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THE LAW OF AGENCY

IN EQUINE SALE TRANSACTIONS IN CALIFORNIA

by

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THE LAW OF AGENCY

IN EQUINE SALE TRANSACTIONS IN CALIFORNIA

INTRODUCTION

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It is a rare equine sales transaction which does not involve, in some form or manner, the expertise, advice and services of an agent for one or both of the parties. Whether it is a private sale, a consignment, or a public auction, the relationship of agency is ever present, and so too are the issues and problems that arise as a result of that relationship.

In general, an equine sales agent may be anyone. A seasoned horse trader, a bloodstock agent, a trainer, a farm manager, a pedigree expert, a syndicate manager, an auctioneer, a partner in a joint venture, a lawyer, or a best friend. Almost any person over the age of 18 can act as an equine sales agent in a private sale. With respect to public sales, within the last five years, most of the major thoroughbred auction houses have instituted requirements to have all agents qualified as "authorized" before they are allowed to either sell or bid on the horses. In addition, authorized agents are now also required by the same said auction establishments to submit a credit application which makes them financially responsible for the purchase of a horse in the event the principal disclaims that express authority existed for the purchase of the animal.

Typically, a bloodstock agent is someone who participates in the sale and purchase of Thoroughbred race horses exclusively. The word "bloodstock" was originated in England in approximately 1830 to describe horses of Thoroughbred breeding. For purposes of this article, the use of the word "agent" will connote all general agents including "bloodstock agents" "horse traders" and any other agents involved in the purchase of all equines. However, when the term Bloodstock Agent is used, it will refer only to those agents involved in Thoroughbred sales

transactions. It should be noted that due to already established traditions and infrastructure created by the Thoroughbred race industry, the specter of gambling involved with thoroughbred racing, the lucrative purses offered (The Breeder's Cup offers eight races in one day with a purse of at least \$1 million per race), and the fact that the horseracing industry is protected by both state and federal law as being a significant employer and contributor to the tax base of each state, a majority of the professional equine sales agents are "Bloodstock Agents" simply because there is more money to be made with Thoroughbred related transactions.

Equine agents often act as intermediary in a transaction involving the sale of a horse because they provide the opportunity for exposure and visitor activity to horses or they have significant contacts in the marketplace. For his/her efforts in preparation, marketing and presentation of the horse, the sales agent is usually paid an agreed upon commission. The role of a sales agent can also be quite varied and multidimensional, and can touch on almost every aspect of owning, breeding, standing, raising, racing, showing, selling and buying a horse. In a survey of ten industry leading Bloodstock Agents published by Thoroughbred Times Magazine in December, 2001, the agents described the services which they performed as follows:

- Advise, consult and assist in the private and public sale and purchase of stallion prospects, racing and breeding stock;
- Advise and serve as agent for clients in private sales and at public auction as well as for the purchase and sale of stallion seasons and shares;
- Stallion and broodmare band management;
- Purchases for racing and breeding purposes;
- Management of broodmare portfolios and syndication of racing stock;
- Advise and assist in purchases for pinhooking;
- Consultant work for leading breeders;
- Conduct appraisals and provide breeding recommendations; and

In providing their services, it is clear that many Bloodstock Agents wear more than one hat. To be successful, they cannot afford to simply be sharp horse traders, but they must also be marketing specialists, pedigree and biomechanics experts, savvy businessmen and women, and sophisticated evaluators and forecasters of industry trend and economics.

To date, the role of an agent in equine sales transactions in the state of California, unlike that of an insurance agent, talent agent, athlete agent or real estate agent, has been largely unregulated. As a consequence, activities may sometimes take place which are not altogether lawful or appropriate, or which may lead to distrust of and disillusionment with horse ownership at large.

This article is written to briefly identify current customs and practices in the equine sales industry, set forth and clarify the law as it applies to agents in the State of California, and highlight some special problems that agents may encounter in equine sales transactions. In the attached Appendix, the reader will find model agency agreements with provisions intended to avoid misunderstandings.

II.

AGENT FEES, CUSTOMS AND PRACTICES

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A. **AGENT SALES FEES.** Every agreement with an agent should be in writing. This statement does not mean that every agency relationship is, in fact, memorialized in writing. Horse people are notorious for avoiding written contracts like the plague. Fees are the subject of negotiation but follow a general industry rule of thumb. On private purchases or sales, most agents receive five to ten percent of the gross

sales price. All costs of the sale are passed through directly to the owner. In addition, many agents have started to charge a minimum fee ranging from between Five Hundred to One Thousand Dollars.

At public auctions, the auction house usually takes five percent of the gross sale, leaving only five percent for the selling agent or consignee. All direct costs of preparing a horse for auction are billed back directly to the selling owner. Many auction houses are also starting to charge a minimum fee in case the horse does not sell for enough to return a reasonable profit to the house for its efforts.

The real cost of selling a horse at a public Thoroughbred auction runs between \$2,000 to \$2,500. This amount does not include the direct expenses of sale preparation such as boarding with a consignee, training, vet bills, shoeing and the like.

B. AGENT CUSTOMS. A "Custom" is defined as a long-established practice that has taken on the force of law. To understand agent customs, it is important to understand that Article Two

of both the Uniform and California Commercial Code controls the sale of horses as "goods."

Historically, the appointment of an agent in equine related transactions has been accomplished on an oral basis. This is because "the traditional horse deal was made between people who knew each other, who had dealt with each other before and who would deal with each other again. It was negotiated quietly, secretly in the clubhouse or the backstretch, and it was made in the context of shared expertise and known, accepted risk. If there was a writing, it was on the back of a cocktail napkin or pari-mutuel ticket, or in the margin of the *Daily Racing Form*." However, at least one court has held that this custom fails to satisfy the requirements of the statute of frauds embodied in §2-201 of the Uniform Commercial Code because an agent is given the right to sign on behalf of the principal with respect to a "sale of goods for a price of \$500 or more."

In the text of §2-201(3)(b) of the 1962 California Commercial Code, oral contracts were removed from the unenforceability strictures of the Statute of Frauds "if the party against whom enforcement was sought admitted in his pleadings, testimony or otherwise in court that a contract. . . ." had been made. The theory in the 1962 official text was that the Statute of Frauds intends only to prevent the enforcement of contracts not in fact made. "It does not seek to prevent their enforcement just because they are oral."

CC §2-201(3)(b), amended in 1988, removes the 1962 text and now provides that an oral contract is enforceable if it is admitted by the defendant and only to the extent of the quantity of goods admitted. Under the amended language, it is no longer possible to admit the existence of a contract but interpose the Statute as a bar to enforcement.

Since the amendment, there have been no cases in California which examine oral contracts between a principal and his/her agent, or as between a principal and a third party, concerning equine sales transaction. Further, it is widely accepted without challenge that the Uniform Commercial Code does not

control the agency contract itself but only the sale of horses as "goods."

