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Mucking Out the Stalls: How KRS § 230.357 Promises to Change Custom and Facilitate Economic Efficiency in the Horse Industry

R. Kelley Rosenbaum¹

INTRODUCTION

Agency relationships permeate the horse industry; however, those in the business have not always followed the common-law agency principles of loyalty and good faith. Recently, the horse industry has seen numerous lawsuits filed across the country, each sharing the same theme of dual agency and undisclosed payments in the sale of horses.² In response to this growing problem, the Kentucky legislature enacted KRS § 230.357,³ which defines dual agency as any person acting as an agent for both the purchaser and the seller, without full disclosure of such, in a transaction involving a sale, purchase, or transfer of an interest in a horse used for racing or showing.⁴ It also provides that an undisclosed payment or “kickback” occurs when “a person acting as an agent for either a purchaser or a seller or acting as a dual agent in a transaction involving the sale, purchase, or transfer of an equine[,] . . . receive[s] compensation, fees, a gratuity, or any other item of value in excess of five hundred dollars (\$500) and related directly or indirectly to such transaction from an individual . . . other than an agent’s principal” without the principal’s knowledge and written consent.⁵

¹ J.D. expected 2008, University of Kentucky College of Law; B.A., Miami University (Oxford, Ohio), 2004.

² James McIngvale, furniture tycoon and thoroughbred owner, filed suit against thoroughbred trainer Bob Baffert and agents J.B. McKathan and Kevin McKathan, alleging the three received secret commissions and kickbacks while acting as agents and advisors to McIngvale. The lawsuit was filed in U.S. District Court in Texas in September, 2006. See Ryan Conley, et al., *McIngvale Suit Charges Kickbacks to Trainer and Agents*, BLOODHORSE.COM, Sept. 8, 2006, <http://news.bloodhorse.com/viewstory.asp?id=35240>. Thoroughbred owner Jess Jackson of Kendall-Jackson Wines filed suit in 2006 against various entities and individuals, alleging that his advisors took payments of which he was unaware. See Janet Patton & Mary Meehan, *Shady Dealing Has Been Hard to Rein In: Horse Industry Reacts to Lawsuit*, LEXINGTON HERALD-LEADER, Mar. 26, 2006, at A1.

³ KY. REV. STAT. ANN. § 230.357 (West 2006) (hereinafter “the Act”).

⁴ *Id.* § 230.357(3).

⁵ *Id.* § 230.357(4).

This recent enactment by the Kentucky legislature does not represent the first efforts to combat problems associated with dual agency. These practices have plagued the horse business for many years,⁶ and professional organizations have attempted, without legislative intervention, to remedy the problem.⁷ The British Jockey Club, for example, set forth its Code of Practice in July of 2004.⁸ Unlike the United States Jockey Club, the British organization has the power to ban individuals from racetracks and other licensed grounds.⁹ This power enables the British Jockey Club to enforce its Code provisions. In 2005, the Thoroughbred Owners and Breeders Association (TOBA), an American organization, created the Sales Integrity Task Force, which promulgated a Code of Ethics for Thoroughbred Auctions.¹⁰ The TOBA code encourages buyers to use a written disclosure agreement and states that dual agency without disclosure to all parties is inherently fraudulent.¹¹ Although TOBA experienced success in developing the Code, its implementation proved more difficult due to the lack of a viable enforcement mechanism. American professional organizations, unlike their British counterparts, have no centralized power to impose penalties for violations of their codes of ethics.¹²

In January of 2006, the Horse Owners Protective Association (HOPA), was formed to address fraudulent business practices in the horse industry. Later that year, HOPA successfully urged the Kentucky legislature to enact KRS § 230.257.¹³ The Act carries with it the promise to clean up the horse

6 "You disclose who you represent. That's the issue and has been the issue for so long . . . The problem has been people haven't been willing to do that. [I]t's been [this way] since the beginning of the horse trading business . . ." Patton & Meehan, *supra* note 2 (statement by Headly Bell, President of Nicoma Bloodstock). "For many years, this infrequent, but abhorrent practice [of dual agency without disclosure] has received publicity from time to time . . ." CODE OF ETHICS FOR THOROUGHBRED AUCTIONS, at Art. II, (Thoroughbred Owners and Breeders Association (TOBA) 2005), *available at* http://www.salesintegrity.org/downloads/Code_of_Ethics2.pdf.

