

USE OF REPOSITORIES
THE BUYERS' PERSPECTIVE

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I. INTRODUCTION

The most fundamental change in recent years to thoroughbred auctions is the creation of repositories where information about horses in the auction can be placed for review by potential purchasers. Typically, consignors deposit information such as radiographs, videotapes, veterinary certifications and other materials that a potential purchaser can use to evaluate the horse and which may be used in lieu of announcements concerning certain warranted conditions.

While repositories are an important addition to the sources of information available to purchasers of horses, they have not alleviated the potential pitfalls involved in auctions. They have merely changed the nature of the potential claims and created new ones.

II. PURPOSE OF REPOSITORIES

In the Terms, Conditions and Procedures Binding Upon Consignors And Buyers for the Keeneland Repository at the September 1998 Yearling Sale, the General Description provided:

Due to inefficiencies attendant to multiple x-rays of sale horses and due to potential harm from multiple endoscopic examinations of sale horses, and for other reasons, Keeneland has established a Repository where consignors may place certain information applicable to the sale of horses.

As anyone with experience in the equine industry knows, horses, especially young ones, are skittish and are under considerable stress from the change in surroundings and routine of an auction. This stress is compounded by multiple examinations. For this reason, auctions have created repositories of veterinary information where a consignor can place examination information about the horse for viewing by all potential purchasers. The obvious intent of the repository is to reduce the need for buyers to perform their own independent veterinary examinations. The result is that consignors (as agents for sellers) are effectively performing the examinations for buyers and buyers

may be induced to rely (and are intended to rely) on the information as accurate in evaluating the animal for purchase.

III. CAUSES OF ACTION

Traditional causes of action of disgruntled purchasers of horses at auctions have been for breach of warranty or for rescission, fraud, breach of fiduciary duty and negligence.¹

A) BREACH OF WARRANTY/BREACH OF CONTRACT

The Uniform Commercial Code recognizes express and implied warranties. An express warranty is an affirmation of fact that becomes a part of the bargain, as opposed to mere sales “puffing.” Unfortunately, the case law on warranties is not always consistent. For example, in Frederickson v. Hackney, 198 N.W. 806 (Minn. 1924), a bull was sold because of his bloodlines. The seller apparently understood the bull was purchased for breeding purposes. The bull was immature and the seller could not be expected to know whether the bull would be able to breed. The court rejected a claim that the seller had given a warranty of fertility, finding that the seller could not be expected to know of the animal’s fitness for breeding. In Appleby v. Hendrix, 673 S.W.2d 295 (Tex. Ct. App. 1984), the animal was a stallion sold because of his bloodlines. Unlike Frederickson, the court found an express warranty of fertility.

1) EXPRESS WARRANTIES

The Courts of Kentucky implicitly addressed express warranties at auctions in the decision of Keck v. Wacker, 413 F. Supp. 1377 (E.D. Ky. 1976), which involved litigation over a mare bought

¹ This outline was prepared with the aid of Robert S. Miller, *The Sale of Horses and Horse Interests: A Transactional Approach*, 78 Ky.L.J. 517 (1989-90); Michael D. Meuser, *Current Law on Fraud and Sale of Horses*, Fayette County Bar News, p. 11 (March - April 1997); Elizabeth J. duFresne, *Litigation Flowing From Equine Auction*, Equine Law Conference (1987).

at auction which had been listed in the catalog as “barren,” when she should have been listed as “slipped.” While the court in Keck did not speak in terms of an “express warranty,” the court allowed the purchaser to rescind the sale because the mare did not conform to her description in the sales catalog. This description can be viewed as an express warranty by description.² U.C.C. 2-313(b); KRS 355.2-313(b).

A similar fact situation was presented in Chernick v. Fasig-Tipton, 703 S.W.2d 885 (Ky.App. 1986), in which the court concluded that the purchaser was entitled to punitive damages as well as rescission because the seller manifested conscious wrongdoing in listing a mare as “barren” as opposed to “slipped.” Perhaps the Keck decision set a precedent on how mares were to be listed, defeating any claim of innocence by the consignor and seller and setting up the buyer’s fraud claim. Although the court in Chernick spoke in terms of fraud, the decision still revolved around a mare who did not fit a description in a sales catalog – a warranty by description.

Generally, the Conditions of Sale for equine auctions create few express warranties. They may warrant or require disclosure of certain conditions, such as wind, eyes, whether the horse is a “cribber” or whether it is a “ridgling.” Most Conditions of Sale, however, make few express warranties and attempt to disclaim any express or implied warranties not specifically set forth in the Conditions of Sale. The effect of the disclaimers is discussed below. The issue we will address is whether the repository changes the nature of the express warranties made at a sale.

Prior to use of repositories, buyers frequently had their own independent veterinary examinations performed on potential purchases. The buyer and seller might have little or no contact

² The interplay between the concepts of nonconformity and warranty can best be summarized by stating that if there are no “warranties,” there can be no “nonconformity,” because there is nothing with which the good must conform.

and the consignor might provide no information about the horse other than what is listed in the sales catalog. In some cases, the consignor or seller might make an affirmative representation to a buyer about a horse's condition, but that was a rare case.

The use of repositories changes the way business is done and horses are evaluated. For the first time, a consignor submits veterinary information for review by potential purchasers. This information may create express warranties. U.C.C. 2-313, as set forth in KRS 355.2-313, provides:

- (1) Express warranties by the seller are created as follows:
 - (a) Any affirmation of fact or promise made by the seller to the buyer which relates to the goods and becomes part of the basis of the bargain creates an express warranty that the goods shall conform to the affirmation or promise.
 - (b) Any description of the goods which is made part of the basis of the bargain creates an express warranty that the goods shall conform to the description.
 - (c) Any sample or model which is made part of the basis of the bargain creates an express warranty that the whole of the goods shall conform to the sample or model.