In California, the creation of an enforceable contract is controlled by Civil Code §1619 et seq. Under Civil Code §1622, oral contracts are valid unless they are required to be in writing by statute. (However, under the equal dignities rule, CC § 2309, authority to enter into a contract required by law to be in writing can only be given by an instrument in writing.) Pursuant to Civil Code §1624, any agreement which by its terms cannot be performed within a year must be in writing.

Although not articulated in any California case law, the prevailing understanding in the horse business at the current time on matters concerning "Custom" is that the courts will impose standard, generalized doctrines and statutes on the industry. The basis for this consensus derives from the holding in the case of *Marsh v. Gentry*, 642 S.W. 2d 574 (Ky. Supreme Ct. 1982). In that case, a trial court concluded that the defendant in a partnership did not breach any duties to the other partners by (1) purchasing a filly through a secret agent at a public auction, and (2) failing to disclose that he was the secret purchaser of a filly in a private sale and misleading the partners to believe that the actual purchaser was a California citizen. The defendant in *Marsh* argued that he only engaged in "accepted practices" which were the custom of the industry and that general statutory partnership law did not apply. The Kentucky Supreme Court disagreed. In reversing the trial court, the Court determined that "where an 'accepted business practice' conflicts with existing law, the law, whether statutory or court ordered, is controlling. To hold otherwise would be chaotic."

However, in a more recent case, *Dimario v. Coppola*, 10 F. Supp.2d 213 (E.D.N.Y. 1998), a New York Court gave extraordinary effect to custom and usage in the Thoroughbred horse business by rewriting an oral contract between the trainer of a multiple stakes winning horse called "Runaway Groom", and the owners of the horse who agreed that they had orally promised to give the trainer 10% of the proceeds of the horse's syndication, but later argued that such a promise was barred by the statute of frauds. In holding that the enforcement of the oral agreement was not barred by the statute of frauds, the Court stated "These customs must be construed as implied precise terms of the original contract." After rewriting the oral agreement to conform to the customs of the industry, the trainer was awarded only customary compensation for his services.

C. AGENT PRACTICES. Agents are ubiquitous in the horse industry. It seems like every trainer, farm manager and work out rider knows somebody that has the perfect horse to sell, lease, buy or use in a show. In addition, it is often the case that the person with the money to purchase a new horse is usually involved in business or in the business of making money so that they do not have the time and/or expertise to put into locating and vetting a prospective horse.

With respect to Thoroughbreds exclusively, in a review of the most recent public auction held in California, the CTBA Del Mar Yearling Sale in August, 2002, of the 98 horses which were sold, 80 were either consigned or sold by an agent, leaving only 18 to be sold directly by a farm or owner. With reference to the Keeneland September yearling sale ending September 21, 2002, 2,934 yearlings were sold. The top ten leading consignors and agents sold 1,029 of those yearlings for an approximate sum of

\$106 million which represents over half the gross proceeds of the entire sale. The leading buyer for the sale was John Ferguson Bloodstock purchasing 26 horses for \$13,555,000 or an average price of \$521,346 per horse. Of all leading buyers of Thoroughbreds for the summer selected sales, 14 out of 32 are agents. What this tells the reader is that the marketplace works more efficiently with the assistance of sales agents than without.

Practices vary depending on the agent's charge and whether the agent is working in the setting of a private or public sale. While auctions provide great selection organized into easy to read catalogs for buyers, and the opportunity for liquidity for sellers, the private market allows time for research and efficient evaluation of an equine prospect.

Equine sales agents are at heart, deal makers. At times, they have also been called bandits and tricksters. The practices in which they engage to accomplish their express or implied tasks run the gamut from honorable to criminal. Many times, the agents are not aware that certain activities may be regulated or may be illegal. They simply believe in such maxims as *Caveat emptor* or the "notion that the loser in today's deal will be accorded some advantage in a future transaction."

For that reason, the "Practice" of agents may sometimes hinge on the agent's subjective viewpoint of what is "fair" regardless of the legal implications involved. However, due to increased scrutiny in the horse industry within the last twenty years, the "authorized agent" authority imposed by the Bloodstock auction houses, the introduction of "new money" from people not previously acquainted with horses but instead coming from business backgrounds with the expectation of a higher level of accountability and professionalism, most agents are standardizing their practices by using written agreements and conforming their conduct, representations and sales activities to nationally accepted customs.

III.

CHARACTERISTICS OF AN AGENCY RELATIONSHIP

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Pursuant to Civil Code §2295 an agent is one who represents another, called the principal, in dealing with third parties.

In *Alvarez v. Felker Mfg. Co.* (1964) 230 CalApp.2d 987, the Court stated that the essential characteristics of an agency relationship are as follows: (1) the agent holds power to alter legal relations between a principal and a third person, (2) the agent is a fiduciary with respect to matters within the scope of the agency, and (3) the principal has the right to control the conduct of the agent with respect to the matters entrusted to him.

In *Dearborn v. Mar Ship Operations, Inc.* 113 F.3d 995, (9th Cir. Cal. 1997) the Court determined that an "Agent is one who is employed as a fiduciary, acting for a principal with the principals consent and subject to the principal's overall control and direction in accomplishing some matter undertaken on the principals behalf."

In *In re Coupon Clearing Service, Inc.*, 113 F.3d 1091 (9th Cir. Cal. 1997), the Court stated that "Under California law, an agent is anyone who undertakes to transact some business, or manage some affair, for another, by authority of or on account of latter, and to render account of such transactions."

The Restatement (Second) of Agency defines the agency relationship as "the fiduciary relation which results from the manifestation of consent by one person to another that the other shall act on his behalf and subject to his control and consent by the other so to act. Thus, "Agency" is a consensual relationship that is governed internally by the terms of the agreement (if there is one) between the parties. Any person having the capacity and ability to contract may appoint an agent and any person may be an agent.

An agency may be actual or ostensible. Pursuant to Civil Code §2299, an agency is actual when the agent is really employed by the principal, and pursuant to Civil Code §2300, an agency is ostensible when the principal intentionally, or by want of ordinary care, causes a third person to believe another to be his agent who is not really employed by him. With limited exception, an agent may be authorized to do any lawful act which the principal would be able to do personally. Consideration or payment of a commission is not essential to the creation of an agency relationship.

IV.

TYPES OF AGENCY RELATIONSHIPS EMPLOYED IN

EQUINE SALES TRANSACTIONS

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A. **Bloodstock Agents**. Bloodstock agents are understood to be agents purchasing Thoroughbred horses or horse interests exclusively for racing and breeding purposes. Most of the law suits and case law on equine agency matters concerns itself with "Bloodstock Agents" due to the higher levels of commissions realized in those sales transactions. As an example, in the case of *Allen Paulson v. Richard J. Lundy, Stephen C. Grod and Executive Bloodstock Agency*, brought in Los Angeles Superior Court in 1992, the Plaintiff, the founder of Gulf Stream Jets and owner of an enormous stable of fine horses including the most lucrative race horse ever, Cigar, sued his trainer and agent, Dick Lundy, for \$1.1 million which represented the sum of commissions earned by the defendants on the sales of several horses. Paulson alleged in his complaint that Lundy and Grod conspired to defraud Paulson. Lundy, a well known horse man in Southern California and trainer of the 1989 Eclipse Award winner, Blushing John, allowed Paulson to take a default judgment against him in 1995 for \$1.7 million. The case has never been appealed and Lundy now trains successfully on the East Coast.

