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The Art Auctioneer: Duties and Assumptions

Jorge Contreras

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The Art Auctioneer: Duties and Assumptions

by

JORGE CONTRERAS*

Table of Contents

I. Assumptions Underlying the Auction Process ............. 720
   A. Assumption 1: Auctions Should Result in Optimal Prices for Goods .................................... 720
      1. Assumption 1a: The Auctioneer Should Excite and Manage the Bidding .................... 721
      2. Assumption 1b: The Auctioneer Should Not Cause Buyers to Pay Too Much for a Work ...... 721
      3. Assumption 1c: The Auctioneer Deserves a Commission for His Services .................... 722
   B. Assumption 2: A Work Should Not be Sold for Less Than the Consignor is Willing to Receive ...... 722
   C. Assumption 3: No Buyer Should Have an Unfair Advantage at the Auction ...................... 722
   D. Assumption 4: The Auctioneer Should Report the Events of Each Auction Truthfully and Completely ... 723

II. The Auctioneer's Duty to the Seller ..................... 723
   A. Duty of Diligence ................................ 723
      1. Obtaining the Best Price ........................ 723
         a. Exciting the Bidding ........................ 724
         b. Advertising ................................ 724
      2. Duty of Care ................................... 725
         a. Areas of Special Expertise .................... 725
         b. Care of Property ............................ 725
   B. Duty of Disclosure ................................ 726
   C. Fiduciary Duty .................................... 727
      1. Self-Dealing Transactions ......................... 727
      2. Separation of Funds ............................ 728

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3. Self-Defense ........................................ 729
4. Competition with Principal .......................... 729
5. Secret Profits ........................................ 729
D. Inadequacy of Agency Law .......................... 730

III. The Auctioneer’s Duty to the Buyer .............. 731
A. Double Agency ........................................ 732
B. Restrictions on By-Bidding .......................... 733
C. Warranties ........................................... 734
1. Warranty of Title ................................... 734
2. Warranty of Merchantability ......................... 734
D. Obligations of Disclosure ........................... 736

IV. The Auctioneer’s Duty to the Public .............. 737
A. Art Auction Houses as Public Institutions ......... 738
B. Disclosure Requirements ............................ 738

V. The Practices of Art Auctioneers: Conflicts with the Basic Assumptions? ............ 740
A. Buyer’s Premium ....................................... 740
B. Buyer’s Loans ......................................... 741
C. Secret Reserves ........................................ 743
1. Arguments for Secrecy ............................... 744
   a. Protecting the Seller from Buyer “Rings” .... 744
   b. Building up Excitement in the Auction ....... 744
   c. Conformity with International Practices ... 745
2. Arguments for Disclosure ............................. 745
   a. Bidding Off the Chandelier ..................... 745
   b. Disappointed Expectations ...................... 746
   c. Efficient Pricing ................................ 746
D. Guaranteed Prices .................................... 747

VI. Proposed Rules for Regulating the Auction Industry ......................... 750

VII. Conclusion ........................................... 751
Introduction

The sale of unique art objects at auction has changed dramatically over the past thirty years. Auction houses have grown from wholesale suppliers for art dealers to huge, multinational concerns that market art directly to the public. As the character of auction houses has changed, the traditional agency and sales rules governing auctions have become increasingly inadequate.

At one time, the auctioneer's duty to his principal, the consignor of the goods, was the most important of his duties. Today, the auctioneer's duties extend not only to the consignor, but also to shareholders, bidders at auction, and the public. Laws regulating auctioneers have arisen from numerous sources outside of agency law. For the most part, they derive from basic societal assumptions about the auction process and what it should aspire to be. They rely on a fundamental vision of the auction as a unique market with the ability to generate uniquely optimal prices for its participants if it operates smoothly.

Part I of this Article will focus on these societal assumptions as the groundwork for the rules that govern auctioneers. It will then summarize the legal duties of auctioneers as agents and sellers in the marketplace. Part II will examine the traditional agency relationship between auctioneer and seller. Part III will address newer doctrines governing an auctioneer's behavior toward bidders. Part IV will explore the auctioneer's emerging role as provider of a public function. Part V will discuss some of the controversial practices of large, modern art auction houses, including secret reserves, loans to buyers, buyer's premiums, and guaranteed prices. These practices conflict with both the current laws governing auctioneers and the basic assumptions from which they derive.

Part VI will address the criticisms identified in Part V and proposes a series of rules for regulating the auction industry response to current criticism of auction practices. These rules, based on the underlying societal assumptions about auctioneers, can serve as a model code of conduct for auctioneers. They provide, in short, that

1. Secret reserve prices are permissible;
2. The auctioneer may enter protective bids up to the reserve price;
3. The auctioneer may openly bid to purchase any lot, thus guaranteeing prices to the consignor;
4. The auction house may not engage in any practice that favors one bidder over another; and
5. The auctioneer must disclose all transactions truthfully and completely.
I
Assumptions Underlying the Auction Process

Until the past century, an auctioneer was regarded primarily as an agent of his consignor. As such, he was governed by the rules of agency. Today, however, the rules of agency are insufficient to describe the many legal relationships and obligations in which the art auctioneer is involved. He has duties, not only to his consignor, but also to the bidders at the auction, his own shareholders, and the general public. These new duties have been inspired by sources as varied as the law of sales, consumer protection law, and corporate law. In effect, this diversity means that no single, explicit, legal theory underlies the regulations governing auctioneers.

Society does, however, have assumptions about auctions and auctioneers that create a consistent foundation for these new rules; a fabric that binds them together. These basic assumptions explain why certain auction practices are tolerated and why others are sharply criticized. Ultimately, they are based on the modern notions of fairness, efficiency, and competition that permeate all areas of the law. The auction of unique objects, however, presents a distinct market setting in which many conventional rules of conduct are inapplicable. The assumptions about auctions, therefore, are somewhat special and deserve individual treatment.

Because these assumptions are based on fundamental societal norms, they may seem to be mere statements of the obvious. Identifying and stating them is, however, valuable. It allows us to refer to them systematically during our analysis of particular auction practices. The assumptions are summarized in the following discussion.

A. Assumption 1: Auctions Should Result in Optimal Prices for Goods

The advantage of the English auction procedure is its theoretical effect of efficiently pricing goods. As Feldman suggests, "The buyer is assured that he is paying only the smallest necessary increment over
what a rival purchaser would be willing to pay. The seller is assured that he is receiving the best price that anyone present is willing to pay."  

Though somewhat naive, these assertions form our basic view of how the auction market should operate. Of course, the auction market rarely works to price goods so optimally. Nonetheless, the rules we enact to regulate it attempt to move the market in the direction suggested by the ideal.

Assumption 1 postulates that the auction market optimally prices goods at a level that is beneficial to both the buyer and the seller. It is rooted in the fundamental values of perfect competition among buyers and the smooth operation of a free market system. There are three corollaries related to the auctioneer's role in the achievement of the goal stated in Assumption 1.

1. Assumption 1a: The Auctioneer Should Excite and Manage the Bidding

This assumption recognizes the auctioneer's essential function in the auction process. The oldest and most enduring duty of an auctioneer is that of obtaining the highest price for a consignor. It is necessary to minimize the factors lowering the prices buyers are willing to pay for a principal's goods. In effect, the auctioneer is responsible for achieving the optimal prices of Assumption 1.

2. Assumption 1b: The Auctioneer Should Not Cause Buyers to Pay Too Much for a Work

Of course, in exciting the bidding, the auctioneer should not deceive the bidders by entering false bids that artificially raise prices. Such behavior is perceived as subversive of the price optimizing process. Popular notions of fair play and mistrust of any deceptive practice rebel against any hint that an auctioneer is taking advantage of the audience. If bidders suspect they are being tricked at the auction, they will be reluctant to bid freely. Suspicion will then inhibit their bids and corrupt the optimal pricing ideal of Assumption 1. Though the auctioneer is expected to be a showman of sorts, he is also expected to act with honesty and impartiality.

4. Id. at 183. One of the great advantages of purchasing art at auction is that prices are generally lower than they would be for comparable works purchased from art dealers. Art dealers, in fact, purchase much of their art at auction, and necessarily mark it up for resale. See S. Naifeh, The Bargain Hunter's Guide to Art Collecting 73 (1982) ("By bidding against dealers for the same object, the collector can avoid paying the dealer's markup — ranging from 5 to 50 percent, depending on the cost of the item.").

5. However, the real effect of artificially inflating the bidding is not necessarily detrimental to the auction process. See infra Part III(B).
This assumption places a ceiling on the optimal price of Assumption 1. The highest price that should be paid at an auction is the highest price a bidder is willing to pay absent improper interference by the auctioneer.