This provision does not set forth any specific language for the creation of an express warranty. Rather, express warranties can be created through broad language, descriptions or samples. From a buyer's perspective, the veterinary information contained in a repository can create a warranty by the consignor and the seller — the information contains affirmations of fact and descriptions of the horse.

The use of repositories may place increasing importance on the decision of Slyman v. Pickwick Farms, 472 N.E.2d 380 (DCA Ohio 1984), which involved the purchase of a yearling at the

Scioto Downs Harness Horse Breeders October auction. A statement was read over the public address system at the auction concerning the colt as follows:

This animal at very rare intervals will make a slight noise on expiration of air — This is due to the so-called false nasal folds being very slightly more softer than normal — The true nasal openings and nasal cavities are normal in size and in no way is the animal's breathing affected —

The statement was prepared by a veterinarian at the request of the seller and was dated the week of the sale. The conditions of the sale provided that there were no warranties of any kind as to soundness or the condition of horses sold at the sale, except as expressly announced at the time of sale.³

After the sale, the purchaser discovered that the horse had trouble breathing. A veterinarian was consulted and reached a conclusion different from that announced at the time of sale. The purchaser then sued the seller for breach of warranty and requested rescission, compensatory and punitive damages. The trial court directed a verdict for the seller, finding that no warranty was created by the statement. The appellate court reversed, finding that under U.C.C. 2-313 (as somewhat modified in Ohio), the veterinary statement constituted an express warranty. The appellate court reasoned that the purchaser could reasonably have relied upon the statement to indicate that the horse was physically capable of racing. It also stated that it could “reasonably be concluded that the main purpose behind having the statement read aloud before the sale was to relieve any apprehension or suspicions that might arise as a result of the peculiar sound [the horse] would occasionally make while breathing, and to convince all those interested in purchasing the horse that

³ Because the statement was announced at the time of sale, it can be argued that it did not fall within the disclaimer provision.

it does not have any serious respiratory problems that would affect its racing ability.” Id. at 384. Thus, the appellate court concluded that the statement became a part of the basis of the bargain and created an express warranty. Id. at 384.

The issue of whether repository information creates an express warranty has not yet been addressed. However, courts have held that express warranties are created by documents, pictures and records similar to the radiographs, veterinary records and certifications and examination videos typically submitted by a consignor in a repository. See, In re Repco Products Corp., 8 U.C.C. Rept’r 2d 950 (Bnkr. E. D. Pa. 1989) (blueprints create an express warranty); Miles v. Kavanaugh, 22 U.C.C. Rept’r 911 (Fla. App. 1977) (log book of airplane repairs creates express warranty); S-C Industries v. American Hydroponics Systems, Inc., 468 F.2d 852 (5th Cir. 1972) (greenhouse specifications create express warranty); Phillips v. Ripley & Fletcher Co., 541 A.2d 946 (Maine 1988) (financial statements create express warranty in stock sale); Rinkmasters v. Utica, 348 N.Y.S. 2d 940 (City Ct., Oneida County, 1973) (catalog pictures create warranty); Antonucci v. Stevens, 340 N.Y.S.2d 979 (Civ. Ct. N.Y. 1973) (illustrations create warranty). Given the wide range of items held to create express warranties, consignors and sellers using repositories run a great risk that the documents they submit will be held to create an express warranty to the buyer.

While the Conditions of Sale attempt to disclaim warranties except as set forth therein, a seller should be entitled to rely on the information submitted by a consignor for the horse. Otherwise, the Repository will not effectuate its intended purpose of reducing the number of intrusive veterinary examinations of the horses at sales. By submitting information to the Repository, the consignor arguably makes warranties that the horse conforms to the description contained in the records. If it does not, the purchaser may have a claim for breach of an express warranty. Unlike fraud claims, the

buyer need not prove that the seller or consignor knew or should have known about the defect. It is enough to establish that the horse did not conform to the warranty.

2) RECISSION/FAILURE OF CONSIDERATION

The U.C.C. provides that a buyer may reject a good if it fails “in any respect to conform to the contract.” U.C.C. 2-601; KRS 355.2-601. Such a rejection must come within a “reasonable time.” U.C.C. 2-602; KRS 355.2-602. If a good has been accepted, the buyer can reject the good if a “nonconformity substantially impairs its value,” so long as it was accepted under a reasonable assumption that the nonconformity would be cured, but it has not been, or if the nonconformity was not discovered and acceptance was induced by a difficulty in discovering the nonconformity or by the seller’s assurances. Revocation of acceptance must occur within a reasonable time after discovery of the nonconformity or after it should have been discovered. U.C.C. 2-608; KRS 355.2-608.

The Keck case dealt with a revocation of acceptance. As discussed above, the court allowed rescission of a sale because the mare had been listed in the sales catalog as “barren,” instead of the correct “slipped.” Importantly, the court did not hold that any disclaimers in the Conditions of Sale prohibited a return of the mare.

A different result was reached in Cohen v. North Ridge Farms, Inc., 712 F. Supp. 1265 (E.D.Ky. 1989), in which a filly was purchased and was alleged by the buyer to have many defects. The buyer sued on a number of claims, including failure of consideration and the buyer sought rescission. The court rejected the argument, applying a warranty analysis, rather than one under U.C.C. 2-608. The court stated:

In plaintiff’s response thereto, he argues that there was a failure of consideration because the horse cannot fulfill the sole purpose for which it was purchased. Obviously, plaintiff is arguing warranty, and

since all warranties were disclaimed, his argument is without merit. The only way there could be a failure of consideration would be if plaintiff had received (1) nothing, (2) a dead yearling, or (3) a live yearling different from the one on which he bid. None of these contingencies are present here.