B. **GENERAL AGENTS**. Pursuant to Civil Code § 2297, an agent for a particular act or transaction is called a special agent. All others are general agents. Accordingly, an equine sales agent may either be a general agent or a special agent depending on the instructions given to him/her by the principal. The scope and extent of the agency relationship depends on the terms and conditions of the agreement and the intentions of the parties.

Typically, an agent acts as an intermediary in the purchase or sale of a horse or horse interest and is paid a negotiated commission for his/her efforts in locating a willing buyer or seller. Because the horse business is a small community and the agent may have ongoing or previous relationships or transactions with third persons, it sometimes becomes a prickly question as to whom and for whose benefit an agent is acting. As a rule, agents may not act in a dual capacity unless full disclosure is made to both the buyer and seller, and consent is given for the dual representation. If a sales agent acts as a dual agent without first obtaining the required consent, the seller may void the contract of sale and the agent is not entitled to receive or keep his/her commission.

C. Consignments/FACTORS. A Factor is an agent pursuant to Civil Code § 2367 and as defined by Civil Code § 2026, which states "A factor is an agent who, in the pursuit of an independent calling, is employed by another to sell property for him, and is vested by the latter with the possession or control of the property, or authorized to receive payment therefore by the purchaser." A Factor is both a bailee and a sales agent, and he/she cannot set up an adverse claim to the property or to its proceeds as against the principal. Factors must obey the instructions of the principal to the same extent as any other employee. Factors are the equivalent of a consignee in a consignment transaction.

A consignment transaction creates an agency relationship whereby the Consignor/Owner of a horse delivers actual possession of the horse to his consignee/agent for ultimate sale by the agent, but as the property of the Owner. A consignment is an "in trust" relationship as opposed to a general agency where the agent does not take actual possession of the horse to be sold. In a true consignment, the consignee sells only in the name of the principal.

Equine sales agents may also be consignees if they accept delivery of the horse to their property for training and marketing purposes with respect to a prospective private sale or as normally done in preparation for a public auction. A consignment is a relationship very much like a bailment where the consignee is not a purchaser, but instead, a trustee. Ownership title of the horse does not pass through the consignee, but it moves directly from the consignor to the eventual purchaser. If the consignee agent is acting as a general agent to sell and is given possession of the property, Civil Code § 2325 allows that him/her to directly receive the purchase funds.

A consignment relationship should always be memorialized in writing by an agreement due to the problems that may arise over actual possession of a valuable animal. Further, in a consignment agreement, the owner of the horse has the right to fix the price at which the agent will sell. At public auction, this right plays out by establishing a minimum reserve price. If the minimum reserve price is not met at auction, the consignee/agent has no obligation to sell and deliver the horse to the highest bidder and the horse is returned to the owner. The owner then has the opportunity to enter into a private agreement with the prospective buyer if the owner wishes.

Commercial Code § 2326 amended 1999, controls the consignment of goods, and treats a consignment as either "sale on approval" or a "sale or return." Historically, while the seller's goods are in the

possession of the consignee, they have sometime become subject to the claims of the consignee's creditors. Any question about ownership of consigned horse may be cured by a written agreement between the parties which provides the Owner/consignor with a security interest in his/her consigned property. The retention of a security interest in the owner's horse(s), coupled with the filing of a UCC-1 Financing Statement with the office of the Secretary of State will ensure and perfect the consignor's ownership rights as against the claims of any consignee creditors.

Both consignees and factors have more limited powers than a general agent in so much as they are charged *only* with the sale of the property which has been delivered to them, and they must adhere to the specific instructions provided by the principal on the sale terms or face a potential lawsuit for conversion. However, factors also have additional powers in excess of a general agency because they are given actual authority from their principal, unless otherwise restricted. Pursuant to Civil Code § 2368, factors may also (1) insure the property consigned to them, (2) sell, on credit, anything entrusted to the factor for sale, and (3) delegate his/her authority to a partner or servant.

D. COMMISSION MERCHANTS. A Commission Merchant is a sales representative, similar to a consignee, in that he/she is entrusted with possession of the goods for sale, but does not actually purchase the goods himself. Although a commission merchant was the terminology previously used to mean what was formerly known as a "factor", in today's usage it means a particular type of agent as defined by §§ 42502 and 56105 of the Food & Agricultural Code.

Under the Food & Agricultural Code, an agent or consignor of "farm products" must be licensed under the provisions governing produce dealers. Contained within the definition of "farm products" is "livestock", and livestock includes horses. Any person engaged in the business of buying, receiving on consignment, soliciting for sale on commission, or negotiating the sale of farm products from a licensee or producer for resale, must have a state license.

Equine sales agents probably don't think that they are required to be licensed under the Food & Agricultural Code as Commissioned Merchants in order to engage in the lawful sale or consignment of horses in the state of California, but such a position may not be accurate. In addition, the Food & Agricultural Code has numerous provisions regarding the duties and obligations of Commission Merchants, as well as restrictions on certain conduct.

In researching the question of whether or not the Food & Agricultural Code provisions applied to private and public equine sales, the author could find no case law enforcing said statute against equine sales agents. Further, numerous telephone calls to the Food & Agricultural Department for the State of California failed to produce any person who had a meaningful understanding of the relevant codes as applied in equine sales transactions.

Accordingly, *if* the Food & Agricultural Code is also applicable to equine sales transactions, it appears that it has never been enforced. The author suggests that the only time that the issue might arise would be in the context of litigation where a buyer of a horse wished to enforce the sale against a reluctant

seller who claimed that his/her agent did not have authority to sell the animal. In such a situation, a buyer might argue that the agent was a "Commissioned Merchant" under the Food & Agricultural Code, and thus, § 2403(2) of the Commercial Code operated to protect the buyer.

E. **AUCTIONEERS.** Whether it is an auction at a state fair for cutting quarter horses or the Saratoga Yearling sale where Man O' War was sold for \$5,000 in 1918, auctions and auctioneers have always played an important role in the horse industry.

In its duties as an agent, the auctioneer prepares the catalog, extends credit to purchasers, creates the rules of the sale, and administers the relationship among the parties. In general, an auctioneer has authority to (a) sell by public auction to the highest bidder, (b) to sell for cash only except that the auctioneers own rules for extension of credit may apply, (c) to warrant the title of the seller and the quality of the property sold, (d) to prescribe reasonable rules and terms of the sale, (e) to deliver the property sold upon payment of the price, (f) to collect the purchase price, (g) to pay the purchase price over to the seller, and (h) to do whatever is necessary, in the ordinary course of business, to effectuate the purpose of the auction.