3. Assumption 1c: The Auctioneer Deserves a Commission for His Services

As noted in *Art Law*, "the auction house, in return for its expertise in bringing the buyer and seller together, earns a relatively modest commission without exposing itself to the normal hazards of the art trade."\(^6\) It is a deeply rooted assumption in our society that labor is remunerated with money. The auctioneer receives as a commission a percentage of the auction price of the objects sold, reinforcing the work ethic adage that "greater labor brings greater profit."\(^7\)

B. Assumption 2: A Work Should Not Be Sold for Less Than the Consignor Is Willing to Receive

Implicit in this assumption are currents of contract offer and acceptance theory. There appears to be something wrong when the owner of a painting is forced to part with it for less than he paid. Naturally, he should not be forced to sell if no bidder is willing to pay an acceptable price. Hence, society tolerates certain protections for the seller to insure that this does not occur. This assumption places a floor on the optimal price sought in Assumption 1. The lowest price that should be paid for a work at auction is the lowest price that the seller is willing to receive.

C. Assumption 3: No Buyer Should Have an Unfair Advantage at the Auction

Inherent in a free market is the notion that market participants should play on a relatively level playing field. Objectionable factors that could tilt the field improperly include leaks of information and special privileges to certain buyers without the knowledge or consent of others. When a market is perceived as a place for popular participation, favoring certain participants is inconsistent with its nature. This assumption operates visibly in the securities market. It makes the idea of "insider trading" repugnant to the public despite academic debate about the actual harm of the practice.\(^8\)

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7. Although the auctioneer's exertion in selling an inexpensive painting and an expensive painting are probably similar, such considerations do not dilute the simplistic appeal of the ideal that rewards come in proportion to labor.
8. See, e.g., *R. Clark, Corporate Law* 271 (1986) ("It is simply obvious to [many people] that it is unfair for some investors (insiders and their tipees) to have preferential access to information, and no more need be said.").
D. Assumption 4: The Auctioneer Should Report the Events of Each Auction Truthfully and Completely

Honesty is a deeply rooted societal value. Dishonesty in reporting, either through the press or private publications, is viewed as wrong regardless of the actual consequences of such dishonesty. Full disclosure is also highly valued in modern business practice. Incomplete or misleading corporate disclosures are frequently construed as misrepresentations by omission.

The falsification of auction records has a real market effect. It subverts the operation of an efficient market by distorting views of price trends and gives either sellers or buyers false hopes about their prospects.

Agency loyalty is not an assumption about auctions: None of these assumptions imply a relationship of trust or loyalty between the auctioneer and the seller. Although such a relationship is established by the agency law principles that govern auctioneers, it is not native to the popular conception of the auctioneer or the auction process. Such loyalty is surely not expected by the consignor, who must generally sign a long contract full of disclaimers before the auctioneer will accept the goods. Notions of trust and "utmost good faith," though popular with courts, are not present in the popular image of this business relation. So long as the auctioneer honestly and thoroughly performs his function as a price-optimizer, the auction process will be viewed as functioning correctly.

II The Auctioneer’s Duty to the Seller

The most explicitly defined duty of an auctioneer is that of an obligation to the consignor of goods for sale. An auctioneer who receives goods on consignment from a seller becomes an agent of that seller in all matters pertaining to the sale of the seller's goods. In addition to contractual obligations, statutory and common law impose on the agent a number of additional duties toward the principal. These include duties of diligence, obedience, disclosure, accounting, and loyalty as a fiduciary. The major duties required of auctioneers are summarized below.

A. Duty of Diligence

1. Obtaining the Best Price

An auctioneer is an agent retained for the purpose of selling the principal’s goods. As such, the auctioneer's primary duty is to obtain for the principal the highest possible sale price for those goods. The auctioneer should report the events of each auction truthfully and completely.
tioneer must do everything possible to counteract the bidders' reluctance to bid higher. Such a counterbalancing upward pull on the price results in the optimal pricing required by Assumption 1 (optimal price). In return, the auctioneer is entitled to a commission on the sale, as recognized by Assumption 1c (commission).

a. Exciting the Bidding

An auctioneer is expected to excite the competition of bidding to achieve the highest possible price. It is during the auction that the skill and style of individual auctioneers can be used to the seller's advantage. In exciting the bidding, the auctioneer has a great deal of discretionary power. For example, he is responsible for determining the bidding increments. If too small, the bidding may proceed slowly and become bogged down. If too large, bidders may be reluctant to jump up to a sufficiently high price.

In addition to his verbal techniques, the auctioneer may alter the auction procedure to produce higher bids. For example, he may temporarily postpone bidding on a lot if the bidding seems too low, or he may even withdraw a lot from bidding.

b. Advertising

In addition to exciting bidding during the auction, the auctioneer is responsible for generating interest in a principal's goods before the auction. To do so, the auctioneer may distribute sale catalogs, advertise upcoming auctions, and spread news by word of mouth.

10. Typically, art auctioneers receive 10% of the sale price from both the buyer and the seller. See ART LAW, supra note 3, at 199. In some cases, auctioneers will reduce the seller's commission in order to attract a particularly lucrative client. For example, the seller's commission negotiated by Cristallina, Inc. for the sale of eight Impressionist paintings was to be only 4% of the sale price. See McGill, Sweeping Reassessment in the Auction Trade, N.Y. Times, July 31, 1985, at C20, col. 3.


12. A lot is an article or set of articles offered as an item for sale at an auction. WEBSTER'S DICTIONARY, 586 (encyclopedic ed. 1987).


14. Sotheby's alone prints almost 400 catalogs each year, sending them to an estimated 75,000 subscribers. See Lee, Greed Is Not Just for Profit, FORBES, Apr. 18, 1988, at 65, 68.

15. The New York City Administrative Code restricts advertising "at or near any place of sale, auction room, residence of any auctioneer, or at or near any auction whatsoever" to signs or flags. NEW YORK CITY ADMIN. CODE, Title 20, Ch. 2, Subchapter 13, Reg. IV, § 25 [hereinafter N.Y. CODE], reprinted in R. LERNER & J. BRESSLER, supra note 1, at 195-96. It is doubtful whether the major art auctioneers would be prone to use advertising means such as sound trucks, but auction catalogs also seem to be excluded by this short list.
Traditionally, the customers of art auctioneers were well-informed art dealers who used auctioneers as wholesalers for their business purchases. Today, however, the major auction houses tap directly into the public market. As a result, much consumer legislation regulating advertising has arisen. The New York Consumer Code, for example, contains numerous provisions penalizing fraudulent or misrepresentative advertising. Courts applying other consumer protection doctrines also have little tolerance for dishonest advertising. In such cases, intent to deceive is not necessary so long as a false advertisement has the capacity to deceive a large portion of the public.

2. Duty of Care

An agent is generally responsible for acting in conformity with the care and skill required of a reasonable agent in the area and field of the agency.

a. Areas of Special Expertise

An auctioneer often develops special expertise in the area of his practice. If so, he may apprise sellers as to the expected prices and marketability of their goods. The ability to give such advice makes the services of the auctioneer more valuable.

However, the provision of extra services and special skills imposes extra duties on the auctioneer. When the auctioneer is hired because of his special fitness for a particular job, he assumes an obligation to exercise the care and skill of an expert in the field. He will no longer be held liable only to the standards of an ordinary citizen, and the principal will be justified in relying on the representations of such auctioneer as an expert.

b. Care of Property

An auctioneer generally receives temporary custody of the principal's property. While the property is in his custody, the auctioneer must exercise ordinary care to ensure that it is not damaged or altered. The

16. See Lee, supra note 14, at 68.
20. Cristallina, 117 A.D.2d at 293, 502 N.Y.S.2d at 172 (Auctioneer "held to a standard of care commensurate with the special skill which is the norm in the locality for that kind of work."); see 3 AM. JUR. 2D Agency § 217 (1986).
standard for an auctioneer's liability is that of ordinary negligence. Some legislation, however, refers to property held by an auctioneer on consignment as "trust" property, implying a higher standard of care.

B. Duty of Disclosure

An agent has an affirmative duty to use reasonable efforts to communicate to his principal "all material facts" that he has regarding the subject matter of the agency and that might affect the seller's interest. This duty arises from a combination of Assumption 2 (floor price), which protects the consignor from too low a price, and Assumption 1 (optimal price), which accords the consignor the highest possible price. If an auctioneer withholds information about the value of the works from a principal, then the principal may not know what price to expect for the work. He may set his minimum price unrealistically high, and prevent the work from being sold, thwarting Assumption 1 (optimal price).

For example, in Cristallina v. Christie, Manson and Woods, International, Inc., the auction house failed to inform the principal that internal experts at Christie's disagreed over the "auction appeal" of the paintings chosen for sale. When seven of his eight paintings failed to sell, the principal claimed a breach of the duty to inform. He argued that he could have avoided the poor sale by withdrawing the paintings had he only been given the relevant information before the auction.

The overriding importance placed on the auctioneer's duty to disclose is illustrated by Missouri ex rel. Jay Bee Stores, Inc. v. Edwards. Some of an auctioneer's records were necessary for the legal defense of the principal in an unrelated controversy. The records, if revealed, would have been financially damaging to the auctioneer. The court held that the agency duty outweighed any personal interest of the auctioneer, and forced it to produce the records.