At first impression, this decision seems at odds with Keck. The court in Keck allowed rescission under U.C.C. 2-608 even though the buyer did not receive “(1) nothing, (2) a dead [horse] or (3) a live [horse] different from the one on which he bid.” Perhaps, however, Keck and Cohen can be reconciled because Keck involved an affirmative representation about or description of the horse as “barren” — there was an express warranty by description. There were no such descriptions (warranties) in Cohen (or at least none that were found to be inaccurate). Therefore, the Cohen court did not really have before it an express warranty by description, it merely involved a horse that the seller alleged had a non-warranted defect. Second, it could be argued that the buyer in Keck did, in fact, get a “live [horse] different from the one on which she bid.” While the horse was certainly the same one bid on in the auction ring, it was not the one described in the catalog — it was not “barren,” but “slipped.”

In the end analysis, a buyer is left with a possible claim for rescission under Keck and U.C.C. 2-608 if a horse does not conform to an affirmative representation about it, if that description was part of the basis of the bargain and if that nonconformity substantially impairs the horse’s value. This description can come in the form of information contained in a repository. Under Cohen, however, rescission cannot be had absent some affirmative representation. It cannot be based upon an implied warranty – unless the Conditions of Sale fail to disclaim implied warranties.

3) IMPLIED WARRANTIES

Implied warranties under the U.C.C. consist of the implied warranty of merchantability U.C.C. 2-314, and implied warranty of fitness for a particular purpose, U.C.C. 2-315. These warranties have important implications in horse sales, see Cohan, *The Uniform Commercial Code as Applied to Implied Warranties of “Merchantability” and “Fitness” in the Sale of Horses*, 73 KY. L. J. 665 (1984-1985), but their usefulness in the context of auctions is severely limited by disclaimers set forth in most Conditions of Sale. As discussed immediately below, courts have consistently upheld disclaimers of implied warranties like those found in most Conditions of Sale (which track the language in U.C.C. 2-316). The information deposited in the repository might create an express warranty, but will probably not change the analysis of implied warranties.

4) DISCLAIMERS OF WARRANTIES

Conditions of Sale at auctions usually attempt to disclaim express and implied warranties. For example, Keeneland’s Conditions of Sale First provides:

As stated above, the horses included herein are offered for sale according to the laws of the State of Kentucky. In accordance with KRS 355.2-328(4) and other applicable laws, the right to bid in this sale is reserved for all sellers, including their disclosed and undisclosed agents, unless otherwise announced at the time of sale.

THERE IS NO WARRANTY EXPRESS OR IMPLIED BY KEENELAND OR CONSIGNOR (INCLUDING OWNER), EXCEPT AS SET FORTH HEREIN, AS TO THE MERCHANTABILITY OR FITNESS FOR ANY PARTICULAR PURPOSE OF ANY HORSE OFFERED IN THIS SALE. SUBJECT TO THE LIMITED WARRANTIES STATED HEREIN, ALL SALES ARE MADE ON AN “AS IS” BASIS, WITH ALL FAULTS AND DEFECTS.⁴

⁴ Similar provisions in most Conditions of Sale attempt to limit what is “nonconforming” for purposes of rejection and revocation of acceptance provisions of the U.C.C.

The significance of this disclaimer must be determined first with resort to UCC 2-316. In Kentucky, that provision can be found in KRS 355.2-316, which provides:

- (1) Words or conduct relevant to the creation of an express warranty and words or conduct tending to negate or limit warranty shall be construed wherever reasonable as consistent with each other; but subject to the provisions of this article on parol or extrinsic evidence (KRS 355.2-202) negation or limitation is inoperative to the extent that such construction is unreasonable.
- (2) Subject to subsection (3), to exclude or modify the implied warranty of merchantability or any part of it the language must mention merchantability and in case of a writing must be conspicuous, and to exclude or modify and implied warranty of fitness the exclusion must be by a writing and conspicuous. Language to exclude all implied warranties of fitness is sufficient if it states, for example, that “There are no warranties which extend beyond the description on the face hereof.”
- (3) Notwithstanding subsection (2)
 - (a) unless the circumstances indicate otherwise, all implied warranties are excluded by expressions like “as is,” “with all faults” or other language which in common understanding calls the buyer’s attention to the exclusion of warranties and makes plain that there is no implied warranty; and
 - (b) when the buyer before entering into the contract has examined the goods or the sample or model as fully as he desired or has refused to examine the goods there is no implied warranty with regard to defects which an examination ought in the circumstances to have revealed to him; and
 - (c) an implied warranty can also be excluded or modified by course of dealing or course of performance or usage of trade; and
 - (d) with respect to the sale of . . . equine animals, . . .

there shall be no implied warranty that the animals are free from disease or sickness. This exemption shall not apply when the seller knowingly sells animals which are diseased or sick.

- (4) Remedies for breach of warranty can be limited in accordance with the provisions of this article on liquidation or limitation of damages and on contractual modification of remedy.

Courts have addressed the disclaimer of warranties in equine auctions and have generally upheld the limitation of warranties similar to the one set forth above. For example, in Cohen v. North Ridge Farms, 712 F.Supp 1265 (E.D.Ky. 1989), the court stated that Keeneland's Conditions of Sale "are a contract between the parties herein. These Conditions of Sale plainly state that there were no warranties surrounding the yearling; it was sold 'as-is.' A sales contract that properly excludes all warranties is enforceable. . . . Therefore North Ridge submits that as a matter of law, any and all warranties, including guarantees of merchantability and fitness for a particular purpose, as well as to soundness and wind, were effectively disclaimed by conspicuous language in the Conditions of Sale." Id. at 1269 (citing Keck v. Wacker, 413 F. Supp. 1377 (E.D. Ky. 1976)). The court concluded that the warranty disclaimers precluded the buyer's claim for "lack of consideration."

