

A Commission Quandary Plays Out in Kentucky Courts

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Can someone serve two masters? Well, if that someone is, for example, a real estate broker, the answer is a qualified “yes.” In most jurisdictions, a realty agent is permitted to receive compensation from both buyer and seller so long as both sides of the transaction are fully aware of all of the details of the “dual agency” relationship and both consent to it. The question as to why two informed folks on opposite sides of a deal would ever agree to such an arrangement is better answered by someone schooled in the field of psychiatry.

Late last month, the state and federal courts in Kentucky were presented with a unique twist on the dual agency concept, and the backdrop for the hullabaloo was none other than the state’s storied racehorse breeding industry. While the facts that make up the clash are somewhat complex, the end result is both simple and straightforward... and not without its own controversy. Read the facts, follow the reasoning of the judgment and decide if you agree with the conclusion.

Lane’s End is a 2,000 acre Thoroughbred breeding farm in central Kentucky. It is arguably one of the top operations in the world. Its syndicated stallions include Breeders’ Cup and Triple Crown Classic race winners and horses of the year. Two of these stallions, 1999 Belmont – Travers winner Lemon Drop Kid and his sire, the recently pensioned Kingmambo, were the subjects of the dispute.

Lane’s End is a syndicate owner in both stallions, as well as the manager for each consortium. Ashley Andrews owns one syndicate share in Lemon Drop Kid, while Andrews and Robert Raphaelson together own a share in Kingmambo. The terms of the respective syndicate agreements provide that no member may sell their interest in either stallion without first offering the soon to be purchased share for the same price to all other syndicate members. This vests in all other members what is known as a “right of first refusal.” The process is rather simple: a member or his agent receiving an offer to purchase his shares notifies the syndicate manager who, in turn, notifies all syndicate members that they have a seven-day window to exercise their option to purchase the share by matching the offered price.

Last September, an entity known as KNC Investments, LLC offered Andrews \$350,000 for his share in Lemon Drop Kid, and offered Andrews and Raphaelson \$175,000 for their share in Kingmambo. Notices disclosing the offered prices were sent in accordance with the syndication agreements to Lane’s End by Jerry Jamgotchian, a California-based Thoroughbred owner/breeder who acted as a broker for the transactions. The initial notices stated that both purchase prices included a commission to Jamgotchian. Lane’s End promptly sent notice of the offer to all other syndicate members. Then, Lane’s End apparently had second thoughts.

Six days after sending the notices, and one day before all members' first refusal rights would have expired, Lane's End went into Kentucky state court and obtained a temporary restraining order, or TRO; a device used to stop the clock from running out on the seven day window. Lane's End argued that the Jamgotchian notices were defective, primarily because they did not specify the exact commission amount he was to be paid, and thus did not present syndicate members with sufficient information in order to make a decision about exercising first refusal rights.

In response to the TRO, Andrews and Raphaelson disclosed the full purchase agreements. They revealed that the purchase price for each transaction included a \$50,000 commission payable to Jamgotchian, meaning that the true purchase prices for interests in the horses were \$300,000 and \$125,000 respectively. Upon receipt of this requested information, Lane's End didn't voluntarily discontinue the TRO. Instead, it went back into court to get a second one.

What was the syndicate manager's main complaint this time? Simply this: That Jamgotchian was an owner of KNC Investments, LLC, the proposed purchaser. Thus, the premise was that inasmuch as Andrews and Raphaelson had to pay \$50,000 on each purchase to a broker who was acting for both sides of the deal, they were in reality only realizing \$300,000 and \$125,000 for the horses. Lane's End argued that amended notices should state that first refusal rights may be exercised by paying only the true value of the share, meaning less the commission, instead of having to pay the full purchase price contained in the previous notices, which included the dual agent's commission. The dual agency arose by virtue of Jamgotchian being a principal of the buyer while charging the seller(s) a finder's fee commission. It argued that the arrangement was not simply unfair, but also violated a Kentucky statute that prohibits any dual agent from receiving more than a \$500 in an equine transaction without the prior written consent of purchaser and seller. Its alternative position was that if the first refusal option was exercised by any member for either horse, Jamgotchian should receive no more than an "industry standard" commission of 5%. Those amounts, \$15,000 for the Lemon Drop Kid share and \$6,250 for Kingmambo share, were obviously significantly less than what Jamgotchian had in mind.

To make it easier to appreciate the syndicate manager's concern, consider that since Jamgotchian was an owner of KNC, the thought was that purchaser KNC was getting back a rebate of \$50,000 on each transaction from its alter ego broker. If, however, anyone else in the world purchased from Andrews and Raphaelson, including syndicate members, they would not only be required to pay for the commission Andrews and Raphaelson owed to Jamgotchian, but one far in excess of what the marketplace bears. Lane's End's argument was that the arrangement effectively destroyed the right of first refusal vested in syndicate members, since presumably no one would agree to pay such a significantly inflated price for a stallion share.

As citizens of different states have a right to have their disputes decided by federal courts, the defendants in the lawsuit removed the case to federal court in Kentucky. On January 28, 2011, the federal judge assigned issued her ruling.

Initially, the court determined that since full disclosure of the purchase terms had been made, the September TRO should be vacated and discontinued. As to the content of the amended notices to be sent to the syndicate members, the court ruled that since the purchase agreements obligated Andrews and Raphaelson to pay the commissions in the event the share price is matched, syndicate members choosing to purchase must include the full commission amount in their offers. The court explained that Kentucky's equine transaction dual agency statute was not violated, since Andrews and Raphaelson had known and consented to the arrangement.

Now, since all syndicate members also know, but are under no obligation to buy, they must consent to the commission payment if they choose to purchase. The court rejected the argument that the \$50,000 commissions charged were unusually large, pointing out that Andrews and Raphaelson had agreed to pay them. In any event, the court stated that even if the commissions were inflated, the court had no power to permit a syndicate member to offer less for a share than KNC was willing to pay, thus rejecting Lane's End's so called "industry standard" argument.

The court also noted that the entire situation could have been avoided if the syndicate agreements had simply allowed members to invoke first refusal rights by matching purchase offers excluding any commission amounts to be paid by sellers.

Of course, the court's decision didn't answer the more important questions. First, why was Lane's End so concerned about the payments to Jamgotchian? Why would it care if those making the payments, Andrews and Raphaelson, had no objection? Did the farm want to exclude KNC (Jamgotchian) as a shareholder? If so, did Jamgotchian know this and structure the transactions in such a fashion as to shut the door on any Lane's End syndicate member from blocking the KNC buy via a first refusal purchase? Moreover, if the syndicate agreements allowed members to match offers less a commission, would that have solved the problem for anyone other than Lane's End? Wouldn't Andrews and Raphaelson still be liable to pay the purportedly exorbitant commissions to Jamgotchian based upon their respective agreements with KNC?

Did the judge make the right decisions? Maybe Lane's End will appeal. What do you think? Feel free to chime in!

Also, if you have an idea for a future column or would like to see a particular legal issue discussed in this forum, please let us know: WittstruckC@aol.com

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