

At Auction Sales, Does The Hammer Ever Finally Fall?

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In commerce, finality is important. No matter how harmful the result, there are laws that prevent the commencement of litigation beyond a certain date for damages based upon a wrongfully committed deed. These laws, known as “statutes of limitations,” are generally strictly enforced by the courts.

For the same reason, warranties and representations also contain definite expiration dates. Why? Imagine if automobile manufacturers were under a continuing obligation to repair major components of sedans they manufactured in 1980, warranty expirations notwithstanding. The economic fallout would spell the end of the industry. It’s not hard to understand that the business world functions based upon closure. At a certain point, it’s important that what you sold has been sold and what you bought has been bought, no matter what.

Assuredly, fair dealings are also important in the commercial world. For this reason, instances of fraud have led to creation of one of the traditional exceptions to strict limitations periods. As it necessarily involves some form of concealment, when fraud is alleged, what commonly changes is the point at which the limitations period starts to be measured.

For example, while the period within which to sue for breach of contract in a certain jurisdiction starts from the date of the breach, the limitations period for alleging fraud might not start from when the fraudulent act was committed, but rather from the later date when the fraud could have been reasonably discovered. So, while the limitations period for an action for breach of contract might start in 2010, when the contract was breached, the limitations period for a claim of fraud based on circumstances involving the breach might not start for years after 2010, when the underlying circumstances could have reasonably been discovered. A court objectively concludes the determination of that later date.

At horse auctions, the specific conditions or terms of sale contained in the front of the catalogue are controlling. When you buy a horse at the sale, those are the terms to which you agree to be bound. As a general rule, there are absolutely no warranties or representations of any kind implied by virtue of buying a horse at the sale. The Latin term “caveat emptor,” meaning, “let the buyer beware” is in full force and effect. Thus, the only valid warranties are those expressly stated in the terms of sale, and as to those, there are strict time limits within which a certain warranty must be “invoked,” meaning that the buyer formally complains that the horse was not sold as represented. The phrase, “speak now or forever hold your peace,” is very much applicable here.

For example, common terms of sale might provide that the buyer may return a horse to the consignor if an endoscopic exam discloses epiglottic entrapment, provided that the condition was not announced from the auction stand or otherwise disclosed and the horse has not yet been removed from the sales grounds. Here, the short time period for discovery of this or any defect highlights the importance of an immediate post-purchase veterinary exam.

Against this backdrop, last month a Kentucky Circuit Court was faced with the interpretation of auction terms in the fraud realm. In **Solitary Oak Farm v. Murphy**, the buyer, Solitary Oak Farm purchased a yearling colt at a major Thoroughbred auction. It is not in dispute that sometime before the sale, the colt underwent invasive joint

surgery. Inasmuch as visual inspection does not always show evidence of such surgery, the terms of sale required disclosure of the procedure.

Additionally, in the event a horse is sold without disclosing such a surgery, the terms of sale provided the horse's buyer with a right to return the horse within fourteen (14) days of the sale by notifying the auction company in writing and providing a veterinary certificate attesting to evidence of the prior surgery. Finally, the terms also provided that any lawsuit regarding purchase be brought within six months of the sale.

In this case, neither the breeder nor the consignor disclosed the prior surgery. In fact, in response to questioning from the then prospective buyer's representative, the consignor specifically told the buyer that no prior surgery had been performed.

Since the buyer purchased the horse as a yearling, no training regimen was commenced until months after the sale. When training began and leg problems became apparent, the horse was diagnosed with a problem that required surgery. During the shaving of the now two-year-old's legs in preparation for the surgery, evidence of the undisclosed prior invasive joint surgery was for the first time discovered.

When the discovery was made, the buyer immediately made notification of the prior surgery via veterinary certificate, albeit several months after the fourteen-day period had expired. Additionally, the buyer commenced a lawsuit with causes of action sounding in breach of contract and fraud approximately eleven (11) months after the sale had taken place, and five (5) months later than the terms of sale required.

The court dealt first with the issue of the statute of limitations applicable to bringing the lawsuit. Kentucky law provides that a breach of contract claim must be brought within four (4) years, but that contracting parties are free to reduce the period of limitations to, "not less than one (1) year." Since the terms of sale called for an abbreviated six month limitations period, the court found that less than one year period to be in violation of Kentucky law, ruled it invalid, and decided that the buyer had timely commenced its breach of contract action.