In California, prior to 1993, the Business & Professions Code § 5700 et seq., (The Auctioneer and Auction Licensing Act) regulated the business, conduct and licensing requirements of auctioneers. That statute was repealed and replaced with Civil Code § 1812 et seq., which no longer requires the licensing of auctioneers, but only the bonding of said agents. Civil Code § 1812.607 mandates a list of ten duties which every auctioneer must follow in addition to all of the rest of the duties and obligations imposed on agents. The four key duties imposed § 1812.607 are:

- a. Distribute to the audience the terms and procedures by which the goods will be sold.
- b. Account for, and pay over, the proceeds due the owner or consignor within 30 working days after the sale.
- c. Maintain the owner's or consignor's funds separate from the auctioneers personal funds and accounts.
- d. Disclose to the audience any lien or other encumbrance on the item to be sold.

Auctioneers are unique agents because after the conclusion of a sale, the auctioneer, now holding the purchase price, becomes the agent of both the seller and the buyer. Thus, it appears that an auctioneer, by its very nature, must always act as a dual agent. To some extent, that is correct and an auctioneer is the exception to the rule against dual agency.

In the equine sales arena, auctioneers are considered super-fiduciaries. In *Castille v. Folck*, 338 So. 2d

328 (La. Ct. App. 1976), the Court held that where the horse auctioneer is the "party who makes the rules of the game," he "expresslypledges his own responsibility." The seminal case concerning the "super-fiduciary" duties of an auctioneer is *Chernick v. Fasig-Tipton Kentucky, Inc.*, 703 S.W. 2d 885 (1986). The facts in the *Chernick* case were as follows and are important to understanding the determination of the court which was both political and legal in nature.

1. The Chernicks bought a thoroughbred broodmare named "Fiddler's Colleen" at the Keeneland breeding stock sale held in November 1981, for the sum of \$175,000.
2. The Chernicks repeatedly tried to breed Fiddler's Colleen and were unsuccessful. During the time that they owned her, she spontaneously aborted (slipped) twin foals.
3. Any broodmare that has a propensity to conceive twin foals is less valuable because twin foals are not favored in the industry. This fact greatly reduces a mare's value.
4. The Chernicks placed Fiddler's Colleen in the Fasig-Tipton consignment sale in November, 1982, without disclosing that she had slipped twin foals.
5. Although Fasig-Tipton is one of the premier Bloodstock auction houses in the world, and it conducts a back-ground check of every horse placed with it for sale by accessing the Jockey Club Statistical information as well as requiring a veterinarian's certificate of good health, Fasig-Tipton failed to publish in its catalog the fact that Fiddler's Colleen had slipped twin foals and only stated that she was "barren."
6. Relying on the Fasig-Tipton catalog, Cloverfield Farm purchased Fiddler's Colleen for \$85,000.
7. The day after the sale, Cloverfield had its veterinarian inspect Fiddler's Colleen. Said vet found the broodmare not sound for breeding and Cloverfield declined to accept the broodmare. Cloverfield attempted to return the mare to Fasig-Tipton but the auction house rejected her. Cloverfield then demanded that the Chernicks accept return of the broodmare based on the fact that the catalog contained a material misrepresentation and they refused.
8. The Chernicks then used Fasig-Tipton for the \$85,000 purchase price and Cloverfield intervened; requesting rescission, return of the purchase price, and punitive damages for fraud against both the Chernicks and Fasig-Tipton.
9. The trial court sitting without a jury made exhaustive findings of fact and conclusions of law that (a) the Chernicks committed fraud and actively engaged in misrepresentation in the sale of the broodmare, and (b) Fasig-Tipton was negligent in failing to use ordinary care to obtain accurate information concerning the breeding history of Fiddler's Colleen.
10. The trial court ordered the return of the \$85,000 purchase price of Cloverfield and assessed

\$40,000 in punitive damages against the Chernicks. Both Fasig-Tipton and the Chernicks appealed.

The Kentucky Appellate Court upheld the lower courts determination on all accounts. It stated that "The Chernicks' attempt to unload this (problem) horse on an unsuspecting buyer amounts to conscious wrongdoingand demonstrates a wanton disregard for the rights of others." More importantly, because it has since effected how all auctioneers have conducted business, the Court concluded:

Although under the terms of the consignment contract the Chernicks were responsible for the accuracy of all information contained within the catalog of sale, Fasig-Tipton had a fiduciary duty to the purchaser and to the Commonwealth's most prestigious and valued industry to use ordinary care to ensure that its catalog and/or announcements were as accurate and comprehensive as possible.

The Court further concluded that Fasig-Tipton's then current practices of obtaining information was insufficient to protect against claims of incomplete disclosure.

The *Chernick* decision changed the standard in the auction industry by putting all Bloodstock auctioneers on notice that the courts would view auctioneers' professional fiduciary duties to fully investigate and disclose all material facts under the standard of strict scrutiny.

E. PARTNERS. A partnership is a form of a mutual agency and is governed by California Corporations Code § 16404 which states that a partner owes a fiduciary duty of loyalty and care to the partnership and each partner therein. Further, the duty of loyalty includes the duty to account to the partnership for any property and profits, to refrain from self dealing, to refrain from conflicts of interest, and to exercise good faith and faith dealing towards the partnership and each partner.

Although the California Commercial Code governs the sale of horses in this state,

§ 1-103 states that it does not displace the principles of law and equity relative to the "capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, bankruptcy", or any other validating or invalidating provisions which shall supplement the CCC provisions.

Once again, the seminal case concerning a partner's duties to his partnership comes from the state of Kentucky. In *Marsh v. Gentry*, 642 S.W. 2d 574 (Ky. 1982), the Court held that every partner has the obligation of to account to the partnership for any profit derived without the consent of the other partners in a transaction related to the partnership. Therefore, despite the defendant's contention that his conduct was consistent with current industry practices of secret bidding and non-disclosure of partner as buyer, the Court was not going to approve of such practices which directly contradicted the statute on the duties and obligations of partners. Just as in the *Chernick* case, the Court invoked the importance of upholding the integrity of the horse industry in the state of Kentucky as being paramount.

F. **NON-AGENCIES**. There are several relationships which have the indications of an agency, but which in fact are non-agencies. Those non-agency relationships are: (1) Bailor/bailee, (2) Buyer/Seller, (3) Employer/employee, and (4) Employer/Independent Contractor. All of these relationships lack the imposition of a fiduciary duty upon one of the participants.

V.

SCOPE OF AGENT AUTHORITY

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Civil Code § 2315 states that the measure of an agent's authority is that authority actually or ostensibly conferred upon by the principle. Thus, it is always necessary, when dealing with an agent, to understand the scope of that agent's authority. Persons dealing with an agent must inquire as to the extent of the agent's authority.

A. **ACTUAL AUTHORITY**. Civil Code § 2316 defines actual authority as being that authority which the "principal intentionally confers upon the agent, or intentionally, or by want of ordinary care, allows the agent to believe himself to possess." Actual authority may be implied or express.

