

Art for fraud's sake

The glamorous, uber-wealthy, largely unregulated and opaque world of art dealing and collecting has intrinsic features that make it vulnerable to fraud. Christopher A Noel of Sequor Law sketches recent cases and legislative steps toward combating the problem.

Andy Warhol is famously quoted as saying, "Art is what you can get away with." Since the explosion of the contemporary art market during the past two decades, artists, collectors and fraudsters alike have embraced Warhol's precarious perspective. The modern art market no longer exists in wood-panelled galleries lining the streets of London, Hong Kong and New York. Today's collectors are mobile, purchasing artworks at all price points, sight unseen, during their commutes and while on holiday. These new business practices have had positive impact – UBS estimates that global art and antiquities sales in 2021 reached an estimated US\$65.1 billion, surpassing even the peak sales figures seen in 2019.

Newcomers and speculative investors, however, do not always see the returns expected on those purchases. In just the past six months, sales of non-fungible tokens (NFTs) have plummeted to less than one-twelfth the level seen at the turn of the New Year. Overall, increased activity in the art market and the broad offering of new products, like NFTs, mean more fraud, around US\$6bn per year according to FBI estimates.



The Salvator Mundi at Christie's in 2017

So much appeal

The largely unregulated and private global art market is prime for fraud – forgeries, money laundering, Ponzi schemes and tax fraud are all common wrongs associated with the art world. Art is so favoured by international fraudsters because of multiple factors: for example, art is a high value and relatively stable asset that can be easily transported across borders with limited scrutiny. Fraudsters may also use art as a tool to bolster their image as a successful (and legitimate) businessperson. To add insult to injury, even the largest of art sales are often sealed just by a handshake, with minimal documentation, if any. While many *bona fide* art consumers purchase pieces that they find attractive, most also see the purchase of art as an investment. Nevertheless, sophisticated art consumers have yet to demand the documentation and due diligence regularly seen in other similarly sized financial transactions. The typical provenance information outlining the believed history of ownership for a work of art should be just the beginning of any due diligence process. Historic pricing data, market sales data and contractual guarantees by a seller or broker against deception, misrepresentation, or omission, should be considered by anyone purchasing art works. Further, an art purchaser may want to expand the investigation by contacting prior owners or brokers to ensure accurate disclosures. Finally, if in the United States, the filing of a consignment agreement and UCC-1 provide greater enforceability of rights should a dispute arise regarding ownership. These sources of information and extra protections are often available for non-art assets and should become more commonplace in the art world.

Caveat emptor

The cases of Dmitry Rybolovlev and Ronald O Perelman provide clear examples of the perils of deception in the art market. In 2015, Swiss freeport [1] baron Yves Bouvier was accused by Russian oligarch Dmitry Rybolovlev of systematically overcharging Rybolovlev's family trust more than US\$1bn over the course of ten years, while Bouvier served as intermediary for the acquisition of more than 38 blue chip art works. These accusations led to civil and criminal investigations as well as prosecutions in the courts of France, Monaco, Switzerland, Hong Kong, Singapore and the United States. Most notable among the art works involved in this six-year legal saga is *Salvator Mundi*, the purported lost Leonardo da Vinci that reportedly sold to Saudi Crown Prince Mohammed bin Salman Al Saud for a record-breaking US\$450.3 million in 2017. Bouvier originally purchased the *Salvator Mundi* for US\$83m from a consortium of art dealers. Hours after Bouvier's acquisition, he then sold the *Salvator Mundi* to Rybolovlev for US\$127.5m – a potential US\$44.5m profit for Bouvier. In late 2021, a Geneva prosecutor found no criminal misconduct and dismissed the last remaining criminal complaint against Bouvier. Only a 2020-filed Swiss tax evasion prosecution remains pending, though Bouvier claims his reputation was destroyed in the interim.

In 2012, the leveraged buyout billionaire Ronald O Perelman sued art dealer Larry Gagosian in New York for similar allegations of having overpaid on purchased art works. While Perelman's allegations do not rise to the billion-dollar fraud alleged by Rybolovlev, both disputes resolved in the same way. The New York Supreme Court held that because Perelman, a sophisticated collector, conducted no due diligence prior to the transaction, he failed to demonstrate any actionable manipulation or misrepresentation.

While art buyers are often sophisticated, such sophistication is not always a viable defence for allegations of fraud. The ongoing (and well-publicised) case of Inigo Philbrick provides an example of a growing Ponzi scheme trend in the art industry. Philbrick was an art world wunderkind, beginning his career at the esteemed White Cube gallery in London. After starting his own firm in 2013, Philbrick eventually opened galleries in Mayfair and Miami, which specialised in market making for contemporary artists while also selling pieces by the likes of Jean-Michel Basquiat, Christopher Wool, Wade Guyton, Yayoi Kusama, Donald Judd, and Rudolf Stingel.

