# CURRENT LAW ON FRAUD AND SALE OF HORSES

By

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Those of us who practice frequently in the equine area have recently observed an increasing number of claims of fraud asserted in connection with the sale of horses at public auction. This does not appear in any way to represent an increase in nefarious activities on the part of sellers. Rather, the increased utilization of veterinary information by buyers to closely scrutinize their purchases, whether before or after sale, coupled with their natural suspicions about what their seller may have known in advance have caused in many cases these claims to at least be investigated, even if not ultimately pursued.

Because a flurry of negotiations between the buyer, auction company and seller often occur immediately after a problem is discovered it is worthwhile for any practitioner to be cognizant of the current law regarding fraud in connection with the sale of horses at public auction in order to prudently advise their client.

The pervasive question to ask oneself in reviewing these cases may be whether disclaimers of warranty in connection with such a sale can in and of themselves negate a claim of fraud on the part of the buyer. A related, but more troubling question, is whether such a result is appropriate given the fundamental importance of the integrity of the industry's auction sales.

The starting point for our analysis is the case of *Keck v. Wacker*, 413 F.Supp. 1377 (1976). Though the court there found that there had been no actionable fraud in connection with a statement that a mare sold as "barren" (bred, but failed to conceive) had in fact "slipped" (was bred, found in foal after 42 days but later found to no longer be carrying a foal), Judge Siler identified the elements of actionable fraud as follows:

(1) that [the seller] made a material representation;

(2) that it was false.

(3) that when he made it he knew it was false, or made it recklessly, without any knowledge of its truth and as a positive assertion;

(4) that he made it with intention of inducing [the buyer] to act, or that it should be acted upon by [the buyer];

(5) that [the buyer] acted in reliance upon it, and

(6) that [the buyer] thereby suffered injury.

413 F.Supp. At 1383.

The next published opinion to take that test and apply it to sufficient facts was *Chernick v. Fasig-Tipton, Kentucky., Inc.*, Ky. App., 703 S.W.2d 885 (1986). The Kentucky Court of Appeals there had no difficulty in upholding a trial court verdict of rescission and punitive damages against the seller of a thoroughbred mare. The proof at trial revealed that the mare in question was unfit for breeding, had aborted twins in a prior year and had been bred to two different stallions in the current year prior to being listed as barren in the catalog, none of which facts were disclosed in the catalog or by announcement to prospective purchasers.

All of the information regarding the mare's produce history, fitness and pregnancy status had been warranted under the Conditions of Sale to be true and correct as stated in the catalogue. In this factual sense, then, *Chernick* easily satisfied the notion of a breach of a duty to disclose on the part of the seller since the information and facts in question were the subject of an affirmative warranty under

the applicable Conditions of Sale. The misrepresentations of the seller supported the punitive damage award. As the court stated in its Opinion:

The Chernicks argue that there was no evidence to support the award of punitive damages. This court is in complete agreement with the Fayette Circuit Court's findings and conclusions and will not disturb the aware of punitive damages. That such damages are appropriate is found in the overwhelming evidence that the Chernicks were aware many months before the sale, during the sale and following the sale, that the mare had a profound defect which made her unsound for the purposes of breeding. Although the Chernicks have throughout attempted to portray themselves as "novices in the thoroughbred industry," Mr. Chernick admitted that Fiddler's Colleen was a "problem mare." It is not disputed that her "problems" were not revealed to Fasig-Tipton or to any potential buyers. The trial court found, and we agree, that her condition was deliberately and consciously suppressed. The Chernicks' attempt to unload this horse on a unsuspecting buyer amounts to "conscious wrongdoing." *See Fowler v. Mantooth*, Ky., 683 S.W.2d 250 91984), and, as the trial court found, demonstrates the Chernicks' "wanton disregard for the rights of others," *see also Hensley v. Paul Miller Ford, Inc.*, Ky., 508 S.W.2d 759 (1974), and *Island Creek Coal Co. v. Rodger*s, Ky. App., 644 S.W.2d 339 (1982), thereby warranting the imposition of punitive damages. 703 S.W.2d at 888.

After *Keck v. Wacker* and *Chernick v. Fasig-Tipton*, the next departure into uncharted waters in auction sales was the case of *Cohen v. North Ridge Farms, Inc.*, 712 F.Supp. 1265 (E.D. Ky. 1989). In that case, the purchaser of a thoroughbred yearling sought rescission of his $575,000 purchase on a host of grounds, including fraud on the part of the seller, North Ridge Farms.

The alleged defect in the subject yearling was related to the horse's wind, a condition not warranted under the applicable Conditions of Sale for the sale of a thoroughbred yearling at that auction and therefore specifically disclaimed under the "as is" disclaimer of the sale. The essence of the buyer's claim for misrepresentation was

that because North Ridge failed to inspect, discover and thereafter disclose the alleged defect in the yearling, the sale contract was required to be rescinded.

In response, North Ridge argued it was under no duty to discover and disclose an unknown, unwarranted condition. In granting its Motion to Dismiss, the court stated:

Plaintiff seems to forget that North Ridge was under no duty to him or any other prospective purchaser to inspect, discover and disclose any defects in this yearling. Plaintiff was put on notice by the Conditions of Sale that (1) this yearling was being sold "as-is," with no warranties, and (2) he assumed the risk of loss.