Section 2319 of the Civil Code provides "An Agent has authority:

1. To do everything necessary or proper and usual, in the ordinary course of business, for affecting the purpose of his agency; . . ."

The actual authority of an agent may arise as a consequence of conduct of the principal that causes the agent to reasonably believe that the principal consents to the execution of an act on the principal's behalf. Every agent has that authority set forth in Civil Code §§ 2295-2423, unless specially deprived of that authority by the principal.

In the equine sales transaction setting, there is one recent case in California which discusses the actual and ostensible authority of an syndicate manager to bind the members of the syndicate to a license contract which would send their prize stallion, Naevus, to Australia for the 1987 Southern hemisphere breeding season. In *Lindsay-Field v. Friendly*, the Court undertook an analysis of the authority vested in a syndicate manager under a written syndicate agreement and it determined that no actual authority existed to bind the objecting syndicate members to the stallion license agreement because the syndicate agreement required a 75% approval vote and it was not satisfied. Accordingly, because the vote in favor of licensing Naevus did not meet the required percentage as set forth in the syndicate agreement, the syndicate manager did not have actual authority to bind the syndicate to the stallion license. Further, ratification was not possible under the circumstances because a principal cannot ratify if the principal

lacks original power to confer authority. In holding that no breach of contract could be had where the syndicate manager did not have the actual authority to bind the entire syndicate to the stallion license agreement, the Court reversed the trial court ruling and directed that judgment should be entered for the defendant syndicate members.

B. THE EQUAL DIGNITIES RULE. The Equal Dignities Rule is codified in § 2309 of the Civil Code and is a unique California statute which requires that an agent have written authority to bind a principal on any agreements constituting the class of contracts covered by the Statute of Frauds or other laws that make a writing necessary.

The rule is most often applied in real estate transactions or probate matters. However, in a case with equine sales overtones, in *Clifton Cattle Co. v. Thompson*, 43 Cal.App.3d 11 (1974), a third party sued a principal for the purchase price invoiced on three shipments of cattle after obtaining a judgment against defendant's agent. The principal defended by arguing that (1) he had paid his agent the funds and the Plaintiff could only seek satisfaction from the agent, and (2) the Equal Dignities Rule prevented enforcement of the purchase contract falling under the Commercial Code for the purchase of cattle as "goods," because the defendant's agent had not been authorized in writing to buy the cattle.

The *Clifton Cattle Court* found that (1) due to prior dealings between the plaintiff and defendant whereby the plaintiff extended credit to the defendant, it was clear that the plaintiff was not relying on the agent to pay for the cattle, and (2) the Equal Dignities rule did not apply because there is no statute expressly pertaining to the sales of cattle or agency, and despite the language of § 1-206 of the Commercial Code which requires a writing in order to purchase "personal property" with a value of over \$5,000, said statute is made expressly inapplicable to "contracts for the sale of "goods" encompassed by CCC § 2-201(3)(c) which provides that a written contract for the sale of goods is not required "With respect to goods . . . which have been received or accepted." See *Price v. McConnell*, 184 Cal. App.2d 660 (1960.)

Accordingly, the principal was found liable for the entire purchase price of the cattle due to the actions of his agent on the basis that an agent's authorization to deal for the principal may be oral.

Section 2310 of the Civil Code allows the written ratification of an agent's act after it has been completed. The lack of original written authority may be cured by subsequent written authority.

However, it should be noted that under certain circumstances, a principal may be estopped from claiming the benefit of the Equal Dignities Rule based on the principal's own acts or representations.

C. OSTENSIBLE AUTHORITY. Under § 2317 of the Civil Code, ostensible authority is that authority which a principal, "intentionally or by want of ordinary care, causes or allows a third person to believe the agent to possess."

It has been held that ostensible authority must be established through the acts or declarations of the

principal and not the acts or declarations of the agent. Also, where the principal knows that the agent holds himself out as clothed with certain authority, and remains silent, such conduct on the part of the principal may give rise to liability.

A principal is liable for the acts of an ostensible agent when the party dealing with the agent reasonably believes in the agent's authority; when the agent causes the belief; and when the third party is not negligent in relying on the agent's apparent authority.

Generally, if a principal entrusts the agent with possession of the property and the indicia of ownership or the ostensible authority to sell, one who purchases from the agent will be protected under

the general equitable doctrine of estoppel, and under § 2-403 of the Commercial Code.

D. LIMITATIONS ON AUTHORITY. Although an agent generally has the authority to do everything that is necessary and proper to effect the purpose of his agency, a grant of authority expressed in general terms, no matter how broad, does not authorize the agent to do the following:

- (1) Act in the agent's own name, unless it is the usual course of business to do so;
- (2) Define the scope of the agency; and
- (3) Violate a duty to which a trustee is subject under Probate Code §§ 16002, 16004, 16005, or 16009.

Pursuant to Civil Code § 2306, an agent never has authority, either actual or ostensible, to do an act which is, and is known or suspected by the party with whom the agent deals, to be fraud upon the principal.

In the case of *Thompson v. Stoakes*, 46 Cal.App.2d 285 (1941), the Court held that an agent must exercise the utmost good faith, is bound to disclose facts of the transaction, must acquire no secret adverse interest, and cannot lawfully make a secret profit. Further, the Court determined that if an agent conceals his interest in property sold, or buys at a lower price than he charges his principal, he must disgorge the secret profits, even if the property were worth the larger amount and the principal was willing to pay it. This case is most often referred to in the context of real estate litigation; however, its application to equine sales transactions would not be incongruous.

In a case regarding the fiduciary duties of an agent with respect to the purchase of stock, the Court found that an agent is not permitted to make any secret profit out of the subject of his agency. All benefits and advantages acquired by the agent as an outgrowth of the agency, exclusive of the agent's agreed compensation, are deemed to have been acquired for the benefit of the principal, and the principal is entitled to recover such benefits in an appropriate action, and in the absence of special circumstances, moneys received by one in the capacity of agent are not his, and the law implies a promise to pay them to the principal on demand.

This limitation on the authority of an agent would have most certainly come up in the context of any active litigation between Mr. Paulson and Richard Lundy and Stephen Grod as described in Section IV (A) above.

VI.

DUTIES AND OBLIGATIONS OF AGENTS TO PRINCIPAL

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Every agent is a fiduciary with respect to the matters within the scope of his/her agency and owes the principle the following duties and obligations:

- a. The Duty of loyalty and good faith Probate Code § 16002
- b. The Duty of obedience to instructions CC § 2320
- c. The Duty of full disclosure CC § 2020
- d. The Duty to exercise skill, care and diligence
- e. The Duty to account Probate Code § 16009 and CC § 2020
- f. The Duty not to Retain Secret Profits CC § 2020
- g. The Duty to avoid conflicts of interest Probate Code § 16004

Acts in violation of a fiduciary duty of an agent are regarded as fraudulent. See *Ramey v. Myers*, 159 Cal. App.2d 82 (1958), citing *Darrow v. Robert A. Klein & Co., Inc.*, 111 Cal. App. 310, 316, (1931) where the court determined that "A violation of duty on the part of a trustee is treated as a fraud upon the beneficiary and a violation of duty on the part of an agent should be treated in the same manner."