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23. See N.Y. ARTS & CULT. AFFS. LAW §§ 11.01.2, 12.01.1(a)(ii) (1991) (Section 11.01.2 defines "auctioneer" as an "art merchant," and Section 12.01.1(a)(ii) calls art delivered to an art merchant for the purpose of sale on commission "trust property").
24. See 3 AM. JUR. 2D § 211 (1986); Eaddy v. Dorn, 289 S.C. 356, 345 S.E.2d 513 (Ct. App. 1986) (Auctioneer did not inform his principal that the high bidder on a lot of land and equipment was mentally defective and might be unable to pay for it. When the buyer defaulted on the sales contract, the auctioneer was held liable for the sale price.); see also Cruishank v. Horn, 386 N.W.2d 134, 137 (Iowa Ct. App. 1986) (auctioneer held liable for principal's funds when he placed them in a bank that became insolvent without informing the principal of the bank he was using).
26. Id. at 292, 502 N.Y.S.2d at 171.
27. Id. at 293, 502 N.Y.S.2d at 171.
28. 636 S.W.2d 61 (Mo. 1982).
29. Id. at 63-64.
C. Fiduciary Duty

In addition to the duties enumerated above, an agent owes to his principal a general fiduciary duty. This duty is similar to that owed by a trustee to a beneficiary, by a director of a corporation to its shareholders, or by a professional to his or her clients. Often, the fiduciary relationship is described as a duty of utmost good faith, honesty, and loyalty in all matters relating to an agency.

As mentioned above, the fiduciary duty of auctioneers to their consignors is not among the basic assumptions associated with the auction process. The extent and power of the fiduciary bond attributed to auctioneers might be relatively surprising and unintuitive to the layperson. Nonetheless, the Supreme Court established the importance of an agent's loyalty in Wadsworth v. Adams, stating that a principal "is entitled . . . to the benefit of diligence, zeal, and disinterested exertions of the agent in the execution of his employment. The law requires the strictest good faith upon the part of one occupying a relationship of confidence to another."

Courts have traditionally viewed breaches of the fiduciary duty very unfavorably. They have applied the rules governing fiduciaries "inevitably" and "inflexibly," often refusing to even consider evidence of extenuating circumstances affecting the agent. At stake, one court claimed, is no less than "the safety of mankind."

1. Self-Dealing Transactions

As in all agency and fiduciary relationships, there is an inherent suspicion associated with an agent acting for his own account while performing the duties of his agency. Generally, the presumption runs against the validity of any transaction between the principal and agent in which the agent receives a benefit.

An agent employed to sell the principal's goods may not become the purchaser of those goods without the principal's express consent. Even with the principal's consent, the agent is obliged to deal "fairly" with the principal in any self-dealing transaction. The agent must not take advan-

32. 138 U.S. 380 (1890).
33. Id. at 389.
35. Id. (quoting Parker v. McKenna, 10 Ch. App. 96 (1874) (per James, L.J.)).
37. See Restatement (Second) of Agency § 390 (1984); see also L. Smith, supra note 30, at 354.
tage of a superior position to persuade the principal to make an improvi-
dent bargain. In the context of sales, the payment of a price lower than
fair market value for property from the principal is prima facie evidence
of an unfair transaction.\footnote{See Restatement (Second) of Agency § 390 comment c (1984).}

In the context of auctions, it is a deeply grounded rule that the auc-
tioneer may not bid on or purchase the goods up for sale.\footnote{Combs v. Baker, 203 Ark. 602, 158 S.W.2d 48 (1942); see also Indiana Real Estate Comm'n v. Meier, 244 Ind. 12, 17, 190 N.E.2d 191, 194 (1963). In this regard, auctioneers differ from brokers, who may both buy and sell their principals' goods. See 7A C.J.S. Auctions and Auctioneers § 2 (1980).} The Supreme
Court warns against such behavior, stating that

[allowing] an auctioneer . . . to bid off for himself the very property he
is selling . . . would give to the auctioneer many undue advantages. It
would tend, also, to weaken his fidelity in the execution of his duties
for the owner. He would be allowed to act in double and inconsistent
capacities.\footnote{Veazie v. Williams, 49 U.S. (8 How.) 134, 151-52 (1850).}

The prohibition on self-dealing for fiduciaries has been interpreted
very strictly in the context of estate trustees. Often, trustees are permit-
ted no benefit from the trust they administer. As the court in In re
Gleeson notes, "[t]he good faith and honesty of the petitioner or the fact
that the trust sustained no loss on account of his dealings therewith are
all matters which can avail petitioner nothing" when he benefitted from
the estate for which he was a trustee.\footnote{In re Gleeson, 5 Ill. App. 2d 61, 66-67, 124 N.E.2d 624, 627 (1955) (The deceased had leased a parcel of farm land to petitioner. When she died in 1952, he became the trustee of her estate. He continued to lease the land until 1953, when he leased it to another tenant. The court ordered him to pay all profits from the land during the period of his trusteeship to the estate based on the general rule that a trustee cannot deal with the trust estate in his individual capacity.).}

However, the fiduciary doctrine has been loosened considerably
with respect to corporate directors engaging in self-dealing transactions
with their corporations.\footnote{See R. Clark, supra note 8, at 160-69.} Since the nineteenth century flat prohibition
on self-dealing, the doctrine has evolved so that now most self-dealing
transactions will be permitted if "fair" or ratified by a majority of disinter-
tested shareholders.\footnote{Id.} Inasmuch as modern auction houses resemble
large corporations more than estate trustees, the fiduciary duty for auc-
tioneers should be similarly loosened.

2. \textit{Separation of Funds}

The relationship between auctioneer and seller is also similar to that
of an estate trustee and a beneficiary in regard to the general rule that an

\footnote{Id.}
auctioneer must maintain a separate account for the funds he receives for the sale of his principal's property. The auctioneer may not, in other words, commingle his own funds with those held for the principal.

3. **Self-Defense**

Another concept related to the prohibition on self-dealing is the notion of self-defense. In a recent case, a district court decided that an auctioneer could not charge its principal with the cost of defending itself in a lawsuit when the auctioneer would have been adequately defended by the principal's counsel. The court held that, "where the principal defends itself, the agent is not eligible for indemnification unless the principal's defense leaves the agent's interest unprotected."

4. **Competition with Principal**

The fiduciary duty prevents an agent from competing with the principal in any matter related to the agency. In the context of auctions, such a situation could arise if the auctioneer offers goods that it owns and that are similar to those it has on consignment from the principal. The auctioneer's own goods would then be competing with the principal's for buyers.

Moreover, the agent may not act on behalf of another party whose interests conflict with those of the principal in the matter of the agency. This prohibition typically prevents the same agent from representing both parties to a contract. The auctioneer, in representing both the buyer and seller of goods, thus faces a potential conflict of interest.

5. **Secret Profits**

While acting on the principal's behalf, the agent is forbidden from receiving secret profits. All such profits rightfully belong to the principal. Courts have interpreted this restriction strictly, awarding the principal all secret profits received by their agents, even if the profits exceed the original contractual agreements.

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44. See *Art Law*, supra note 3, at 203 n.30 (Illinois has recently enacted a statute requiring auctioneers to maintain special bank accounts for customer funds).


47. See *Restatement (Second) of Agency* § 389 (1957).

48. See infra Part III (A) (discussion of the auctioneer's double agency).

49. See *Restatement (Second) of Agency* § 388 (1957).

50. See Tarnowsky v. Resop, 236 Minn. 33, 51 N.W.2d 801 (1952).
D. Inadequacy of Agency Law

Agency law is rapidly becoming an inadequate doctrine for the governance of large art auction houses. Principles of agency, developed in the context of one-on-one relationships between masters and servants, may be inherently inapplicable to the complex market inhabited by modern auctioneers.

The auctioneer's obligations and liabilities to the bidder and to the public have no place in his traditional agency relationship with the seller. The number of regulations governing the auctioneer's behavior toward others brings into question the strength of his duties toward the principal. In many cases, the rules imposed on the auction process harm the consignor in order to benefit potential buyers and the public. For example, the curtailment of loans to buyers ensures that no buyer will have an undue advantage during the bidding. It also means that consignors may not receive as much for their works as they would have received if the bidders were financed by the auctioneer.

The "core legal concept" of an agency relationship implies a relationship "in which the principal retains the power to control and direct the activities of the agent. Typically, the principal sets the ultimate objective and general strategy for the agent to pursue, occasionally specifies details of the agent's behavior, and stands ready to countermand specific acts of the agent." 51

Modern consignors of art have very little control over the actions of their auctioneer agents. Virtually the only power they retain is that of withdrawing their work before auction and setting the amount of the reserve (usually that suggested by the auctioneer). Each auctioneer serves thousands of consignors each year, and it would be absurd to believe that each consignor is represented with the same "diligence, zeal, and disinterested exertion." 52 This agent is huge, powerful, and far more knowledgeable than most of its principals in the area of the agency. The


agent is not even a person, but a multi-national corporation. Art auction houses and their consignors simply do not fit traditional assumptions about agents and principals.

Professor Robert Clark argues that principles of agency law should no longer be applied to modern corporate actors. In his view, corporations have outgrown the "face to face" nature of agency, and have become governed by a body of complex rules and laws which often incorporate agency principles, but do not entirely adopt them. Similarly, the auction industry would be well served by abandoning some of the agency rules which have hindered it.