Plaintiff's claim for misrepresentation might be proper if this horse had been a two-year-old, where there are generally more guarantees and warranties, especially as to wind. However, it seems that plaintiff, a man experienced in the horse business, has lost sight of the fact that he purchased a yearling, with no warranties, express or implied. Therefore, his claim for misrepresentation must be dismissed. 712 F.Supp. At 1272

A reading of the *Cohen v. North Ridge* Opinion, therefore, on its face seems to suggest that where the defect complained of is otherwise disclaimed in the context of warranties, a claim for actionable fraud cannot be maintained. The question then, beyond the face of the Opinion, is whether such a result would follow in a case where proof was offered that the seller had actual knowledge of such a defect and the defect was material to the buyer, but not otherwise warranted. Arguably, such a broad principle from *Cohen* is limited only to a situation where there is an alleged *omission* and no active concealment of the truth. Said another way, the rule of *Cohen* might be that absent proof of active concealment, the buyer under such circumstances, is the loser.

The next case to confront this issue was *Keeneland Association, Inc. v. Eamer*, 830 F.Supp. 974 (E.D. Ky. 1993). In Eamer, the buyer sought to pursue a claim of fraud based upon a filly's

owner's alleged misrepresentations concerning the condition (bone imperfections seen on an x-ray) of the filly's front hooves, a defect in the filly's coffin bones, failure to disclose OCD lesions and that the filly was a cribber. In its Opinion the court concluded based on the record that neither the seller nor the seller's veterinarians were aware that the horse suffered from any condition that would impair its performance as a racehorse. There was also no evidence of any active concealment on the part of the seller. Finally, there was apparently also no claim that the seller deliberately elected "not to know" of the existence of these suspected problems. The *Eamer* opinion it could be argued at least suggests that the buyer has a duty to conduct a pre-sale inspection and the failure to do so will defeat a claim of fraud. However, it unclear whether this would be true under the Opinion in such a case if proof of active concealment of a problem could be presented.

Finally, we are brought to the unpublished Court of Appeals Opinion in *Newman v. Armstron Holdings Ltd.*, Opinion No. 94-CA-1350 MR. While mindful that the Opinion cannot be cited as authority, the Opinion is based upon a trial court determination from the Fayette Circuit Court and is certainly food for thought before advising a client to bring a claim for fraud in connection with the sale of a horse at public auction. In the face of a fraud claim, the trial court in *Newman* dismissed the Complaint and the Court of Appeals upheld that dismissal relying on the buyer's "failure to inspect" as precluding such a claim, stating:

Nothing alleged in the proceedings before the trial judge or in his brief to this Court is sufficient to relieve appellant of the effect of the plain and conspicuous disclaimer contained in his agreement to purchase the colt. Appellant's failure to have the colt inspected prior to sale is, in the opinion of this court, the critical factor in this controversy and the sole cause of his dissatisfaction with his purchase. As stated in *Keeneland Association, Inc. v. Eamer*, 830 F.Supp. 974, 994 (1993):

Since O.C.D. lesions can only be detected by x-rays or seen in surgery, and since the Filly was sold "as-is," Eamer had the duty to exercise reasonable diligence in inspecting the Filly. *Cohen v.*

*Wedbush, Noble, Cook, Inc.*, 841 F.2d 282 (9th Cir. 1988). Thus, Eamer was obligated to fully inspect and examine the Filly, including x-rays, prior to the sale, and Eamer cannot pass the buck to the owners for his failure to have the Filly examined prior to the sale when he knew or should have known that the Filly was being sold "as-is," with no warranties.

Thus, as noted, to read these recent decisions as precluding a claim for fraud where evidence of actual knowledge of an alleged material defect (although not separately warranted) can be produced, may be inconsistent with the essential elements of actionable fraud as set forth in the basic Kentucky fraud cases. In fact, the "failure to investigate" defense is squarely rejected by the Restatement (Second) of Torts, Section 540, where there is evidence of an actual misrepresentation.

The difficult issue is the "no duty" maxim as set forth generally in *Cohen*. In contrast to the broad statement in *Cohen*, where a misrepresentation is made, "duty" is not a required element of a fraud claim. See Restatement (Second) of Torts, Section 531, which states the general rule that a defrauding party is liable to any class of persons he would have reason to expect to act in reliance. The rule is different in an omission case; "duty" must be shown. See Restatement (Second) of Torts, Section 551.

Some commentators and Kentucky cases suggest the confusion on these issues may relate directly to factual distinctions. Since reliance of the Buyer on a misstatement by the Seller is generally an element of actual fraud, how can a seller who is guilty of an "omission" of a material fact be said to have induced reliance on the part of a buyer? *See e.g.*, *Fasig-Tipton Co. v. Jaffe*, 449 N.Y.S.2d 268 (N.Y. App. Div. 1982). The answer may ultimately be that an omission by the seller, standing alone, cannot support a fraud claim. That omission must be coupled with proof of guilty knowledge or concealment (for example, through the administration of medication) in order for the buyer to recover.

The difficulty these issues present for advising consignors relates

primarily to decisions they may make about acquiring knowledge of certain facts prior to the sale. While the recent cases would seem to suggest that so long as there is no active concealment of a discovered defect the seller is out of harm's way, the Restatement and earlier Kentucky cases dealing with the elements of actionable fraud, would suggest caution in such advice.