A. **The Duty of Loyalty and Good Faith.** The obligation of an agent to his principal demands of him the strictest integrity, good faith and most faithful service. *Boulenger v. Morison* 88 Cal. 664 (1928). An agent is a fiduciary whose obligation of diligent and faithful service is the same imposed upon a trustee. *Spector v. Miller*, 199 Cal.App.2d 87 (1962). The relationship of a principal to an agent is fiduciary in character and the law imposes on the agent the highest good faith towards his principal. *Gammon v. Ealey & Thompson*, 97 Cal.App. 452 (1929).

The duty of loyalty has been defined to mean that an agent may not engage in self-dealing for his own benefit. In addition, the duty of loyalty demands that an agent is not permitted to simultaneously serve two principals whose interests' conflict about the matter served — at least, not without full disclosure and consent from both. An agent therefore cannot be a dual agent.

"Good Faith" has been held to mean an "honesty of intention" and encompasses among other things, an honest belief, the absence of malice and the absence of design to defraud or to seek an unconscionable advantage. *In re Marriage of Reuling* 23 Cal.App.4th, 1428, 1438 (1994), see also *Marriage of Duffy*, 91 Cal.App.4th 923 (2001).

B. Duty of Obedience to Instructions. Pursuant to Civil Code § 2320, it is a general principle of law that an agent must act within the terms of his authority, and a substantial variance therefrom defeats his right to compensation.

Under the Restatement of Agency (Second) § 469 the rule is that "An agent is entitled to no compensation for conduct which is disobedient or which is a breach of his duty of loyalty."

C. Duty of Full Disclosure. Pursuant to Civil Code § 2020, an agent must use ordinary diligence to keep his/her principal informed of his acts in the course of the agency. The suppression of pertinent and material facts by an agent is fraud. An agent has the duty to exercise ordinary care to communicate to his principal knowledge acquired in the course of his agency with respect to matters pertaining to it. An agent must disclose all information relevant to the agency that the principal would desire to know or that might effect the principal's decision for a transaction.

The duty of full and fair disclosure requires that an agent account to his principal for secret profits and kickbacks. This is also indicated in the duty of an agent to provide a complete accounting. See *Arcturus Mfg. Corp. v. Rork*, 198 Cal.App. 2d 208 (1961), where the Court determined that all benefits and advantages acquired by an agent as a result of the agency relationship, exclusive of the agreed compensation, are deemed to have been acquired for the benefit of the principal, and the principal is entitled to recover those benefits.

D. Duty to Exercise Skill, Care and Diligence. An agent is ostensibly a professional. Principals usually seek their assistance to facilitate transactions using a requisite level of skill, care and diligence. Usually, as part of the agent's duty to use reasonable care, diligence and skill, the agent will be held to a higher standard. If the agent violates this duty, he/she may become liable for any losses sustained by the principal as a result of the agent's negligence.

The question of this breach of duty lay at the middle of an equine related lawsuit in *Gebert v. Yank*, 172 Cal. App. 3d 544 (1985). In the *Gebert* matter, the plaintiffs sought damages against a respected bloodstock agent, Albert Yank, for loss of their filly. In 1978, the plaintiffs decided to place their filly in the CTBA select sale at Del Mar, California. In preparation of the sale, the plaintiffs employed Albert Yank as their agent and they transported their filly to his facility, the Swiss Ranch, for prep work, schooling and training. While at Swiss Ranch, the filly was walking with a groom when she became entangled in a loop in the lead chain, reared up, and fell backwards injuring herself. Unfortunately, the filly's injuries were so severe that she was euthanized that very same day.

At trial the plaintiff's argued, and it was a matter which was hotly contested, that looping a chain around the filly's head constituted a negligent handling of a thoroughbred race horse. Numerous witnesses appeared for both parties testifying to the fact that chain loop leads were either careless, or industry standard. Even hall of fame jockey, Johnny Longden, appeared for the defense at the ripe old age of 77.

Because the plaintiffs only pleaded a cause of action for negligence and breach of bailment, the Court

was limited in its discussion of the duty of skill, care and diligence required of an agent. At the trial court level, the plaintiffs were awarded damages for breach of a bailment but denied any recovery for their negligence claim. The defendant appealed the finding of a bailment.

The Appellate Court determined that the consignment of the filly to Albert Yank and Swiss Ranch was a bailment of a living creature even though Yank was clearly in the business of being a bloodstock agent and accepting consignment of horses for sale. The Appellate Court determined that the burden of proof fell on the defendant, Albert Yank, to prove that the inability to deliver the filly to her owners was not the result from his own negligence. Because Yank was unable to show that by a preponderance of the evidence all of the fact necessary to show that the loss of the filly occurred without negligence on his part, the Court upheld the judgment.

Quite frankly, this is a perplexing case in the annals of California equine law. In light of the law concerning the duties due from agents and the higher standards of care imposed on consignors, it appears that the original causes of action were not well plead, and the finding of a bailment (a non-agent relationship) does not make much sense.

E. Duty to Account. The agent's duty to account to his principle is embodied in two separate statutes Probate Code § 16009 and CC § 2020. The agent's duty to account ordinarily includes the duty to inform the principle of the amount due as well as the duty to maintain accurate records to all persons involved in the transaction, dates and amounts of goods received, and any and all payments made. *Kennard v. Glick* 183 Cal. App. 2d 246 (1960).

The duty to account to the principal for secret profits and kickbacks is fundamental. See *Arcturus Mfg. Corp. v. Rork*, 198 Cal.App. 2d 208 (1961). The Restatement, Second of Agency § 388, states: "Unless otherwise agreed, an agent who makes a profit in connection with transactions conducted by him on behalf of the principal is under a duty to give such profit to the principal." § 403 of the same Restatement reads: "If an agent receives anything as a result of his violation of a duty of loyalty to the principal, he is subject to a liability to deliver it, its value, or its proceeds, to the principal." In the comment to section 403 it is said, "The principal has a cause of action either for a breach of contract or for a tort, as a remedy for damage caused by the violation of any duty of loyalty on the part of the agent. The principal may also charge the agent with anything which the agent receives as a result of the violation of duty, its value or its proceeds."

In *Van de Kamp v. Bank of America*, 204 Cal. App. 3d 819 (1988), the Court stated that the agent's duties to his principal include the duty to account for profits arising out of the employment.