This finding was reiterated in Keeneland Ass'n v. Eamer, 830 F.Supp. 974 (E.D.Ky. 1993), in which the court rejected a breach of warranty claim because Keeneland's Conditions of Sale "properly exclude[] all warranties" Id. at 986.

Both Eamer and Cohen cite Keck v. Wacker as support for the proposition that a purchaser's contract claims were barred by the disclaimers in the Conditions of Sale in an auction. In Keck v. Wacker, however, the court held that a purchaser was entitled to rescission of the sale of a mare who was listed as "barren," when she should have been listed as "slipped." The court held that the

purchaser had the right to reject the horse pursuant to KRS 355.2-601(a) (U.C.C. 2-601(a)). Arguably, Keck does not stand for the broad proposition for which it is cited in Cohen and Eamer — Keck allowed rescission. The court in Chernick v. Fasig-Tipton, 703 S.W.2d 885 (Ky.App. 1986) reached a similar conclusion as did the court in Keck, with the exception that Chernick involved conscious wrongdoing on the part of the seller, entitling the purchaser to punitive damages. These cases leave open the possibility that a purchaser can sue for rescission (or breach of an express warranty by description) under Chernick and Keck, despite disclaimers of warranties.

U.C.C. 2-316 implies that express warranties may be disclaimed, but as to express warranties it is little more than a construction provision. It provides that language creating and that limiting or negating express warranties must be construed, wherever reasonable, as consistent, but that limitation or negation of an express warranty is “inoperative to the extent that such construction is unreasonable.” In cases not involving equine auctions, courts have held that a disclaimer of an express warranty may not be effective because it would be inconsistent to exclude statements that, by definition, were part of the basis of the bargain. *See, e.g., Ohio Sav. Bank v. H.L. Vokes Co.*, 560 N.E.2d 1328 (Ohio 1989). If an express warranty is given, and is excluded only as part of a general provision, the express warranty may prevail as inconsistent with the blanket disclaimer. *Mercedes-Benz of North America, Inc. v. Dickenson*, 720 S.W.2d 844 (Tx. App. 1986); *Art Hill, Inc. v. Heckler*, 457 N.E.2d 242 (Ind. App. 1984); *Thompson v. Huckabee Auto Co.*, 379 S.E.2d 411 (Ga. App. 1989) (general disclaimer did not exclude express warranty that goods were “new”); *Woods v. Secord*, 444 A.2d 539 (N.H. 1982) (disclaimer that car is sold “as-is” did not bar warranty claim concerning representation that car was in good working condition and ran properly, when the buyer had trouble immediately upon purchase).

In Travis v. Washington Horse Breeders Ass'n, 759 P.2d 418 (Wash. 1987), the Plaintiff purchased a horse at an auction advertised as offering “truly outstanding” horses, “bound to run” and that were “the very best with respect to pedigree and conformation.” The plaintiff was a novice to the sport. He examined an animal and was told that it was “a fine athlete,” that it was in “very good condition,” that there were “no problems” with the horse and that in the field it was the “leader of the pack.” After the Plaintiff purchased the horse, it was found to have a heart murmur and that it was incapable of carrying a rider. The Plaintiff sued for breach of an express warranty and prevailed. The Washington Supreme Court rejected an argument that the disclaimers in the auction’s conditions of sale waived all express warranties not specifically set forth therein. It held that express warranties cannot be disclaimed under UCC 2-316 to the extent the express warranty is inconsistent with the disclaimer or limiting language.

While blanket disclaimers of warranty may not protect a seller or consignor who makes an affirmative representation about the horse, including those contained within repository records, it may protect the auction company. Typically, the auction company does not place or review records in the repository and most Conditions of Sale give notice that the auction company is not responsible for and will not review the repository information. Therefore, the auction company, itself, makes no warranties other than those set forth in the Conditions of Sale or as announced or published in the sales catalog. The breach of warranty claim, if one can be pursued, would probably involve the consignor and the purchaser, but not the auctioneer.

One final question for the contract analysis is whether Conditions of Sale are intended to disclaim all warranties or only certain warranties. For example, the Conditions of Sale set forth above disclaim express and implied warranties “AS TO THE MERCHANTABILITY OR FITNESS FOR

ANY PARTICULAR PURPOSE OF ANY HORSE OFFERED IN THIS SALE.” The warranties specifically mentioned, merchantability and fitness for a particular purpose, are not express warranties, but are implied warranties. Arguably, therefore, the Conditions of Sale do not purport to limit any other express warranty given by a consignor to a purchaser outside of the Conditions of Sale themselves. While this will depend on the particular Conditions of Sale, a buyer may be successful in establishing that the Conditions of Sale do not limit express warranties given by the consignor, including those made through repository information. The Conditions of Sale may also make this clear. For example, Keeneland’s Conditions of Sale Nineteenth states:

Notwithstanding the above, the consignor (including owner) and purchaser may enter into a written agreement which modifies the limited warranties as provided herein, however, any such action by the consignor and purchaser cannot and shall not modify or alter the duties, responsibilities and rights of Keeneland as provided in these Conditions of Sale and the Consignor’s contract.