The proposed set of auctioneer rules in Part VI is based on seven basic assumptions about the auction process in modern society. It does not attempt to apply the individual rules of a pre-existing legal doctrine to the unique auction context. In so avoiding, it seeks to remain truer to the popular vision of an "ideal" auction process.

III
The Auctioneer's Duty to the Buyer

The auctioneer's agency duty to the buyer has traditionally been considered subordinate to that owed to the seller. Courts and commentators seldom mention fiduciary obligations or duties of disclosure to the buyers of goods at auction.

Buyers suffer from having less choice about entering the auction market than sellers. In a market for unique objects, the potential purchaser must deal in the market the seller has chosen. If that market is an auction house, then the buyer is subject to the vagaries of auction practice whether he likes them or not. Sellers, on the other hand, enjoy more freedom. They may consign their unique works to an auctioneer, sell through a dealer, or conduct a sale on their own. Because buyers are thus channeled into the auction arena, they may deserve some measure of protection beyond that of sellers.

printed in ART LAW, supra note 3, at 248 [hereinafter SOTHEBY'S CONSIGNMENT AGREEMENT].

Important clients, on the other hand, with important works to sell are promised much advertising free of charge. Note Christie's assurance to the owner of eight Impressionist paintings that the advertising and promotion for his sale would be "as spectacular as possible." McGill, supra note 10, at C20, col. 3 (regarding the Cristallina case).

53. Sotheby's has 71 offices in 27 countries and employs more than 1,400 employees. It became a publicly held corporation in May, 1988. Christie's has been trading on the London stock exchange since 1973. As of 1988, it had 1,200 employees at 77 offices in 26 countries. See Lee, supra note 14, at 68.

54. See Clark, supra note 51, at 56-60.

55. See 7 AM. JUR. 2D Auctions and Auctioneers § 55 (1986).
Moreover, the auctioneer's agency duty to the seller is often coincident with the auctioneer's own best interest. Both are concerned with receiving the highest prices on as many works as possible. The buyer, on the other hand, is concerned with precisely the opposite: paying the lowest possible price. These two opposing tendencies cause the auction process to work by reaching an optimal price between their limits. Naturally, the auctioneer will desire to operate in his own best interest, contrary to his optimizing function stated by Assumption 1 (optimal price). As a result, the buyer may be short-changed by the auction process. Assumption 1b (ceiling price) responds to this threat, and recognizes that the buyer should receive legal protection against auctioneer misconduct.

The earliest buyer protections included restrictions on the conduct of auctions, such as the prohibition against by-bidding, and the limited agency of auctioneers to buyers. Today, they include sellers' warranties of title and authenticity, obligations of disclosure, and post-auction reporting. These protections, when taken together, form a substantial body of legal rights. Because bidder protections have arisen mainly from the basic assumptions about the auction process, many of them are retained in the set of proposed rules of auctioneer conduct set forth in Part VI.

A. Double Agency

The first attempt at protecting bidders at an auction arose as an extension of agency law. Until the fall of the hammer signifying the completion of an auction sale, the auctioneer is exclusively the agent of the consignor. Once the hammer falls, however, the auctioneer becomes an agent of the buyer as well. This double allegiance to parties with apparently adverse and divergent interests is one of the most unusual aspects of auction law.

Once the auctioneer becomes an agent of the buyer, he can no longer act adversely to the buyer's interests. For example, the auctioneer can not re-open the bidding and buy the property once the hammer has fallen on the buyer's lot. As agent to the buyer, the auctioneer theoretically owes the buyer duties of obedience, diligence, accounting, and fiduciary loyalty, just as he owes the seller. Courts, however, have reconciled these possibly conflicting duties by treating the auctioneer's duty to the buyer as more restricted than that owed the seller. Some courts have limited

56. This practice, detailed infra at notes 60-63 and accompanying text, involves the entering of fictitious bids by the auctioneer in order to inflate the prices of the lots sold.
the auctioneer's agency duty to the buyer to representing him in drawing up the sale memorandum and overseeing the transfer of goods to him.59

B. Restrictions on By-Bidding

Assumption 1b (ceiling price) demonstrates the general public dislike of any practice that deceives. The ideal view of the auction process is one in which "each bid is an independent, bona fide offer by a person willing to purchase the item at the bid price, and bids are not entered on behalf of a consignor (or other person) to raise artificially the prices at which the item will be sold."60

Among the "deceptive" techniques forbidden the auctioneer is the practice of "by-bidding," or entering fictitious bids to continue the upward spiral of prices on an object. This practice, also termed bidding "off the chandelier," "off the wall," or "out of the air," conflicts with Assumption 1b (ceiling price). It deceives bidders into thinking that others are vigorously competing for the same goods, inducing them to bid higher. The Supreme Court has roundly condemned by-bidding, stating that it "deceives, and involves a falsehood, and is, therefore, bad."61 The buyer is said to have been bidding "against a man of straw falsely set up by the auctioneer."62 Contracts induced after by-bidding are void or voidable by the buyer.63

59. See 7 AM. JUR. 2D Auctions and Auctioneers § 55 (1986).
60. ART LAW, supra note 3, at 203.
62. Id. at 156. Although the courts claim that by-bidding subverts the auction process, as such, it may be nothing more than a mechanism for shifting a benefit from seller to buyer. Instead of the highest price which a bidder is willing to pay, the seller receives only one increment above the next-highest bidder's maximum bid. In some cases, the difference between the two amounts may be significant.

By-bidding, when implemented accurately, is a mechanism for near-perfect pricing of goods. For example, A will pay up to $10,000 for a painting, while B will only pay $5,000. Without by-bidding, A will get the painting for $5,100, at a personal savings of $4,900. With accurate by-bidding, A would pay $10,000 for the painting, giving the extra $4,900 to the seller. It would seem that the auctioneer, in pursuing its duty to maximize the profit to the seller, would be well-served by by-bidding. The blanket prohibition of by-bids implies that auctioneers owe a greater duty toward pre-sale buyers than would otherwise be admitted. By bids, however, are called "dishonest" and subversive of the auction process. That view of the auction process is clearly one which favors buyers over sellers.

63. See 7A C.J.S. Auctions and Auctioneers § 15 (1980); see also U.C.C. § 2-328(4) (1978) ("[i]f the auctioneer knowingly receives a bid on the seller's behalf . . . the buyer may at his option avoid the sale or take the goods at the price of the last good faith bid.").
C. Warranties

1. Warranty of Title

In addition to agency principles, rules of warranty impose duties on auctioneers. Section 2-312 of the Uniform Commercial Code provides that in a contract for the sale of goods, the seller warrants that the title conveyed is good. If a seller fails to give good title, the contract for sale can generally be voided by the buyer. Because the contract for sale is usually between buyer and seller, the auctioneer, acting only as an agent to both parties, is generally not liable for defects in the title of goods conveyed.

When an auctioneer fails to disclose the identity of the principal whose goods he is selling, however, the auctioneer becomes liable to the buyer under the warranty of title. This liability attaches even if the auctioneer acts in good faith or did not know of the title defect. The rationale for such liability is grounded in protection for the buyer while maintaining confidentiality in the agency relationship. With both an undisclosed seller and his agent immune to suit, the buyer would have no recourse if he received goods with defective title. Holding the auctioneer liable shifts the burden of the defective title away from the buyer. The auctioneer is held liable rather than the undisclosed seller in order to preserve the principal’s confidentiality in the agency relationship.

The warranty of title may be avoided in a number of ways. First, it may be specifically disclaimed in the contract language. Second, it may be vitiated by circumstances which give the buyer reason to know that the seller or auctioneer does not claim to pass valid title. Third, an auctioneer may often avoid liability under the warranty simply by disclosing the name of the principal.

2. Warranty of Merchantability

An auctioneer is generally not liable for the condition of the goods he sells on consignment. If goods are advertised for sale “as is,” then any claim the buyer has arising from the non-conformity of the goods must be brought against the seller, not the auctioneer. Courts have held that

67. Id. However, the mere knowledge that a buyer is purchasing goods at an auction from an auctioneer is not enough to show that he knew valid title was not warranted. See Universal C.I.T. Credit Corp., 493 S.W.2d at 390.
68. See Universal C.I.T. Credit Corp., 493 S.W.2d at 390.
an auctioneer has no duty to inspect or service "as is" goods, or to require the seller to do so.\textsuperscript{69}

An auctioneer can be held liable for defective goods, however, if he makes some express claim as to their quality or condition independent of the claims of the seller. For example, an auctioneer who pledges his own responsibility for goods or makes a claim as to their quality during the auction becomes liable for them if they do not conform.\textsuperscript{70} Likewise, claims which appear in an auctioneer's advertising or catalogs can often be interpreted as express warranties. The auctioneer has an affirmative duty to ascertain that the information contained in its sales catalog and announcements is accurate and comprehensive.\textsuperscript{71} Some courts have also held that an auctioneer can be held liable for breach of the implied warranty of fitness when the seller is undisclosed.\textsuperscript{72}

Provenance and authenticity are included in the condition of goods sold by an art auctioneer. Although not physical features, these attributes of a work are often essential to their value. In many cases, the warranty of merchantability covers the provenance and authenticity, as well as the physical condition of art works.\textsuperscript{73}

The historical position of auctioneers with regard to warranty policies has been one of strict disclaimer and \textit{caveat emptor}. Sotheby's traditional Conditions of Sale provided that, "All lots are sold as shown with all faults, imperfections, and errors of description . . . [Sotheby's] is not responsible for errors of description or for genuineness or authenticity of any lot . . . Messrs. Sotheby make no warranty whatever."\textsuperscript{74}
Until recently, such disclaimers were considered to be binding on all parties. With the adoption of Article 12-D (now Article 13) of the New York Arts and Cultural Affairs Law in 1966, however, doubt was cast on the effectiveness of such broad disclaimers. Article 12-D provided that giving a buyer of a work of fine art a certificate of authenticity amounted to an express warranty of the material facts of the certificate. The lower court decision in *Weisz v. Parke-Bernet Galleries, Inc.* further buttressed the buyers' position against auctioneers. That decision, reversed on appeal, held that the auctioneer's superior bargaining position obligated it to disclaim only in the clearest and most emphatic language.

