets by the corporation may have sounded a cautionary tone in the stock market concerning the company's overall financial strength.[186] Whatever the company's precise reasoning for deciding to make this multimillion dollar Gift of fine art assets rather than to sell them, the company's directors and officers successfully executed the transfer without triggering a shareholder action challenging the company's action.

3. Proper Documentation of Corporate Sales and Gifts of Art.

Proper transfer documentation is essential for all sales or gifts of art from the corporate collection with provisions to include, among others, warranty disclaimers, indemnifications of the corporation by the buyer or gift recipient, and full claims releases. Resellers of art in

[185] *See* Sara Lee Corp., Quarterly Report (Form 10-Q) at 10-11 (Sept. 26, 1998) (describing corporation's restructuring activities for fiscal year 1998).

[186] *See* BRETTEL & LEE, *supra* note 163, at xix-xx; *see also*, Press Release, Richard Brettell, National Gallery of Australia, An Impressionist Legacy—Monet to Moore: The Millenium Gift of Sara Lee Corporation, *available at*, http://www.nga.gov.au/Exhibitions/MonetMoore/index.cfm.

California may be required to pay royalties (*droit de suite*) under the California Resale Royalty Act.[187] From a tax perspective, state sales taxes on transactions must be paid where required, and proper valuations by a qualified appraiser may be necessary to obtain tax deductions for charitable donations. The Art Advisory Panel of the Commissioner of the Internal Revenue Service typically assists the Internal Revenue Service in reviewing tax returns claiming deductions for art donations in accordance with the Internal Revenue Code of 1986.[188]

VII. THE DUTY OF LOYALTY AND POTENTIAL CONFLICTS OF INTEREST IN CORPORATE ART COLLECTING

Fine art can prove an overwhelming temptation for some. Accordingly, potential conflicts of interest may arise and require review should a corporate insider:

- Use corporate funds or company resources for one's personal art collection;

- Use or misappropriate art from the corporate art collection for one's personal use;

- Accept discounts for personal purchases of art or art services from galleries, dealers, artists, or art shippers, etc. offered because of the potential for or to further an existing trade relationship with the corporation;

- Make corporate purchases of art to build a market for, or to enhance appreciation in, one's private art collection;

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[187] CAL. CIV. CODE § 986 (2008).

[188] *See* Notice of Determination of Necessity for Renewal of Art Advisory Panel, 73 Fed. Reg. 4308 (Internal Rev. Serv. 2008).

- Provide corporate funding or support to museums to gain access to non-public information used to grow or enhance one's personal art collection;

- Wrongfully take a corporate opportunity by acquiring superior works of art for one's private collection over those acquired for the corporation to the disadvantage of the corporation;

- Exchange art between the corporate collection and one's personal collection, or acquire art from the corporate collection, at prices or on terms unfair to the corporation.

Directors and officers are not permitted to use their positions of trust and confidence to further their private interests, or to advantage themselves to the exclusion of other shareholders.[189] Moreover, directors may not usurp business opportunities that could be exploited by the corporation and which would be advantageous to it.[190] "Corporate opportunity" is broadly defined by courts to include opportunities "closely related to a business of the corporation," as well as "opportunities that accrue to the fiduciary as a result of his/her position within the corporation."[191] To this end, directors must rein in improper conduct by other directors, as "[o]ne of the most important duties of a corporate director is to monitor the potential that others within the organization will violate their duties."[192]

Where a director or senior executive privately collects art and is in a position to advantage his/her private collection at the expense of the corporation, the company's board of directors should carefully evaluate the situation to ensure

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[189] Cooke v. Oolie, 2000 Del. Ch. LEXIS 89 (May 24, 2000).

[190] Loft, Inc. v. Guth, 5 A.2d 503, 510 (Del. 1939).

[191] Northeast Harbor Golf Club, Inc. v. Harris, 661 A.2d 1146, 1151 (Me. 1995).