Finally, it must be noted that the President of a horse auction company has been quoted as saying that a consignor can make a warranty outside of the Conditions of Sale: “If the consignor wants to make a private treaty (warranty) outside our conditions, that is fine. The ultimate deal is between seller and buyer.” Bowen, *Setting Out to Conduct a “Squeaky Clean” Sale*, THE BLOOD-HORSE, August 19, 1989 (quoting Fasig-Tipton President Tim Cone). Information contained in the repository may create just such an express warranty and may not fall within any disclaimer provision.

5) PAROL EVIDENCE RULE

The parol evidence rule is set forth in U.C.C. 2-202, as adopted by KRS 355.2-202, provides:

Terms with respect to which the confirmatory memoranda of the parties agree or which are otherwise set forth in a writing intended by the parties as a final expression of their agreement with respect to such terms as are included therein may not be contradicted by

evidence of any prior agreement or of a contemporaneous oral agreement, but may be explained or supplemented

(a) by course of dealing or usage of trade (KRS 355.1-205) or by course of performance (KRS 355.2-208); and

(b) by evidence of consistent additional terms unless the court finds the writing to have been intended also as a complete and exclusive statement of the terms of the agreement.

Application of this rule may, in some cases, prevent the introduction of evidence of an express warranty made outside the four corners of the Conditions of Sale of an auction. The important question is whether the express warranty is inconsistent with the writing. In this regard, the comment of Tim Cone, set forth above, indicates that a warranty between buyer and consignor or seller may not be inconsistent with the Conditions of Sale, but may be a consistent collateral agreement. Similarly, the Conditions of Sale themselves, such as Keeneland's Condition Nineteenth, may make it clear that a warranty made outside of the Conditions of Sale is not inconsistent with, but supplemental to, those conditions. If the warranty is not inconsistent, the parol evidence rule is no bar to suit.

The Conditions of Sale may or may not be intended as the complete and exclusive statement of the terms of the agreement. If not, the parol evidence rule will not prevent the introduction of consistent additional terms. The Conditions of Sale should be reviewed for a merger clause. If this merger clause is anything similar to Keeneland's Condition Nineteenth, an express warranty made by a consignor or seller will not be considered to be precluded by the Conditions of Sale – the conditions are not intended as a final expression of the parties' agreement with respect to express warranties.

A merger clause (as well as disclaimers of liability) may also be unenforceable as unconscionable. While courts have generally upheld warranty disclaimers clauses in auction sales,

the Conditions of Sale are not dickered terms, but are only implicitly consented to by the buyer. Strong equitable arguments can be made that it would be unconscionable to allow a consignor or seller to escape from liability through the use of a boiler-plate merger clause for an express warranty that induced a purchase. While the auction company may escape liability for an express warranty given by a consignor or seller, there are clear reasons why the consignor and seller should not be allowed to do so.

The parol evidence rule has not prevented recovery in all auction cases. See, e.g., Slyman, 472 N.E.2d at 382; Travis, 759 P.2d 418. Its use depends on the particular Conditions of Sale. Finally, the parol evidence rule is a bar to contract recovery, but it is not a defense to a claim of fraud, which shall be addressed below.

6. THIRD-PARTY BENEFICIARY

Most auctions have created rules governing the use of repositories by consignors. The repository might require specific radiographic views to be deposited on all horses and that radiographs be taken a certain period before the sale. Arguably, these rules are intended to benefit potential purchasers who may have a breach of contract claim as a third-party beneficiary. Depending on the Conditions of Sale and rules governing use of repositories, buyers may also be parties to the contract with the consignor and auctioneer governing use of the repository and may not need to resort to a third-party beneficiary theory. This will, of course, depend on the specific contract.

Suppose, for example, that radiographs placed in a repository were taken several months prior to the auction and did not reveal a defect that would have been revealed had more recent radiographs been taken. If the repository requires radiographs to be taken two or three weeks prior to the auction, a buyer may have a breach of contract claim against the consignor. A buyer should be able

to rely on the rules being complied with and should be able to pursue claims for breach of contract if the consignor fails to follow them.

B) FRAUD

Generally speaking, breach of warranty claims by purchasers have not been very successful. Although the additional information provided by consignors in the repository may create additional warranties and may expose the consignor and seller to increased risk for breach of warranty claims, the purchaser's greatest chance of success will probably still come from fraud claims. Fraud claims may arise out of the use of repositories under any number of fact scenarios. For example, if a defect might be discovered through a radiograph, but does not appear or cannot be detected in the radiographs placed in the repository, a purchaser might be able to claim that the seller or consignor placed intentionally misleading information in the repository. A conscious decision to use the repository by the consignor and seller may also give rise to a duty on their part to disclose the existence of any defect that makes the repository information misleading, even if the defect is discovered after the information is placed in the repository and the information was true at the time.

In Keck v. Wacker, 413 F.Supp. 1377 (E.D. Ky. 1976). Judge Siler found there to be no actionable fraud in connection with a statement that a mare sold as "barren" had in fact "slipped."

The court identified the elements of fraud as:

4. That the seller made a material misrepresentation;
5. That it was false;
6. That when the statement was made, he knew it was false or made it recklessly, without any knowledge of its truth and as a positive assertion;
7. That he made it with the intention of inducing the buyer to act or that it

should be acted upon by the buyer;

8. That the buyer acted in reliance on it; and
9. That the buyer suffered injury.

Id. at 1383.

The elements set forth in Keck concern affirmative misrepresentations. Fraud is also committed where there is silence in the face of a duty of disclosure. See, e.g., Bryant v. Troutman, 287 S.W.2d 918 (Ky. 1956). Under some circumstances, silence can be the equivalent of an affirmative misrepresentation.