That decision, among other factors, influenced Sotheby's, and later Christie's, to alter their warranty policies. In 1973, Sotheby's introduced a new authenticity policy for its New York sales. It automatically extended a five year guarantee of authorship for post-1869 works; and offered a five year guarantee that pre-1870 works were not counterfeits. Today, both Sotheby's and Christie's warranty policies retain this form.

Warranty rules create a presumption of deception on the party held liable. When a seller is held liable under a warranty, he is responsible for a condition of the goods about which the buyer was not aware. Whether the condition relates to the title or condition of the goods, the buyer is deemed to be cheated through a lack of information about his purchase. When a warranty is imposed on the seller, or he is prevented from disclaiming one, the cost of that misinformation is shifted away from the buyer as the deceived party. This aversion to deception is incorporated in our assumptions about the auction process. The perceived need for full disclosure (Assumption 4: disclosure) and the auctioneer's honesty (Assumption 1b: ceiling price) support the enforcement of strict warranty rules. Sotheby's and Christie's new warranty policies reflect these assumptions.

D. Obligations of Disclosure

Various doctrines govern the obligations of auctioneers to reveal information to buyers and potential buyers. As discussed above, rules of warranty govern an auctioneer's liability for facts relating to the title and

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75. *Id.* at 97-99 and 193.
76. *Id.*
79. *See ART LAW, supra* note 3, at 195.
condition of goods. Other laws govern an auctioneer's duty to disclose facts about its sales and auctions.

For example, the New York City Consumer Code requires an auctioneer to state immediately after striking down a lot whether that lot was sold to a purchaser, or bought in for the owner. Such a requirement presumably allows buyers to gauge the demand for works similar to those they plan to bid on, further refining the price optimization process (Assumption 1: optimal price). To assist buyers before auction, the New York Consumer Code also requires auctioneers to disclose in their sales catalogs whether lots are subject to reserves, what their loan policies are, and whether guaranteed prices are to be used.

Post-auction reporting is also subject to regulation under consumer protection and fraud statutes. Auctioneers generally issue lists of works sold and their prices after each auction. The New York Administrative Code imposes criminal penalties for fraudulent announcements of this information. Such sanctions were imposed on Christie's after it issued a false press release in connection with the Cristallina case. The auctioneer reported that three, instead of only one, of the principal's Impressionist paintings were sold at auction. The New York City Consumer Affairs Department fined Christie's $80,000 and suspended the licenses of the Christie's officials responsible for the announcement.

IV
The Auctioneer's Duty to the Public

Auctioneers have always, in some sense, been invested with a public function. Courts in a few early cases recognized this status, but it did not become widely acknowledged until recently. Today, many courts have shifted their views from auctioneers as being mere private agents of buyers and sellers to being actors for the public. Even disputes over an

80. See White, Putting Your Possessions on the Block, N.Y. Times, June 14, 1987, § 3, at 11, col. 3.
81. See Hughes, SOLD, TIME, Nov. 27, 1989, at 60, 63.
82. N.Y CODE, supra note 15.
84. See, e.g., Biddies, Inc. v. Enright, 239 N.Y. 354, 365, 146 N.E. 625, 629 (1925) ("the business of an auctioneer . . . has always been affected by a public interest and subject to legislative restriction"); Veazie v. Williams, 49 U.S. (8 How.) 134, 154 (1850) ("[A]ny fraud by auctioneers is more dangerous than by owners themselves. The sales through the former extend to many millions annually, and are distributed through the whole country. . . .").
85. See, e.g., Mizan Arabians v. Pyramid Soc'y, 821 F.2d 357, 360 (6th Cir. 1987) (The conduct of a horse auctioneer was viewed with strict scrutiny in light of its obligation to maintain "the integrity of [Kentucky's] leading industry.").
auctioneer's misrepresentations about specific goods, once thought to be strictly private disputes, have been held to affect "the public interest."\(^{86}\)

A. Art Auction Houses as Public Institutions

The major art auction houses have, to some extent, adopted this public role voluntarily. Christie's and Sotheby's, for example, have often been compared to public museums. They host scholarly seminars, take their collections on tour, lend works to other institutions, print exhibition-quality catalogs, provide lectures and art appreciation classes, and, most of all, make an effort to attract tourists who have no intention of buying art.\(^{87}\) The auction houses have even at times acted as public protectors of the arts. Most notable is Christie's and Sotheby's recent offer to underwrite a one million dollar reward for the return of stolen paintings to the Elizabeth Stewart Gardner Museum in Boston.\(^{88}\)

Another contributor to the "public institution" image of the art auction house has been its changing clientele. Over the past thirty years, the customer base of art auctioneers has shifted from one predominantly made up of art dealers and experts to one largely made up of the general public.\(^{89}\) These customers were naturally less familiar with auction procedures and art than the dealers and experts. As a result, many perceived a need for certain procedural safeguards in the auction process. Notions of public responsibility and accountability thus arose in the art auction context.

Today, the art auctioneer's duties extend well beyond the original agency duty to the consignor and to the bidder. The auctioneer's new duties are rooted in the basic assumptions about overall fairness in the auction process and the desire to create a "level playing field" in the auction market.

B. Disclosure Requirements

Such concerns can be seen in consumer protection legislation regulating auctioneers' disclosures. Under the Consumer Affairs Code of New York City, for example, art auctioneers are held to fairly rigid standards of truthfulness in both pre- and post-auction reporting and advertising. They are required to reveal when "insiders" will be bidding on lots, when guarantees and reserve prices are in effect, and what their poli-

88. See Letters, TIME, Apr. 23, 1990, at 10 (The auctioneers agreed to underwrite the reward after being approached by officials from the museum.).
89. See Lee, supra note 14, at 68.
cies are regarding loans. After an auction, they are restrained from the once-common practice of publishing private post-auction sales as auction sales and from reporting false “record” prices to the press.

In the consumer protection context, the assumption that auction information should be truthful (Assumption 4: disclosure) overrides many other concerns. For example, when Christie’s officials reported that three instead of only one of the eight Cristallina paintings were sold, they offered a number of justifications for their actions. First, the misrepresentation benefitted Christie’s by showing a more successful sale. Second, it benefitted the owner of the paintings, who would otherwise have had more difficulty selling the rest of the “burned” works. Third, the misrepresentation hurt no third parties. Fourth, the auctioneer argued that the misrepresentation would “protect the art market from becoming commercially depressed.” These rationales were, however, overshadowed by the auctioneer’s responsibility to the public and the overwhelming assumption about the importance of truthful disclosure.

The rationale behind disclosure requirements is the creation of a “purer” auction market in which buyer confidence is high and no undue advantages are given to any one customer. Similarly, concerns about tilted playing fields have led to criticism of possible “insider trading” at the major auction houses. Insiders at auction houses conceivably have access to information regarding guaranteed prices, the amounts of secret reserves, and unpublicized appraisals. Possession of this kind of information clearly confers a benefit to the insider-bidder. As recently as 1985, spokespersons for Christie’s and Sotheby’s confirmed that members of their boards of directors regularly bid on and purchased works at auction. This practice, investigated by the New York Department of Consumer Affairs in 1985, has led to new requirements that auctioneers disclose when auction house employees and other insiders bid at sales.

90. See White, supra note 80, § 3, at 11, col. 1.
91. This practice was sharply criticized when Sotheby’s reported a record auction sale price for a Guarnerius violin (£115,800), only to retract its statement three weeks later and admit that the violin was sold privately for only £99,000. See McGill, supra note 10, at A1, col. 4.
92. Art Law, supra note 3, at 268.
93. See McGill, supra note 10, at C20, col. 1.
The Practices of Art Auctioneers: Conflicts with the Basic Assumptions?

Some of the practices of the two major art auction houses, Christie's and Sotheby's, have recently come under attack. Commentators, including associations of art dealers, have repeatedly criticized the auctioneers' practices of charging buyer's premiums, making loans secured by works for sale to bidders, keeping reserve prices secret, and guaranteeing consignors minimum prices by buying works for their own account. None of these practices are presently regulated by law, although there is continuing pressure on the New York Department of Consumer Affairs to regulate auctioneers more heavily.95

This section examines these controversial practices in light of our basic assumptions about the auction process and the auctioneer's duties described above. This examination will serve as a basis for the recommendations for auction regulation proposed in Part VI.