E. Duty Not to Retain Secret Profits. The duty of an agent not to retain secret profits falls under the obligations arising under heretofore discussed duties such as the duty to account and the duty of loyalty. However, in and of itself, this duty also stands alone because it may just be the duty most often violated. Agents are very often asked to step into the business of the principal and affect an outcome usually having some pecuniary interest. But for the agent seeking the expertise, experience, advice and

involvement of the agent, the agent would have nothing to do but read the newspaper. In the course and scope of their engagement, the agent often acquires some inside or confidential information which provides the principal with an edge. If the law allowed the agent to capitalize on this situation and feather his own bed, agents would cease to exist because principals would have no incentive to use them. If all the benefits and advantages of a transaction were always captured by the agent, principals would be less willing to undertake business transactions and the business economy would suffer.

Accordingly, there can be no secret profits allowed to the trustee, inasmuch as it owes to the beneficiary the duty of fullest disclosure of all material facts. *Wyatt v. Union Mortgage Co.* 24 Cal. 3d 773, 782 (1979).

In the equine sales arena, several cases have been brought over the transgression to this particular duty. See *Gussin v. Shockey*, NO. 90-1402 (US Ct. Ap. Maryland 4th Cir. 1991); *Marsh v. Gentry*, 642 S.W. 2d 574 (Ky. 1982); *Paulson v. Lundy, Grod and Executive Bloodstock Agency*, Los Angeles Superior Court (1992); *Johnson v. Moore*, No. 87-CI-273 (Cir. Ct. Woodford County, Ky. 1992); *Victor v. Spragg*, No. 92A-007392-4 (Cobb County, Georgia 1996); *Laxson v. Giddens*, No. 10-99-215-CV (Court of Appeals, Texas, 10th Dist. Waco, 2001).

In both the *Gussin* and *Victor* cases, the agent/trainer admitted to the taking of a secret profit and argued that such conduct was "common practice" in the industry. In none of the case cited above were the courts at all sympathetic to this argument. Each and every court recognized the duty of the agents not to retain a secret profit and ordered that the commissions be disgorged and the profits turned over to the principal.

In the *Johnson* case, the secret profits were taken by a Saddlebred trainer. The dispute started rather insignificantly over the possession of some tack. Through the discovery process, the plaintiff learned that over the course of time beginning 1983 through 1987, plaintiff's trainer earned several secret profits on the sale of plaintiff's horses by convincing the plaintiff to sell to her several horses for less than their true value. The trainer would then "flip" the horse by reselling it at an inflated price. The plaintiff purchased 40 horses through her trainer over a four year period for a total investment of \$2.2 million. The Johnson court took testimony regarding the custom of trainers acting as agents in the Saddlebred industry and found that owners customarily rely completely on the advice of their trainers with respect to the purchase and sale of horses. The Court held that given this close relationship, the defendant trainer owed Johnson a duty not to compete with her on her own account, not to act adversely to Johnson's interests, and to deal fairly with Johnson in sale transactions. Further, the Court concluded that it was fraudulent for the trainer to induce her principal to sell to her a horse at a low price when the trainer was in the midst of negotiating with a buyer the resale of the same horse for a higher price. Based on such fraudulent conduct, the Court imposed punitive damages against the trainer. In the end, the plaintiff won a judgment for \$173,500 representing the wrongfully retained secret profits, and punitive damages equal to three quarters of her attorney's fees.

When interviewed about the case, plaintiff's attorneys stated that they believed the decision "would set a

precedent in educating owners, trainers and agents in the show horse industry about the duties owed to each other."

F. **The Duty to Avoid Conflicts of Interest.** The Duty to Avoid Conflicts of Interest is specifically codified in Probate Code § 16004(a), which applies to trustees and fiduciaries. An agent may not deal with himself to the detriment of his principal. *Schmidt v. Waterford Winery Ltd.*, 177 Cal.Ap.2d 28 (1960). An agent is not allowed to lace himself in antagonism to his principal in conducting the business of the agency. *Rezos v. Zahm & Nagel Co.* 78 Cal.App.728 (1926).

VII.

EXAMPLES OF WRONGFUL CONDUCT BY AGENTS AND REMEDIES

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- a. Undisclosed commissions (Secret Profit)
- b. Illegal Kickbacks
- c. Dual Agency
- d. Padding the Stallion Fee
- e. Bi-bidding

A. Undisclosed Commissions and Secret Profits. Owners rely so heavily on the relationship that they have with their agents, they very often are not aware of the exact terms of an equine sale transaction. Because the sales agents are not as heavily policed as other types of agents such as real estate agents or securities brokers, it leaves the door open for equine sales agents to accept commissions from someone other than his/her principle. So too, secret profits may be derived from ingenious schemes perpetrated on trusting owners by unprincipled agents. The schemes usually involve the agent as an undisclosed buyer, buying for his own account, or the use of a third party who may be part of a conspiracy to defraud.

Remedies. Usually, secret profits and undisclosed commissions may be recovered through the imposition of a constructive trust. However, when the funds no longer exist as *res* and have been dissipated, the principal's only form of recovery is a judgment for money damages. See also the remedies provided below in Section B.

B. Illegal Kickbacks. An illegal kickback is a promise by either a buyer or seller, but not the principal, to provide the agent with a percentage of the purchase price as a bonus to facilitating the sales transaction. It is presumed that the agent does not disclose the offer of a kickback to the principal; otherwise, if the agent obtained the consent of the principal, it would be an allowable commission.

In *Gussin v. Shockey*, NO. 90-1402 (US Crt. Ap. Maryland 4th Cir. 1991), the trainer assisted two investors in the purchase of Thoroughbred race horses for the total sum of \$2.7 million. Shockey quoted to his principals a "fair price" for the investments and his principals accepted his judgment and paid the price. What the Gussins did not know is that the price quoted to them was padded with a kickback amount promised by the sellers of the horses so that when the Gussins paid the quoted amount,

defendant Shockey would then receive some of the purchase price from the sellers in addition to his regular commission from the Gussins.

On summary judgment for breach of fiduciary duty, the Court awarded the Gussins the full amount of \$575,000 in kickbacks on the purchase of seven horses. During discovery, Shockey was candid about his dealings and the details of his arrangements with the sellers and stated on the record that he did not tell the Gussins about the kickbacks because he did not think it would be in *his* "best interests."

Remedies. Breach of Contract, Breach of fiduciary duties, Fraud, Misrepresentation, imposition of a constructive trust, punitive damages to punish agent for willful misconduct. In addition, Restatement of Agency (Second) (1958) §§399 and 401, and Restatement (Second) of Torts (1979) § 874, provide that fiduciaries are liable under contract and tort theories for any harm suffered by the principal as a result of a breach. If the Buyer is upset enough, he may also move to rescind and void the sales transactions, even in the absence of bad faith or actual harm. See *Beasley v. Trontz*, 677 S.W. 2d 891 (Ky. Ct. App. 1984).

C. Dual Agency. An agent cannot have two masters unless they both consent to the arrangement. In the absence of consent, an agent may not receive two commissions on one sales transaction. Dual Agency violates the duty of loyalty to the principal except in the case of auctioneers.

Remedies. In addition to those stated above in Section B, the principal may seek disgorgement of the offending commission. The agent may also be found liable for any loss suffered by the principal on the transaction.