[192] ATR-Kim Eng Capital Partners, Inc. v. Bonilla, 2006 Del. Ch. LEXIS 215, at *71-72 (2006).

any conflicts of interest are properly addressed. It is worth remembering that Dennis Kozlowski, Tyco's C.E.O, was charged with allegedly using Tyco's offices in Exeter, New Hampshire, as a delivery drop point to receive the art he had acquired with corporate funds for his personal collection.[193] Further, he allegedly implicated corporate employees whom he required to sign for the paintings in Exeter, and then redeliver them to Kozlowski's personal residence.[194] Misuse of corporate resources is a breach of loyalty.[195] Systems should have been in place to prevent abuses of these types.

One other potential conflict situation worth mentioning can occur when a corporate director sits on the board of an arts organization to which he/she encourages the corporation to provide philanthropic support. The Business Roundtable, in its *Principles of Corporate Governance*, notes that observers have questioned the independence of directors in these dual directorship situations, and it calls upon corporate governance committees to carefully scrutinize them.[196] Although participation on a museum board may provide corporate directors with a better understanding of fine art collection management principles to improve oversight of the corporate art collection, this type of dual directorship can be fraught with the potential for conflicts of interest. And should a corporate director (or officer) who encourages philanthropic support of an art museum also personally collect art, corporate boards should make the necessary inquiries to ensure corporate funds are not being used improperly to advantage the director's (or officer's) personal art collecting activities and interests. The law is

[193] Indictment, People v. L. Dennis Kozlowski, Ind. No. 3418/02, http://fl1.findlaw.com/news.findlaw.com/hdocs/docs/tyco/nykozlowski60402ind.pdf.

[194] *Id.* ¶ 2.

[195] Broz v. Cellular Information Systems, Inc., 673 A.2d. 148, 155 (Del. 1996).

[196] The Business Roundtable, *Principles of Corporate Governance,* at 12-13 (May 2002), *available at* http://www.businessroundtable.org/sites/default/files/CorporateGovPrinciples.pdf.

"unyielding in its demand that directors owing duties to two constituencies uphold those duties, without compromise, to both groups; or if they cannot, they must relinquish that duty to another."[197]

In closing, section 406 of the Sarbanes-Oxley Act of 2002 requires public corporations to disclose whether or not they have adopted a code of ethics for senior executives.[198] This code of ethics is designed to promote high standards of honest and ethical conduct, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships. In a company's executive code of ethics, as well as the company's code of conduct for employees, companies may wish to identify potential conflicts of interest that can arise in connection with the company's art collection and collecting activities, and outline proper standards of conduct for officers, directors, employees, and other corporate agents. Ensuring the development of a sound system of policies and procedures by which to address potential conflicts of interest is part of the duty of oversight that directors owe to the corporation and its shareholders.[199] Periodic compliance audits with these policies and procedures can help the company avoid liability and unwanted bad press that elevates the corporate art collection to the headlines.

VIII. CONCLUSION

Some of this country's finest public art collections have been formed through the generosity of wealthy industrialists and corporate founders. The public has benefited from these collections, many of which now fill the halls of museums around the country. Indeed, as the price of fine art continues to soar, individual collectors and museums no longer can keep pace with the public's demand to access fine art.

[197] Gans v. MDR Liquidating Corp., 1998 Del. Ch. LEXIS 76, at *10 (1998).

[198] 15 U.S.C. § 7264 (2009).

[199] CORPORATE DIRECTOR'S GUIDEBOOK, *supra* note 2, at 12.

Corporate collectors are a welcomed addition to the pool of museum donors. But the public's demand for fine art cannot overshadow corporate law and governance principles, which tie corporations to their essential profit-maximization purposes. When corporations establish a fine art collection, shareholders must be assured these valuable art assets are properly acquired and cared for by the corporation with the requisite oversight by corporate directors, who are bound by their fiduciary duties of care, inquiry, loyalty, and good faith.