A. Buyer's Premiums

In 1975, Sotheby's and Christie's began to charge a ten percent commission to buyers of works purchased at auction. This charge allowed the auctioneers to meet their increasing costs without driving consignors away with higher seller's commissions.96 Buyer's premiums have been repeatedly criticized and challenged in both Great Britain and the United States.97 However, they have withstood all legal challenges so far.

It is unclear whether the buyer's premium is intended to reflect payment for a service offered, or whether it is merely an "entrance fee" for the auction.98 On either account, it seems fair. It has been argued that the auctioneer provides no service to the buyer, rendering the premium unconscionable.99 However, the buyer receives a number of services from the auctioneer including use of the auction space, the conduct of an organized sale, post-sale reporting of the buyer's purchase, the auction-

95. See Hughes, supra note 81, at 62-63.
96. Seller's commissions at both Sotheby's and Christie's are 20% of the sale price for lots sold for under $1000, 15% for lots sold between $1000 and $5000, and 10% for lots sold for $5000 or more. Minimum seller's commissions are $100 per lot at Sotheby's, and $75 per lot at Christie's. See R. Lerner & J. Bressler, supra note 1, at 160.
97. In 1979, the Society of London Art Dealers and the British Antique Dealers Association brought an unsuccessful antitrust suit against Sotheby's and Christie's. In 1982, the Art Dealer's Association filed a complaint with the New York Department of Consumer Affairs, but was rejected. Legislation seeking to ban the buyer's premium was introduced in England in 1983, but did not pass. See Art Law, supra note 3, at 200-01.
99. See Art Law, supra note 3, at 200.
eer's services as an expert and appraiser, and the auctioneer's services as an agent in concluding and formalizing the sale.

No basic assumption about the auction process is violated by the buyer's premium. It seems, in fact, to be a logical implementation of Assumption 1c (commission), and still costs buyers less than the fifty to one hundred percent mark-ups charged by art dealers.\footnote{100}

B. Buyer's Loans

Sotheby's recently announced that it was ending its policy of "selling art on margin."\footnote{101} This announcement was primarily in response to Sotheby's highly criticized 1987 loan transaction which enabled financier Alan Bond to purchase Van Gogh's \textit{Irises} for $53.9 million. Unknown to other bidders, Bond had arranged an open-ended loan with the financial services division of Sotheby's for half the final hammer-price of the work.\footnote{102} Unfortunately for the auction house, Bond was unable to make his loan payments on schedule. Sotheby's recovered the painting, which stood as collateral for the loan, and plans to sell it again.\footnote{103}

Contrary to the general tone of Sotheby's announcement, the auction house still plans to offer its clients a variety of significant financial services. Sotheby's loan portfolio and assets represented by collectibles are already considerable.\footnote{104} The only service Sotheby's plans to curtail is the lending of funds secured by property the borrower plans to buy at auction. Among the services it will continue are: (1) lending collectors up to fifty percent of the appraised value of works owned for at least ninety days, (2) lending consignors up to fifty percent of the low estimate of works placed for sale with the auction house, and (3) lending to buyers against works other than the works for sale at auction.\footnote{105}

Sotheby's is not the only institution that lends money with art as collateral. Both Citibank and Chase Manhattan Bank do so on a far larger scale and offer lower rates to art collectors and purchasers.\footnote{106}

The lending of money to prospective buyers does not adversely affect the auctioneer's duty to its principal. On the contrary, it ensures the

\begin{footnotesize}
\footnote{100. See S. NAIFEH, supra note 4.}
\footnote{101. Reif, \textit{Sotheby's is Ending its Art Sales on Margin}, N.Y. Times, Jan. 11, 1990, at A1, col. 2.}
\footnote{102. Hughes, \textit{The Anatomy of a Deal}, TIME, Nov. 27, 1989, at 66.}
\footnote{103. \textit{See id.}}
\footnote{104. By September, 1989, Sotheby's loan portfolio reached $254 million. See Brown, \textit{We are Going to See a $100 Million Painting}, FORBES, Feb. 5, 1990, at 170. In 1988, the auction house's net assets were reported at $600 million, $450 million of which were receivables including loans to buyers, advances to sellers, loans to collectors, and money due from buyers. See Wechsler, \textit{Is the Art Market Ready for Mountain Tortoise?}, \textit{FORBES}, Mar. 19, 1990, at 44.}
\footnote{105. \textit{See Brown, supra note 104, at 170.}}
\footnote{106. \textit{Id.}}
\end{footnotesize}
principal a higher price on its works. Despite Alan Bond's financial difficulties, the previous owner of Irises, John Payson, has been paid in full by Sotheby's. The primary risk-taker on a buyer loan is the auctioneer.

One leading case holds that the extension of credit to a bidder by an auctioneer is outside the ordinary scope of the auctioneer's agency duties. In that case, however, the court permitted the auctioneer to extend credit because the particular auctioneer's relationship to the consignor was broader than an ordinary agency relationship. The factors which caused the court to consider the relationship as extending beyond the ordinary agency relationship included the auctioneer's assumption of full control of the property (auto parts), the auctioneer's assortment and preparation of the property for auction, and his guarantee to the buyers of the quality of the property. These factors sway in favor of the expansion of an art auctioneer's authority to extend credit to its customers.

Critics of the Sotheby's loans have made two arguments against the loan practice. Both arguments rely not on principles of agency law, but on notions of public benefit and fairness. The fact that Sotheby's recently agreed to cease at least one conspicuous loan policy indicates its general willingness to consider public and consumer duties in its profit calculus.

The first argument against Sotheby's notes the possible unfairness to other bidders on the same lot as the auctioneer-financed bidder. This argument is responsive to Assumption 3: the auctioneer should give no bidder an unfair advantage. The secret extension of credit to one or more bidders puts bidders who may not be able to bid as high at a disadvantage.

Despite this reasoning, there is no explicit agency duty which requires an auctioneer to treat all buyers alike. The auctioneer's fiduciary duty to the buyer does not arise until the fall of the hammer. The underbidder in an auction pays nothing, although he loses the opportunity to buy the work. This perceived unfairness, although regrettable, is the same as that experienced when a bidder financed by a bank or personal

107. Hughes, supra note 102, at 66; Reif, supra note 101, at C17, col. 4.
109. Id. at 614, 174 N.W. at 374.
110. Skeptics might argue that Sotheby's had two, more mercenary, reasons for abandoning its loan policy. First, the announcement served as a good public relations gesture in the face of public outcry about Irises; and second, that Sotheby's found such loans to be unprofitable. Though such arguments are plausible, they are not wholly convincing. Sotheby's continues many practices which are roundly condemned, such as secret reserves and buyer's premiums. There is also no evidence that it failed to profit from its previous loans. Even the loan to Alan Bond promises to be more than made up by the resale of Irises.
wealth outbids another bidder. The fact that the auctioneer is the lender does not bias the auction in any more significant way.

The second complaint about the Sotheby's loans is that they artificially inflate art prices. Bidders can bid much higher for art, risking only the return of their purchase if they default. The inflation of art prices is, however, generally good for consignors and auctioneers. The losers in an inflated market are buyers and potential buyers to whom the auctioneer owes no legal duty.

Assumption 3 (no unfair advantage) responds to biases created in the auction procedure by the auctioneer. It does not respond to the economic inequalities among bidders. The most objectionable features of Sotheby's loan to Alan Bond were its secrecy and its exclusivity. Had the availability of loans for the purchase of *Irises* been announced before the auction, and had the loan policy been open to all buyers with the requisite credit qualifications, then Mr. Bond would have had no unfair advantage. If loans were available to all qualified bidders, then all bidders would have an equal defense against the resulting inflated prices.

C. Secret Reserves

One of the most criticized practices of art auction houses concerns the secret reserve prices below which a work will be "bought in" by the auctioneer and returned, unsold, to its owner. The reserve price arises from Assumption 2 (floor price) about the auction process. As discussed earlier, it seems wrong to force the owner of a work to part with it for less than the lowest price he is willing to receive. At issue is not the validity of reserve prices, however, but merely the secrecy of reserve prices.

Criticism of the secret reserve comes from art dealers, consumer advocates, and the press who, although acknowledging the need for seller protection, argue that the reserve prices should be made public before or during the auction. Two aspects of the secret reserve procedure have been criticized as being subversive of the auction process. The first is the general secrecy of the reserve price. The second is the fictitious bidding auctioneers must do in order to push the price of an item above the reserve price.