D. Padding the Stallion Fee. Agents very often work to buy owners a season or a share of a stallion. This gives the principal the right to breed his broodmare(s) to a certain stallion during a particular year, or to have a license to breed every year the stallion is in service.

In the Bloodstock industry, many stallion owners publish a flat stud fee in a directory. The fees may run from \$500 to \$500,000. Currently, the reigning champ for high stud fee is Storm Cat at Overbrook Farm with a live foal guarantee (LFG). His stud fee is \$500,000. Before Seattle Slew passed away in May, 2002, he was able to command a stud fee of \$250,000. Deputy Minister has a published fee of \$150,000 while Danzig's fee at Claiborne is considered private. In addition to paying the fees, the principal must apply to these stallions' book and be accepted by the stallion manager as being of sufficiently good pedigree. There are numerous stories of broodmare owners who were turned away from the books of great stallions due to inferior race records or stakes progeny.

Other owners prefer to offer the stallion service under a "private treaty arrangement." Still other owners offer reduced or discounted stallion fee without a guarantee of a live foal. Some owners offer discounted stallion fees if the principal intends to breed more than one broodmare to the stallion. Some don't require payment of the stallion fee until the foal stands and nurses.

With all of these variables, an owner of a broodmare who is not immersed in the industry himself

requires the need of a good agent to negotiate the terms of obtaining a breeding for a mare.

In addition, big money is involved in the purchase of a syndicate share in a hot stallion. As recently as September 11, 2002, Kentucky Derby winner, War Emblem was sold for stud duty in Japan in 2003 for the sum of \$17 million. The buyer, Zenya Yoshida, agent for Shadai Stallion Station on the island of Hokkaido, stated that War Emblem would be syndicated. His stud fee has not been established yet. A syndicate share in War Emblem could cost upwards of \$1 million, and usually will provide that the syndicate shareholder shall have the right to at least one breeding to him a year, which season may be sold with or without restrictions.

Since the Jockey Club does not allow artificial insemination of any horse who intends to race in North America any owner in the United States who wishes to breed a broodmare to War Emblem will be required to ship his mare to Japan. Before shipping, he will want to engage an agent who will secure the right to breeding.

Very often, an agent can cut a good deal on a stallion fee without the principal being made aware of it. In such a case, an unscrupulous agent might tell his principal that the stallion fee was non-negotiable when in fact he was able to obtain a discounted rate. The agent might then pocket the difference without anyone being the wiser. This, of course, is highly illegal because it constitutes a fraud on the principal and violates the agent's fiduciary duties to his client. Nevertheless, it happens all the time.

Remedies. In addition to those stated above in Section B, the principal may seek disgorgement of the amount which the agent netted from the stallion fee transaction.

E. Bi-Bidding. Bi-Bidding only occurs in the public auction setting. It is possible when the conditions of the sale allow owners to bid on their own horses, a practice that would otherwise be unlawful if it were not expressly allowed by the Uniform Commercial Code § 2-328(4). Bi-bidding is used to force up the sales price on a horse beyond what it might have been if the owner had not bid against the final bidder. Bi-bidding is used at the major auction houses by agents to give the appearance that certain offspring of a particular stallion command premium prices at auction. Obviously, the agent engages in this conduct when he is selling a horse by the target stallion. Bi-Bidding is a way for agents to increase their commission on the sale of a horse being presented later in an auction. Typically, an agent will engage the services of at least two other phantom bidders to bid against each other. Very often, the two phantom bidders do not know the identity of the other. The ultimate sales price of the agent's charge may not be fair market value at all, but a deliberately created and manufactured scheme to defraud the public. Bi-bidding is a common practice and custom within the Bloodstock industry and is its dirty little secret.

Remedies. If a buyer realizes that Bi-Bidding has occurred, the buyer may rescind the sale transaction because it is fraudulent. However, the buyer runs the risk that the auction house may not agree with the buyer's assessment of the sale transaction and may refuse to void the sale. In addition, the buyer runs the risk of being publicly blacklisted if he challenges a sale by a major auction house for bi-bidding reasons. Other auction houses may not allow that buyer to bid on future auctions. Because Bi-bidding is

pervasive, insidious, and accepted as a common practice, there are those who refuse to purchase horses at public auction. On the other hand, there are also those who engage in public auctions because Bi-bidding provides them with an opportunity for immediate recognition in the Bloodstock industry. One example, in 1997, Padua Stables bought a yearling colt by Mr. Prospector for \$2.3 million at the Keeneland September select sale. Padua Stables made history with that purchase. It was the most expensive yearling purchased that year. Padua Stables was a brand new player in the industry, and its owner, Satish and Ann Sanan, made millions of dollars when their high technology company went public. Padua Stables was not concerned with the potential for the colt to win back his purchase price in purse money, but instead, Padua Stables wanted instant recognition. It got it.

Currently, the world-record ridiculous price for a yearling at public auction is \$13.1 million, paid for Seattle Dancer at the 1985 July Keeneland sale. Seattle Dancer is a half brother to Triple Crown winner Seattle Slew and is currently standing stud in Japan at East Stud. He was purchased by Robert Sangster and raced only five times as a three year old, winning twice and earning a total of \$150,000.

CONCLUSION

Because equine sales agents derive their livelihood from commissions generated by the money spent by owners in the purchase of horses, stallion fees and seasons, it is critically important for the owner to find an ethical agent with a good reputation.

For agents, the days of getting by on custom and practice are waning. In today's marketplace, the new owners have the expectation of professionalism and accountability from their agents, and they are not afraid to sue in order to vindicate their rights. Due to the increasingly lofty amounts of money spent on horses, and the number of transactions that are being transacted by and between individuals who may not have prior dealings with each other, a handshake deal is no longer a responsible way of conducting business. In order to ensure the longevity of a business in equine sales, a reputation of an agent, and a solid and mutually beneficial relationship between a principal and his/her agent for the long term, equine sales agents and owners should become more aware of their duties and obligations under the law with respect to equine sales transactions and the law of agency, and they should work together to standardize their respective practices by committing to a formal writing the terms, conditions, intentions, expectations and scope of any agency relationship.

Although outside the scope of this article, it should also be noted that in 1986 the United States Congress passed a revision to Section 183 of the Tax Code regarding hobby losses for horse ownership enterprises which requires Owners to engage professional advisors and experts such as bloodstock agents, attorneys and accountants in order to prove that the losses suffered from the ownership of horses is a business loss rather than just a hobby loss. Because of this, more and more Owners are finding themselves having to rely upon agents to help them operate, manage, run their horse ownership ventures pursuant to sound business practices. This makes understanding the basic tenets, duties, obligations and expectations of an agency relationship all the more important to Owners.

END OF ARTICLE

The information provided herein is not intended as legal advice and should not be acted upon. If you have additional questions about this subject matter or would like to consult with an attorney, please call Jennifer J. Hagan or James Hagan at The Hagan Law Firm (650) 322-8498.

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