While the court did not find fraud in Keck, in Chernick v. Fasig-Tipton, Kentucky, Inc., Ky. App., 703 S.W.2d 885 (1986), the court had no difficulty finding fraud and imposing punitive damages. That case involved a mare which was unfit for breeding, had aborted twins in a prior year, and had been bred to two different stallions in the current year, but was listed as “barren” in the sales catalog. None of the above facts was disclosed in the catalog or by announcement at the auction. Because the information concerning the mare’s produce history was subject to a warranty of description, there was clearly a duty by the seller to disclose accurate and complete information. The court upheld an award of punitive damages against the seller, stating:

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 [the mare] 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 Chernick’s attempt to unload this horse on an unsuspecting buyer amounts to “conscious

wrongdoing,” see Fowler v. Mantooth, Ky., 683 S.W.2d 250 (1984) 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. Rodgers, Ky. App., 644 S.W.2d 339 (1982), thereby warranting the imposition of punitive damages.

Id. at 888.

In Chernick, the condition of the mare was subject to a specific warranty and, therefore, the seller had an affirmative duty under the Conditions of Sale to disclose the breeding information. This left open the issue of failure to disclose in the absence of an express warranty.

In Cohen v. North Ridge Farms, Inc., 712 F.Supp. 1265 (E.D. Ky. 1989), the United States District Court addressed one such situation when the purchaser of a yearling sought rescission on a host of grounds, including fraud by the seller, North Ridge Farms. The alleged defect concerned the horse’s “wind,” which was not warranted under the Conditions of Sale. Rather, this condition fell within the “as is” disclaimer in the Conditions of Sale. The buyer alleged that the seller had a duty to inspect, discover and thereafter disclose the alleged defect in the yearling at the sale. The court granted the seller’s Motion to Dismiss, holding:

Plaintiff seems to forget that [the seller] 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 Condition 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.

Id. at 1272.

Chernick and Cohen emphasize the importance of the warranties to a claim for fraud by omission. In Chernick, the condition was subject to a specific warranty. Therefore, there was an affirmative duty of disclosure, and the failure to disclose gave rise to a claim of fraud. It would also seemingly give rise to a claim for breach of warranty or for rescission or revocation of acceptance. In Cohen, on the other hand, the condition was not subject to a warranty. The court concluded that a failure to disclose a non-warranted condition did not constitute fraud.

These cases leave important questions unanswered. First, the courts do not answer the question of whether there can be a fraud claim if the consignor or seller knows of a non-warranted defect but fails to disclose it. Second, the cases do not address the question of whether fraud is committed when a non-warranted condition is known to exist by the seller (or the seller has reason to know it exists, but consciously or recklessly disregards indications of the condition), and the seller takes steps to mask symptoms of the condition, such as administering medications. Third, they do not address the question of whether it is fraud for the seller to make an affirmative representation about a non-warranted condition, such as through use of a repository. Fourth, the cases do not address the duties of the buyer in purchasing a horse at auction, such as whether a claim of fraud can be pursued if the condition is one that could have been discovered from an inspection of the horse.

In Keeneland Association, Inc. v. Eamer, 830 F.Supp. 974 (E.D.Ky. 1993), a buyer sued for fraud claiming that a seller misrepresented the condition of a filly's front hooves, a defect in the filly's coffin bones, and failed to disclose OCD lesions and that the filly was a cribber. In its Opinion, the court concluded that there was no evidence that the seller or the seller's veterinarians were aware that the filly had any condition that would impair its performance as a racehorse. There was also no evidence of active concealment by the seller. Finally, there was no evidence of a deliberate election

by the seller to not know of any defects in the filly. While the court leaves open as many questions as it answers, it can at least be argued that it suggests that a buyer has a duty to conduct a pre-sale examination and that failure to do so will defeat a claim of fraud. It also uses language that suggests that if a seller or consignor is aware of a serious defect, the seller or consignor might have an affirmative duty of disclosure.

In 1996, this conference had a similar panel that analyzed disclosure issues related to horse sales. *Disclosure Issues Related to the Sale of Horses*, National Equine Law Conference 1996. The focus of the seminar materials is on claims of fraud by omission. Essentially, the panel concluded there are few duties of disclosure in horse sales (absent a fiduciary or contractual duty, direct inquiry or a previous representation that is misleading) and the less said by consignors, the better off they will be. The repository changes the legal analysis from the buyer's perspective in many important respects. The repository will contain information from the consignor and seller about otherwise non-warranted conditions. The fraud analysis does not now focus only on omission to disclose warranted conditions, but also on affirmative misrepresentations about warranted and non-warranted conditions.

Suppose, for example, that a colt has an O.C.D. lesion in a stifle. In most, if not all, auction cases, this is a non-warranted condition. The auctioneer, consignor and seller have no duty to inspect, discover and disclose the existence of this condition. If a repository is used, the analysis changes. The information in the repository might or might not disclose the condition. If it does, then the seller, consignor and auction house have a much stronger defense to any claims of the buyer. Indeed, there can be no claim of omission because the condition was disclosed. Suppose, though, that the repository information does not disclose the defect on radiographs that could, but do not,

show the condition. If the consignor or seller know about the defect, then they may have an affirmative duty to disclose its existence to correct a mis-impression created by their own representations. Bryant v. Troutman, 287 S.W.2d 918 (Ky. 1956) (a seller may not remain silent about a known latent defect where the seller knows the buyer assumes no defect exists); Miles v. McSwegin, 388 N.E.2d 1367 (Ohio 1979) (broker represented that house was in good condition, but later discovered it had termites; broker had duty to disclose this defect because it was not detectable by reasonable inspection); Harkins v. Fielder, 310 P.2d 423 (Cal. DCA 1957) (holding that it is fraud to disclose facts that are likely to mislead because of facts being concealed); Dennis v. Thompson, 42 S.W.2d 18 (Ky. 1931) (statement that is true, but creates false impression is actionable as fraud); Vokes v. Arthur Murray, Inc., 212 So.2d 906 (Fla. DCA 1968) (if one party undertakes to disclose the truth, he or she must disclose the entire truth).