111. Reif, supra note 101, at C17, col. 4.
112. McGill, supra note 10, at C20, col. 3. Sotheby's openly reserves the right to enter protective bids for the seller in its conditions of sale. See SOTHEBY'S CONSIGNMENT AGREEMENT, supra note 52, at 236-37 ("Each lot of the property will be offered subject to a reserve"; "all bids to protect your reserves will be made by us.").
Arguments for Secrecy

Confidentiality, though part of an agent's duty to his principal, and though expected in many professional relationships, has not traditionally been a basic aspect of the auction process in America. Therefore, proponents of secrecy have had to link their arguments for secrecy to more generally valued basic assumptions about the auction process.

a. Protecting the Seller from Buyer "Rings"

The traditional reason for maintaining the secrecy of reserve prices is the protection of sellers from collusive "rings" of buyers, usually unscrupulous art dealers. If the minimum price a seller would take for a work were generally known, buyers could conspire to bid no higher than that minimum price. They could then secretly auction the work among themselves, keeping the profit which would otherwise have gone to the auction house and seller. Although it is questionable whether bidding conspiracies among buyers would be greater today absent secret reserves, auctioneers continue to maintain that secrecy is necessary to protect the sellers of art against such conspiracies. As stated by John Marion, former President of Sotheby's, "the only protection [the sellers] have is that little bit of mystery."

b. Building up Excitement in the Auction

Although still mentioned, protection against buyer rings has become a secondary concern for those favoring secrecy of reserves. Secrecy proponents, generally represented by the auction houses, cite two other reasons for maintaining the secrecy of reserve prices. First, they claim that bidding should start low in order to build up drama and excitement in the auction process. They rely in great part on Assumption 1 about the auction process (optimal price). If bidding began at the relatively high reserve price, it might not develop the momentum needed to achieve an optimal price. Starting the bidding at a high price can, in the words of

113. For example, suppose five buyers were considering purchasing a painting whose reserve price was $5,000. Suppose further that Buyer A were willing to pay up to $9,000 for the painting, and Buyers B, C, D, and E were willing to pay less. Buyer A could buy the painting for $5,000 without the risk of competing bids driving the price above the reserve. Then, Buyer A could pay each of the others up to $1,000 for their cooperation. Buyer A will have the painting at no more than $9,000; Buyers B, C, D, and E will each have a small profit; and the seller will be cheated out of a potential $4,000 profit.

Keeping the reserve secret, on the other hand, would make the plotters unsure of the minimum price and unable to bid low for the work without the risk of losing it to the owner. See, e.g., ART LAW, supra note 3, at 186.

114. McGill, supra note 10, at C20, col. 3.
one commentator, create "a roomful of silence," rather than a lively round of bidding.  

2. Arguments for Disclosure

a. Bidding Off the Chandelier

Opponents of secret reserves, led by the Art Dealers Association of America, argue that secret reserves make a "sham" of the auction process. Bidding which occurs below the reserve leads consumers to think that a competitive auction is taking place when it is not. Buyers at an auction have no way of knowing whether the bids being called by the auctioneer should be attributed to a seller, a competitor in the room, an absentee bidder placing bids by telephone, a prearranged "order" bid, the auctioneer as a "by-bid," the auctioneer pushing a lot up to its reserve, or the auctioneer bidding for its own account. The uncertainty imposed on the auction participant, who may assume that all bids come from other buyers, has been said to "border on deception."  

This argument puts Assumption 1a (manage bidding) into direct conflict with Assumption 1b (ceiling price). Secrecy is needed to generate momentum in the bidding, but secrecy is also deceptive and confusing to bidders. The proposed set of rules in Part VI attempts to reach a compromise between these two assumptions. It provides that protective bids may be entered only up to the reserve price, allowing bidding to gain momentum below the reserve, while clearing the floor of extraneous bidding when the bidding counts.

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116. See White, Putting Your Possessions on the Block, N.Y. Times, June 14, 1987, § 3, at 11, col. 3.
117. See McGill, supra note 94, at C17, col. 3. The Art Dealers Association represents the major group of merchants hurt by the recent success of art auction houses.
118. Nuding, supra note 87, at 35. Note that the entry of bids to protect a reserve does not violate the auctioneer's duty not to enter by-bids. By-bids serve to escalate the price of a work once bidding has begun. Protective bids do not cause any other bidder to overpay for a work because the work would not be sold below the reserve price at all.
b. Disappointed Expectations

Another consumer-oriented criticism addresses the disappointed expectations of buyers at the auction. Buyers may come from far away to participate in an auction, only to be prevented from purchasing by prohibitively high reserves.\(^{119}\) However, auction houses claim that their published presale estimates of prices always exceed the reserve on a lot.\(^{120}\) If so, bidders would have at least some idea of their chances of bidding successfully on any lot.

Moreover, recent consumer legislation in New York City has further increased the information auctioneers must disclose regarding reserve prices. It requires auctioneers to state whether a reserve price exists for each lot while allowing them to keep the actual reserve price secret.\(^{121}\) Of course, this requirement is a small concession by auction houses since the Uniform Commercial Code already provides that all auctions are presumed to be with reserve unless otherwise stated.\(^{122}\)

c. Efficient Pricing

The secrecy of reserves also hurts the efficiency of the auction market. The establishment of a minimum price before the auction eliminates the market as the determinant of the selling price of a work. Keeping this price secret eliminates any chance for the seller to adjust the reserve price based on adverse reaction to it. In other words, the seller may not know that his secret reserve was too high until the work fails to sell at auction.\(^{123}\)

To eliminate some of this inefficiency, auctioneers have been known to stretch the bounds of their "secrecy." In some instances, auctioneers may advise selected buyers of the reserve's range, or whether a seller is

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119. See Art Law, supra note 3, at 185.
120. See Sotheby's Consignment Agreement, supra note 52, at 237 (Sotheby's reserves are stated to be between 25 and 60% of the low pre-sale estimate and never in excess of the high pre-sale estimate.) But see Cristallina v. Christie, Manson & Woods, Int'l, Inc., 117 A.D.2d 284, 288, 502 N.Y.S.2d 165, 169 (1986) (Christie's violated this policy, setting a reserve $300,000 higher than the high estimate for a painting.).
121. See New York Code, supra note 15, at Reg. III, § 21. This notification of reserve prices generally takes the form of a small dot or asterisk beside each item in the auctioneer's catalog. See also McGill, supra note 10, at C20, col. 1.
122. See U.C.C. § 2-328 (1983) ("a sale [by auction] is with reserve unless the goods are in explicit terms put up without reserve").
123. The failure to sell due to overly high reserves is not uncommon. See, e.g., Mullen v. Starr, 537 F. Supp. 945 (W.D. Mo. 1982) aff'd, 696 F.2d 1000 (8th Cir. 1982) cert. denied, 461 U.S. 960 (1983) (auctioneer was not liable when seller placed too high a reserve on his horse); McGill, supra note 10, at C20, col. 5 (J.M.W. Turner's Landscape with Walton Bridges, hammered down for $1.65 million, failed to sell because the owners improvidently set the reserve too high.).
"greedy" or willing to settle on a lower price. They may also advise the seller about what certain buyers are willing to pay for a work.\textsuperscript{124}

This "tinkering" with the auction process generally favors rich or prominent buyers personally known to the auctioneers. As a result, it implicates Assumption 3 (no unfair advantage) and is generally unethical.

D. Guaranteed Prices

Today, Sotheby's, Christie's, and a number of smaller auction houses have begun to attract clients by guaranteeing minimum prices for works they wish to auction.\textsuperscript{125} For example, if a seller expects to receive ten million dollars for his painting, the auctioneer may guarantee at least eight million dollars for the work.\textsuperscript{126} If no buyers bid up to the guaranteed price, the auction house itself buys the work and pays the seller eight million dollars. Thus, the guarantee is like a "super reserve." Instead of being assured that he will not have to part with his painting for less than a certain reserve price, the seller is assured that he will receive a guaranteed sum regardless of the auction's outcome. Considering the many ill effects of failing to sell a work at auction, such a guarantee would seem enormously attractive to consignors.\textsuperscript{127}

The major problem associated with an auctioneer's guarantee of a minimum price for a work is the result that the auction houses end up owning the works of art they are acting as agents to sell. In terms of the fiduciary relationship governing auctioneers, this result is disfavored. Although it is not impermissible for an auctioneer to purchase the goods of his principal with the principal's consent, all such transactions are

\textsuperscript{124} Nuding, supra note 87, at 37.

\textsuperscript{125} Sotheby's has guaranteed prices since 1972. In 1989, it guaranteed over $150 million to sellers, and has already announced a guarantee on the sale of the estate of Lydia Winston Malbin, valued at over $60 million, scheduled for May, 1990. See Passell, Vincent Van Gogh, Meet Adam Smith, N.Y. Times, Feb. 4, 1990, § 2, at 12, col. 1.

Christie's has only recently announced its decision to guarantee prices, beginning with the sale of the estate of Robert Lehman, also scheduled for May, 1990. The value of that estate has been estimated between $40 and $60 million. See Reif, Christie's Reverses Stand on Price Guarantees, N.Y. Times, Mar. 12, 1990, at C13, col. 1. Other auctioneers willing to extend guarantees include Butterfield and Butterfield of San Francisco and Los Angeles; Habsburg, Feldman of Geneva and New York; and William Doyle Galleries of New York. See id. at C16, col. 1.

\textsuperscript{126} The commission which a seller pays for the privilege of having his price guaranteed is in the range of 7% of the guarantee amount. See ART LAW, supra note 3, at 192.