Behind many of the premier art works sold by Philbrick was a German art financier, Fine Art Partners, which provided funding for Philbrick's acquisition of new art works. After a flawed fraud against Fine Art Partners involving a forged Christie's sale guarantee for a 2012 Rudolf Stingel hyper-realistic painting of a photograph of Pablo Picasso (which sold for US\$6.52m instead of the guaranteed US\$9m) and missed repayment on debt owed as a result of sales of Fine Art Partners-financed art works, Philbrick's shell game began to crumble. Philbrick's scheme involved veiled trades that led to multiple overlapping sales of the same art works, falsifying documents to inflate values, and using works as collateral on loans without the owner's knowledge or permission. When Fine Art Partners filed suit in Miami-Dade County, Florida, to recover multiple art works in Philbrick's possession, Philbrick caught wind that he was under federal investigation for various crimes in the United States and fled to the small island nation of Vanuatu. Despite the unexpected cover provided by the global Covid-19 pandemic, Philbrick was eventually captured by US officials, extradited back to the United States, and tried for his criminal conduct. In May 2022, Philbrick was sentenced to seven years in federal prison and ordered to retribute US\$86m in ill-gotten funds. Many of the civil lawsuits filed against Philbrick and his gallery remain pending, and many of the art works involved are enjoined from transport or display pending resolution of the litigation.

While each of these cases could serve as a basis for increased consumer protection regulation in the art industry, governments around the world are first tackling perceived money laundering in the art industry before enacting any further consumer protection laws.

Money laundering legislation – EU & US

In 2018, the European Union passed the Fifth Anti-Money Laundering Directive, adding the art industry to the list of regulated industries. The directive's goal is to increase transparency in the art market, to disrupt criminal activity and cut off terrorist financing through the improper use of the global art market. When the directive went into effect in 2020 it had two distinct requirements. First, art dealers must now verify the identity of anyone purchasing works of art worth €10,000 or more, regardless of payment method or split transactions. Additionally, art dealers are obligated to identify the source of a purchaser's wealth. Despite the United Kingdom's 2020 departure from the European Union, the UK nevertheless implemented what can be described as a broader Fifth Anti-Money Laundering Directive, whereby British art dealers, advisers and auctioneers are now subject to strict anti-money laundering regulations like those applied to lawyers and bankers. In the UK, art sellers must register with HM Revenue and Customs, as well as satisfy know your client (KYC) and enhanced due diligence checks that include risk assessments and the filing of Suspicious Activity Reports with the UK's National Crime Agency.

The United States is slow to follow the model forged by its European allies. In December 2020, Congress voted to add antiquities (not art) dealers to the list of covered entities under the 1970 Bank Secrecy Act based on the identification of money laundering in the art market. Under the Bank Secrecy Act, cash transactions of more than US\$10,000 must be reported along with any suspicious activity. Antiquities dealers are also required to understand the ultimate beneficiary of a covered transaction as well as the buyer's source of wealth. These initial steps signalled that the US was catching up to Europe, but an early-2022 Treasury Department study decided that while there is evidence of money laundering in the art market, no further regulation of the art market is needed immediately given the Treasury Department's focus on combating the abuse of offshore shell companies, the use of secretive freeports [1] to facilitate tax fraud, and other illicit activity conducted by individual actors in the art industry. As a result, the US art market is unlikely to see a further expansion of the Bank Secrecy Act to include sales of art works (rather than antiquities).

Other recourse

While the United States' reluctance to expand oversight into the art market may seem like a loss for entities and individuals seeking to reduce occurrences of fraud in the art industry, there are still multiple steps contemplated or being taken by governments and organisations around the world. Greater clarity on the beneficial ownership of offshore shell companies continues to evolve in many of the favoured countries for such financial activity – Panama, for example, introduced a Beneficial Ownership Registry in 2020, which promises to collect, update and integrate data regarding the ultimate beneficial owners of Panamanian entities. Additionally, courts are taking art fraud more seriously – as demonstrated by Philbrick's unusually lengthy seven-year jail sentence for white-collar crime. For fraud practitioners and art market participants looking for best practices to combat fraud, the Geneva-based Responsible Art Market Initiative provides free guidelines regarding authentication of art works, an Art Transaction Due Diligence Toolkit [2] and guidelines for combating money laundering and terrorist financing through the art market. These tools provide expert guidance from a neutral organisation supported by experts in the art industry. Until governments begin regulating or collecting ownership information to create registries similar to those for luxury cars, yachts and private airplanes, these Responsible Art Market tools and global courts' increasing desire to deter further frauds serve as the best sources for reducing fraud in today's ever-changing art market.

Notes

1. www.instituteforgovernment.org.uk/explainers/trade-freeports-free-zones
2. <http://responsibleartmarket.org/guidelines/art-transaction-due-diligence-toolkit/>

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