What happens when a museum closes?

BY MARK S. GOLD

Many believe that when a museum closes, all of its objects find welcoming and happy homes in other cultural institutions. Unfortunately, that would be a very unusual outcome. From the perspective of a creditor, the only difference between the most cherished object in your collection and its display case is that the object will be sold more easily and at a higher price. They are both assets to be liquidated to pay debt when a museum closes.

Who's in control after a museum closes?

Although public opinion may play a role, there are really only three parties involved in determining what happens when a museum closes: the board of trustees, the creditors and the state's attorney general. The trustees are required to maximize the assets available after the payment of debt to continue the mission of the museum in some fashion. The creditors will want to be paid in full, or as close thereto as possible. The attorney general acts on behalf of the public and is responsible for making sure the assets of the museum, after payment of debt, are deployed in the best interest of the public in a form as close as possible to the original mission of the museum.

What happens to the museum's holdings?

It depends mostly on whether or not there are assets remaining after all debts have been paid. (For purposes of this analysis, assets are assumed to be unrestricted.) If the value of the assets (including the collection) is less than the amount of the debt, the assets (yes, including the collection) will be sold to pay the debt. It is up to the trustees to ensure that the sale realizes as much as possible, and the creditors will be watching closely to be sure that happens.

The liquidation can take one of several forms. It can be an orderly process performed by the trustees. It can take the form of a bankruptcy proceeding, in which the liquidation of assets would be within the purview of a court-appointed trustee. Sometimes a receiver or some other individual is appointed to take responsibility. Regardless, the attorney general will have oversight to be sure the liquidation process is appropriate.

How does that work in practice?

A helpful example is the Fresno Metropolitan Museum in California. This museum was home to a permanent collection comprised of more than 3,000 works of art and artifacts drawn from several cultures spanning more than 400 years. The victim of an aggressive growth strategy that hit the recession head on, the institution closed its doors in 2010.

It quickly became apparent that the assets of the museum would not be sufficient to satisfy all of its creditors. Instead
of filing a bankruptcy proceeding, the board of trustees made an "Assignment for Benefit of Creditors" that transferred all of its assets to a "trustee" (not a member of the board) of the museum's choosing, a faster, less expensive and less formal process than bankruptcy. The trustee was charged with liquidating the assets for the benefit of the museum's creditors.

The attorney general consented to that decision, recognizing that there were going to be no assets available for the benefit of the public after the payment of debt. The trustee proceeded to dispose of all of the assets, including public auctions of some objects from the collection by Sotheby's and Christie's. At the end of the process, the general creditors received some, but not all, of what was owed to them.

The collection of the Fresno Metropolitan Museum is gone—all, or substantially all, into private collections and removed from the public domain. The objects did not end up in welcoming and happy homes at other museums.

What if the value of the assets exceeds the debt?
In those cases, the museum has a bit more flexibility. To the extent that the museum controls the process, it can decide which assets are sold first and in what manner. If the museum cedes or loses that control, the creditors (or someone acting on their behalf) will make those decisions. And the creditors will be less interested in squeezing the last dollar out of the sale of an outdated photocopier than they will be in shipping the centerpiece of the collection to auction.

Although creditors cannot force a nonprofit organization into bankruptcy, they can individually bring collection suits and attach assets for later sale. Neither the museum nor the attorney general can stop creditors from collecting their proper debts, including the sale of assets—such as objects from the collection.

The plan for liquidation of assets is pretty straightforward: Get the most money possible, choosing assets for sale that will least adversely affect the mission of the museum.

If there is money left over after the museum assets are sold, what happens to it?
There is a broad spectrum of possibilities, but the overarching criterion is how the use of those assets will most closely meet the mission of the museum that has closed. That decision cannot be accomplished without the approval of the attorney general. If the board of trustees has a preference, it ought to be prepared to present to the attorney general a detailed plan, including how the result would most closely support the original mission. For example, if the institution was a regional museum and the remaining objects relate to local history, perhaps a transfer to the local historical
society would be appropriate. If the museum had a strong arts education component and the remaining objects did not present a coherent narrative of anything, perhaps a sale of the remaining objects could fund a new nonprofit organization providing arts education.

In the case of North Carolina’s Fayetteville Museum of Art, which closed in 2010, the liquidation of the collection generated a surplus after the payment of creditors. With the approval of the attorney general, the surplus funds were transferred to the custody of the Cumberland Community Foundation for use by a possible future art museum entity, with a local task force formed to begin that process. But the actual collection is gone.

In some cases, an institution could merge with another museum or nonprofit organization so that remaining assets, programs, staff, etc., do indeed find a welcoming and happy home. This scenario, however, is only possible if assets are greater than debt.

What should the museum do if closing is inevitable?
In general, creditors are economic creatures. They want to be paid, but they also prefer to avoid the cost and delay of litigation. If they are satisfied that they will be paid, most of them will be willing to defer to an orderly process rather than invest legal fees for a quicker return.

If there is a realistic hope that there may be assets remaining after the payment of debt, the museum should work closely with its creditors and with the attorney general to construct a plan addressing: 1) how (and which) assets will be sold to pay debt, and 2) how the remaining assets will be deployed to best accomplish the original mission of the museum.

The creditors will have a keen interest in the former. The attorney general will have a keen interest—and perhaps a lot to say—on the latter. The board of trustees has a legal obligation to be interested in both.

What if closing is not yet inevitable, but heading in that direction?
The board of trustees must recognize and react to inevitability. The best time to develop a plan to continue the museum’s mission is before the debt becomes suffocating. There must be realistic, multi-year, pro forma financial statements so that trustees make informed decisions before the threat of creditor attachments arises. It could mean resisting the urge to tap the endowment to buy more time. The best strategy may be to acknowledge failure and handle it early, using what remains to support the core mission of the institution in some new and different way. «

Mark S. Gold is a partner in the law firm of Parese, Sabir, Smith & Gold, LLP, Pittsfield, Massachusetts. A version of this article appeared in NEMA News (New England Museum Association, Winter 2012).