\textsuperscript{127} Consider, for example, the fate of unsold works. They are usually returned to the owner, often resulting in a loss of value. The object becomes "burned," or less likely to sell in the near future. Absent a showing of negligence on the part of the auctioneer, the auctioneer is not responsible for such intangible damages to the seller. See DeBruno v. Sotheby Parke Bernet, Inc., No. 84 Civ. 3021, bench op. (D.N.J. Nov. 8, 1984).
viewed with suspicion.\textsuperscript{128} Sales to an auctioneer of his principal's goods for a price lower than the fair market value of the goods sold are considered prima facie unfair.\textsuperscript{129}

When the auctioneer becomes a potential buyer of the goods he is selling, an inevitable conflict of interest arises. Some commentators speculate that the issuance of high guarantees may encourage auctioneers to over-publicize and overestimate the value of the guaranteed works in order to avoid the expense of buying them.\textsuperscript{130} Alternately, it is possible that the prospect of paying a relatively low guarantee price for a potentially "record-breaking" work would lead auctioneers to under-publicize and underestimate the value of those works. In this way, they could later sell the works at a great profit.

The latter scenario is supported by the nature of the guarantee price itself. The guarantee will generally tend toward the low estimate of a work's value. Its ostensible purpose is to ensure a minimum price for the seller, not a high price. Thus, the actual sale value of a work will generally exceed its guarantee. Presently, auction houses are satisfied to guarantee works for less than their sale values (generally 50\% of their estimated value) and collect commissions on the sale. It will not escape auctioneers' attention, however, that a more profitable scheme would be to buy a work for the relatively low guarantee price, then resell it for the higher market value. In such a situation, the auctioneer would profit directly from the work's "appreciation," not merely from commissions.\textsuperscript{131}

Once auctioneers become investing buyers, their status as fiduciaries of the seller is severely compromised. Sellers often depend on auction house appraisers for valuations of their works. If it is in the interest of the auctioneer to underestimate the value of a work, that interest directly

\begin{itemize}
  \item \textsuperscript{128} See supra Part II(D)(1) (auctioneer self dealing).
  \item \textsuperscript{129} See Restatement (Second) of Agency § 390 comment c (1984).
  \item \textsuperscript{130} See Reif, supra note 125, at C16, col. 1-2.
  \item \textsuperscript{131} For example, consider Sotheby's recent sale of the estate of John T. Dorrance, Jr. \textit{Id.} Sotheby's guaranteed approximately $100 million to the owners of the collection of art and antiques. \textit{Id.} They sold for approximately $130 million. \textit{Id.} Sotheby's probably collected the following amounts:
    \begin{itemize}
      \item 7\% guarantee fee \quad $7$ million
      \item 10\% seller's commission \quad $13$ million
      \item 10\% buyer's commission \quad $13$ million
      \item Total \quad $33$ million
    \end{itemize}
    If, on the other hand, Sotheby's had bought the collection for the guarantee price of $100 million and later sold it for $130 million, it would have profited as follows:
    \begin{itemize}
      \item 7\% guarantee fee \quad $7$ million
      \item Appreciation \quad $30$ million
      \item 10\% buyer's commission \quad $13$ million
      \item Total \quad $50$ million
    \end{itemize}
\end{itemize}
conflicts with its duty to obtain the highest price for the seller. The duty of diligence may be violated during the auction itself if the auctioneer, even unconsciously, promotes with less vigor those items the auction house has a possibility of owning. Likewise, an auctioneer who owns works being sold at auction indirectly competes for bidders with the other sellers at that auction, perhaps violating the fiduciary duty not to compete with his principal.

Auction houses cannot become buyers of works while maintaining fiduciary duties to sellers. Therefore we should determine which of these practices is most justified in light of the basic assumptions about the auction process. The agency relationship may, as discussed above, be an inappropriate doctrine for controlling the behavior of art auctioneers. The extreme loyalty demanded by the fiduciary relationship does not form a basic assumption about the auctioneer-consignor relationship. Achieving the highest price for the consignor, however, is supported by Assumptions 1 (optimal price) and 1a (manage bidding). If the auctioneer is willing to pay the highest price for a work of art, then it works in the seller’s favor to let him buy it. Therefore, absent any bad faith on the auctioneer’s part, allowing it to bid for and own works is not problematic.

The effect of guaranteed prices on the art market as a whole is uncertain. Auctioneers already compete to sell the most lucrative works that come onto the market. It might be argued that guarantees are only another service that extends the realm of healthy competition between the auction houses. It is also possible, however, that the widespread use of guarantees could inflate art prices considerably. Consider, for example, the effect of Christie’s and Sotheby’s competition for a particularly important consignment. Their negotiations with the seller could amount to no less than a mini-auction among auctioneers, with the guarantee price bid higher and higher to secure the consignment. The situation would escalate if other auctioneers and dealers entered the competitive arena.

132. See supra note 41 and accompanying text (describing the stringent fiduciary duty).
133. A useful analogy is that of the modern investment bank. Investment banks trade securities as brokers for clients to whom they owe duties of care and honesty. However, they may also buy and sell on their own accounts. The securities market is highly regulated to ensure against dishonest practices.
134. Art dealer William Acquavella, for example, offered a guarantee of $100 million for the estate of John T. Dorrance, Jr., discussed supra note 131. Sotheby’s only narrowly beat his offer. See Hughes, supra note 81, at 62.
VI

Proposed Rules for Regulating the Auction Industry

In light of the foregoing analysis of present auction practices and the seven basic assumptions about the auction market, this author proposes the following rules for the regulation of the auction industry:

1. *Reserve prices may be agreed upon between the consignor and auctioneer* (satisfying Assumption 2: floor price) and may remain secret. Secrecy of the reserve price should not disappoint buyers if it is always below the auctioneer's low estimate published for each lot. Buyers will know the range of prices and will only have to worry about losing to the reserve if their "winning" bid is below the low estimate. With adequate disclosure, the requirements of Assumption 4 (disclosure) are satisfied.

2. *Auctioneers may enter by-bids only up to the reserve price.* There is little harm in allowing an auctioneer to "bid off the chandelier" while bidding is still below the reserve price. If no bidder is willing to pay the reserve or more, the work would not sell anyway. The auctioneer does have a duty to excite bidding (Assumption 1a: manage bidding) to achieve the highest price for his consignor.

However, once bidding attains the reserve price, the auctioneer should not by-bid. Once there is a real chance that a bidder will be bound by his bid, all bids should be real, or risk violating Assumption 1b (ceiling price).

3. *The auction house may bid to purchase any lot.* The auction house may, in effect, guarantee prices for consignors. Ownership of works by the auctioneer is not problematic, so long as its appraisal and publicity for the works it buys are fair. With adequate disclosure of guaranteed lots and works owned by the auctioneer, Assumption 4 (disclosure) is satisfied.

To permit this practice, the fiduciary duty regulating self-dealing by the auctioneer must be relaxed in the way the duty for corporate directors was loosened in the 1960s.135

4. *The auction house may not engage in any practice which favors one bidder over another.* This rule is based on Assumption 3 (no unfair advantage) prohibiting the creation of a tilted playing field in the ideal auction market.

The loan practices of auction houses are problematic only in that they favor some bidders over others. If the auctioneer chooses to act as a general lender, making lending decisions based on objective criteria and

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135. *See supra* Part III(D)(1) (Corporate self-dealing transactions are currently allowed in most states if "fair" or ratified by a majority of disinterested shareholders.).
offering such financial services to all customers, then Assumption 3 is satisfied.

The auctioneer should not give potential buyers information about upcoming sales, reserve amounts, or values which is not published or available to all bidders. Similarly, auction house employees and other insiders should not bid on works if they have any inside information about the works or consignor.

5. *The auctioneer must disclose all transactions pertaining to his auctions truthfully and completely.* This blanket rule embodies Assumption 4 (disclosure). In addition to the disclosures presently required by consumer protection law, other information of use to auction house customers should be prominently disclosed.\textsuperscript{136}

Current consumer protection and anti-fraud statutes already govern many of these requirements. These rules have not, however, been recognized as logically sound derivations from general principles yet. This Article seeks to so treat them.

\textbf{VII}

\underline{Conclusion}

The character of the art auction industry has changed dramatically in recent years, and auction houses are faced with numerous choices for the future. As the character of auction houses has changed, the traditional agency and sales rules governing auctions have become more and more inadequate for regulating them.

To replace them, this Article looks to the basic assumptions underlying the auction process. These assumptions hold that auctions produce fair prices for unique art objects. The auctioneer who conducts the auction must thus provide an unbiased forum in which the price of unique art objects can be determined.

The current rules governing auctions and the current practices of auction houses in some cases do not wholly embody these basic assumptions. Aspects of current auction practice relating to buyers' loans, secret reserves, and guaranteed prices could be improved by paying closer attention to basic assumptions about the auction process, and adhering less rigidly to inadequate principles of agency and sales law. The proposed

\textsuperscript{136} For example, information relating to clouds over title of works, doubts about authenticity, liens on works, present ownership of paintings, independent appraisals of works, and the status of intellectual property and moral rights attached to works would all be useful to potential buyers.
rules for governing auctioneers presented here seek to link auctioneer practice directly to the basic societal assumptions about the auction process and its advantages.