By analogy, the decision to place information in a repository is similar to responding to a direct inquiry. While a consignor is not required to answer a potential purchaser's questions, if he or she decides to do so, the full truth must be given. See Hays v. Meyers, 139 Ky. 440, 107 S.W. 287 (1908). Therefore, by placing information in a repository, the consignor makes a conscious choice to provide potential purchasers with information or answers to their questions. By doing so, the consignor must give the full truth and may be subject to fraud if a claim of the full truth is not disclosed.

In addition, information in the repository is, itself, an affirmative representation. Therefore, a buyer can sue for affirmative misrepresentations if the information is not true (and the other elements of fraud are present).

While the repository does not change the nature of fraud, it changes the analysis of the

consignor's and sellers duties. If a consignor and seller act in good faith in the information provided in the repository, the buyer may not have much luck in pursuing fraud claims. Use of the repository, however, probably imposes a duty of disclosure on consignors and sellers that does not otherwise exist. If a consignor uses a repository and the information provided therein creates a mis-impression because it is incomplete, inaccurate or if the horse's condition has changed, the buyer's claims of fraud become stronger.

C) BREACH OF FIDUCIARY DUTY/NEGLIGENCE

In Chernick, the court established a fiduciary duty by auctioneers in the equine industry in Kentucky “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.” Id. at 890. While the court stated that the duty was “fiduciary,” the actual standard was to use ordinary care — a negligence standard. In Chernick, the court held that the auctioneer’s “fiduciary duty” of ordinary care required it to report or correct inaccuracies in the sales catalog and to create a veterinary questionnaire that would convey and fully disclose all material facts about a mare’s produce history.

Repositories are a new addition to auctions. Therefore, there have been few cases testing the duties of the auctioneer with respect to operation of the Repository. Auctioneers have foreseen the potential for such claims and have attempted to thwart them in their Conditions of Sale. For example, Keeneland’s Conditions of Sale Eighteenth provides:

Keeneland will **not** review the repository information and makes no warranty or assurance of any kind concerning the authenticity, sufficiency, quality, completeness or accuracy of the Repository information, all of which shall be the responsibility of the consignor. Knowledge of the Repository information therefore shall not be

imputed to Keeneland.

The presence or use of the Repository shall not change any of these Conditions of Sale, which shall continue to be binding upon all parties nor does it create any additional express or implied warranties.

Conditions of Sale also often contain disclaimers of any “fiduciary duties” on the part of the auctioneer. While the effectiveness of these disclaimers has not been addressed in the case law, it is doubtful that the courts will allow an auction company to disclaim its duty “to the Commonwealth’s most prestigious and valued industry.”

In Keeneland Association, Inc. v. Hollendorfer, United States District Court, Eastern District of Kentucky, Opinion of November 5, 1997, Civil Action No. 96-466 (unpublished), the court addressed a claim of negligence made against Keeneland in the operation of the repository. In that case, a purchaser attempted to review information on a filly contained in the repository. The purchaser claimed that the information could not be found. Despite not having been able to review the Repository information, the purchaser’s agent bid on the filly and prevailed with the highest bid. The filly was discovered to have O.C.D. lesions in the right hind pastern. The Repository information contained x-rays that revealed this condition. The buyer sued for rescission. The court granted summary judgment to Keeneland, holding that the “Conditions of Sale disclaim the existence of warranties, either expressed or implied, which are not contained in the Conditions of Sale. Further, the Conditions of Sale contain an ‘as is’ clause.” The court also rejected the negligence claim against Keeneland in its operation of the repository. In so doing, the court did not find that Keeneland had no duty of care in operating the repository. Instead, the court held “even if Keeneland was negligent, Keeneland’s operation of its repository was not the proximate cause of plaintiff’s damages in this case. Hollendorfer knew that there were radiographs taken of the horse but that they could not be

found. Yet, he gambled and chose to bid on the filly without first viewing the filly's medical information housed at the repository and without conducting an independent examination of the filly, both of which the Conditions of Sale advise the buyer to do." Id. at p. 6.

The court's disposition of the case leaves open the question of what, if any, duties are owed by auctioneers in the operation of a repository. In light of Chernick's imposition of fiduciary duties on auctioneers to insure the accuracy and completeness of information contained in sales catalogs, a strong argument can be made that an auctioneer owes a duty of due care in the operation of a repository. If, for example, there is little oversight or security in a repository, and there is evidence of mishandling of repository information, a purchaser might have a claim against the repository operator for negligence or breach of fiduciary duty. Disposition of Hollendorfer's claims might also have been different if a veterinary certification in lieu of announcement was placed in the repository, but the information could not be located. In that case, the required disclosure of a warranted defect would have been lost and Hollendorfer would not have had actual notice of its existence despite efforts to review the records for veterinary certifications. Because purchasers ordinarily rely on disclosure of certain conditions, Keeneland's negligence in misplacing a disclosure would probably be the proximate cause of a purchaser's injury.

While no court has yet held that consignors and sellers owe fiduciary duties to purchasers, it can be argued that they at least owe a duty of due care in submitting information to the repository. If, for example, a consignor negligently provides veterinary information on the wrong horse, the consignor may be liable under a theory of negligence, even if there is no conscious wrongdoing and the court concludes that there are no warranties from the information provided. Similarly, a buyer might have a claim for negligence by the veterinarian providing the information.