With regard to the cause of action for fraud, however, the court took a different view. The court noted that while the buyer didn't sue within six months of sale, it also didn't even sue within six months of its discovery of the allegedly concealed surgery. Thus, the court dismissed the buyer's cause of action based upon fraud.

Turning to the fourteen (14) day limitation period for invoking the return warranty contained in the terms of sale, the court invoked a legal principle known as the "doctrine of unconscionability." Given the specific facts of the case, the judge decided that upholding the two-week window for returning the colt would, in effect, shock the conscience. The judge reasoned that by refusing to enforce the provision requiring the buyer to abide by the fourteen day period, the court was avoiding, "an extremely unfair result of enforcing an oppressive and unfairly surprising contract on (the) purchaser."

The court then found that the consignor had breached the contract through failure to disclose the prior surgery as required by the terms of sale, granted the buyer judgment against the consignor, and called for a hearing on damages. Essentially, the judge agreed with the buyer that he was unfairly treated by the consignor and that the amount of money involved would be decided later.

According to the consignor's attorney, an appeal of the decision is to be filed. Appealed or not, if the decision stands, there are some glaring ramifications for the equine industry.

First, it is important to note that the decision to hold the consignor responsible was not based upon fraud. Remember that the judge ruled the cause of action based upon fraud was in violation of the state's statute of limitations and barred it. The judge did not rule that the consignor committed fraud, but rather that the amount of time given the buyer after the sale to invoke the warranty was unreasonably short.

Since the statute of limitations for breach of contract in Kentucky is four years, is the court saying that the buyer could have sued and recovered from the consignor for breach of contract if discovery of the prior surgery occurred when the horse was as old as five? Yes, the buyer put everyone on notice immediately upon learning of the prior surgery, but it also didn't sue for over six months thereafter. While the court apparently found this reasonable, where does reasonableness end? Was the buyer waiting to see if the horse could make it to the races before expending money on a lawsuit? In sum, at what outside date for commencement of a lawsuit would the court's conscience no longer be shocked by the abbreviated warranty period?

Second, also note that the actual past or present condition of the horse was not a determinative factor. While the first surgery was not disclosed, consider the possibility that the surgery was successful, and that the horse's problems as a two-year-old were not attributable to the old injury that required the pre-auction procedure.

A damages hearing so far remote from the auction date could quickly degenerate into a battle of veterinary experts giving opinions on what conditions caused what problem and when or whether they affected the horse's athletic ability. The buyer would argue for return of its money and the breeder and consignor would argue that the nondisclosure was irrelevant, and could reasonably allege that the buyer's post-sale actions (bad training, bad feed, bad shoeing, etc.) alone caused the horse's poor performance and injury.

More to the point, bringing suit on a supposed 'recent' discovery of an alleged nondisclosed surgery that occurred years ago is quite a convenience for the buyer of a racehorse gone bad, and a logistical and financial nightmare for breeders and consignors who must dust off old records and attempt to reconstruct the particulars of a now-ancient transaction.

Third, while the law makes the breeder, the principal, liable for the acts and omissions of its agent, the consignor, what if the consignor was simply never told about the surgery? Why should the consignor suffer for the fraud of a breeder? The law also exempts agents from contractual liability based upon their actions in furtherance of a principal whose identity is disclosed, but what if after the fact a breeder insists that it told its consignor about the condition, and that the consignor's failure to inform the buyer was solely the consignor's idea?

Clearly, consignors need to protect themselves from disreputable clients by requiring full written disclosure no later than the time of consignment of all conditions subject to sales' warranties. An agreement from the breeder indemnifying and holding the consignor harmless for any and all costs and judgments based upon failure to disclose would also be prudent.

There is an old adage in law that goes, “bad facts often make bad law.” What it means is that a court might strain to tweak, or even twist, existing law in order to achieve a result in a case where the law is otherwise against a party that should win. There is no doubt that if the breeder of a horse conceals a condition that it is under a contractual obligation to disclose, the buyer of that horse is an innocent party.

Still, does that circumstance justify allowing the innocent party to give notice and sue months, or even years, after the date contemplated in the same contractual provision from which it seeks to benefit? Pursuant to the decision in *Solitary Oak*, does the warranty period established in a terms of sale ever end? Can a buyer simply invoke a warranty at any subsequent date and have it considered reasonable, with any stated time limitation rendered invalid?

Based upon this decision, when the buyer leaves the sales grounds with its new purchase, can a consignor and breeder take comfort in the fact that a sale has been made? Hardly... and the implications of that for our industry are downright frightening.

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