The Courts have not yet addressed what duties are owed by users or the operators of repositories. Conceivably, the creation of repositories has opened up a new species of negligence claims.

IV. BUYER'S DUTY OF INSPECTION

The case law addressed above and most conditions of sale impose a duty of inspection upon potential buyers. For example, Keeneland's Conditions of Sale, Eighteenth provides:

All purchasers shall inspect fully each horse that they may purchase. As provided in the Conditions of Sale and otherwise, purchasers are accepting any horse purchased with all defects except those conditions and defects specifically warranted by Keeneland's Conditions of Sale. Purchasers that fail or refuse to inspect for any reason, including lack of opportunity for inspection, purchase the horse at their own risk. It shall be the sole responsibility of the purchaser to determine the sufficiency, quality and completeness of the available inspection; however, full inspection shall include a review of all Repository information for each horse.

...

Purchasers will be charged with knowledge of any defect that is or should be revealed by a reasonable inspection, including any defect that is or should be revealed by a review of the Repository information, with the exceptions of consignors' warranties per Conditions of Sale Fifth (cribbers and ridglings only), Sixth (upper respiratory laryngoscopic evaluation), and Eighth (injury or disease of bone structure for two-year-olds in training). Those limited warranties remain effective, as more fully provided for and stated in Conditions Fifth, Sixth, and Eighth, unless Announcement is made by the auctioneer in conjunction with the sale of the horse in question.

This Condition of Sale imposes a duty by purchasers to review information in a Repository. While use of the repository by sellers is voluntary, it is mandatory upon purchasers. Failure to review repository information will preclude a claim of fraud if the information revealed the existence of the defect. Failure to inspect might also bar breach of warranty or rescission claims, if the defect could have been discovered through a reasonable inspection before the sale. See U.C.C. 2-316 (b); U.C.C.

2-608 (b).

In Newman v. Armstrong Holdings, Ltd., Opinion No. 94-CA-1350 MA (unpublished), the court interpreted Eamer as holding that a buyer has an affirmative duty to inspect a horse and cannot claim fraud if the inspection would have disclosed the defect. In Newman, the court dismissed a claim of fraud because of a buyer's failure to inspect, 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 the 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. . . . 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.

Purchasers must also be aware that the repository may be used by a seller and consignor in lieu of announcements of certain conditions in the horse. For example, Keeneland's repository may contain veterinary certificates in lieu of announcements for all horses that (1) possess any deviation from the norm in the eyes; (2) are a "wobbler" (defined as any horse that suffers from a neurological disease caused by compression of the spinal cord and resulting in lack of balance and coordination); (3) are two years of age or less and have undergone invasive joint surgery or surgical intervention of the upper respiratory tract; or (4) are two years of age or less and have undergone abdominal surgery

of any type except to repair a ruptured bladder in a newborn foal.

A purchaser needs to be particularly careful to examine the Repository for information for all horses he or she might purchase. He or she will be deemed to have knowledge of all information contained in the Repository. The purchaser also cannot rely on announcements being made about certain warranted conditions.

While the repository might limit claims of purchasers under some facts, it may also prevent consignors and the auction company from relying on the defense of lack of inspection. Prior to creation of the repository, purchasers had to have their own veterinary examinations performed on potential purchases. Typically, these examinations did not include any representations by the consignor or the seller. It was up to the buyer's veterinarian to discover any defect in the horse. As set forth in the cases above, the consignor, seller and auction house had no duty to inspect, discover and disclose defects in the horse, except as specifically warranted in the Conditions of Sale. If a defect was discoverable and the buyer did not conduct an inspection, he or she would have little chance of succeeding in any suit against the seller, consignor or auctioneer.

The repository, however, changes the way horses are bought and sold. Now, the veterinary examination may be performed by agents of the seller and the consignor, with the information placed in the Repository to be examined by all potential purchasers. The information deposited in the Repository consists of affirmative representations by sellers and consignors as to the information contained therein. Fault for failure to discover a defect prior to purchasing the horse cannot now be placed squarely on the shoulders of the purchaser and his or her agents. The veterinary exam upon which the buyer relies may be performed by the seller's and consignor's agent. If the defect could not be discovered from that information, the buyer should not be faulted for not performing an

additional independent veterinary examination – he or she should have a right to rely on the accuracy of the information submitted.

The Conditions of Sale may try to limit these claims by stating that a purchaser has a duty to fully inspect the horse, including, but not limited to, reviewing Repository information. In effect, such provisions are attempting to require purchasers to continue to perform full independent veterinary examinations of every horse purchased. It would seem, however, that it is inconsistent to create a Repository for the stated purpose of limiting the number of veterinary examinations performed on horses, while at the same time limiting the right of purchasers to rely on the Repository information. To date, however, no court has addressed the buyer's duty of inspection above and beyond the duty to review repository records. A buyer should be hesitant, however, to assume that a court will not hold him or her to a duty to conduct an independent veterinary exam.

CONCLUSION

While not universally true, as a general rule, buyers have not had much success in suing consignors, sellers, or auctioneers for defects in horses purchased at auctions absent some evidence of conscious wrongdoing on the part of a party. The use of repositories may not change the court's reluctance to allow purchaser's to sue for rescission or damages resulting from the purchase of a defective horse. However, the use of repositories changes the nature of consignor/buyer relations at auctions. The consignors are now making more representations than they did before and their exposure to claims related to the repository information is much greater than if the repository is not used. If a buyer can establish that the repository information is misleading or inaccurate and produce evidence of notice on the consignor or seller of the inaccuracy, the buyer's chances of success are much higher than ever before.