7 An example of this intervention includes the promulgation of the Thoroughbred Owners and Breeders Association's Code of Ethics. TOBA Code of Ethics, *supra* note 6. In addition, the United States Equestrian Foundation has considered creating a task force that would develop a dispute resolution forum to address disputes arising from the ownership of a horse, including any aspect of the sale of a horse.

8 See Mark Popham, 'Code of Practice' Implemented in Great Britain, BLOODHORSE.COM, July 6, 2004, <http://www.bloodhorse.com/articleindex/article.asp?id=23284>. For a copy of the British Code of Practice, see THE BLOOD STOCK INDUSTRY CODE OF PRACTICE (British Horseracing Board et. al. 2004), http://britishhorseracing.com/images/owning_breeding/The_Bloodstock_Industry_Code_of_Practice.pdf.

9 POPHAM, *supra* note 8.

10 TOBA Code of Ethics, *supra* note 6.

11 *Id.* at Art. II.

12 See Dan Liebman & Deirdre B. Biles, *Code of Ethics for Auctions Announced*, BLOODHORSE.COM, Dec. 16, 2004, <http://www.bloodhorse.com/articleindex/article.asp?id=25831>.

13 KY. REV. STAT. ANN. § 230.357 (West 2006).

industry by clearly stating that undisclosed dual agency and kickbacks are *per se* illegal.¹⁴ The Act imposes treble damages and allows the prevailing party to recover “costs of the suit, reasonable litigation expenses, and attorney’s fees.”¹⁵ HOPA sponsored the Act in hopes that the legislation would make it easier to bring claims of this type and to encourage members of the bar to take these cases.¹⁶ Generally, the horse industry has reacted positively to the legislation.¹⁷

This Note evaluates the likely impact that the Act will have on the horse industry in light of the pre-existing agency law. Part I provides an overview of agency law in Kentucky prior to the passage of the Act. Specifically, it examines Kentucky case law, the *Restatement (Second) of Agency*, and Kentucky statutes that comprised the majority of agency law before passage of the Act. Part II addresses the specific features of the Act and how these features contribute to the pre-existing law. This section further compares the Act to similar efforts by other states’ legislatures, specifically, the California Business and Professions Code § 19525. Finally, Part III presents a brief economic analysis of the law and discusses how the Act affects an individual’s incentives in a typical horse transaction.

I. AGENCY LAW IN KENTUCKY AS IT PERTAINS TO “DUAL AGENCY” IN THE SALE OF HORSES¹⁸

Consider the prototypical private horse sale with four main players: the buyer, the buyer’s agent, the seller, and the seller’s agent. Imagine that the buyer wants to buy a thoroughbred named Silver Horse, that recently won

¹⁴ *Id.* §§ 230.357(3)–(4).

¹⁵ *Id.* § 230.357(6).

¹⁶ Jess Jackson, Panel Discussion during the University of Kentucky CLE Equine Law Seminar (Mar. 3–4, 2006) (electronic recording on file with author).

¹⁷ Deirdre B. Biles, *Thoroughbred Industry Reacts Positively to Jackson Legislation*, BLOODHORSE.COM, Jan. 27, 2006, <http://www.bloodhorse.com/articleindex/article.asp?id=31943>. Not everyone in the industry, however, shares the same positive sentiments regarding the legislation. For example, former Kentucky Governor Brereton Jones, owner of Airdrie Stud, defended the right to pay commissions when business warrants. Governor Jones stated, “as a general rule, we don’t pay commissions . . . There have been some paid when I think they are earned and when I think it’s good business to do so. The great thing about the free enterprise system is we have the right to invest and spend our money as is best for our business. That doesn’t mean you have the right to dual agency or conspire to defraud somebody. We haven’t done that.” Ray Paulick, *Jones Defends Payment of Commissions to Former Jackson Advisor*, BLOODHORSE.COM, Mar. 17, 2006, <http://www.bloodhorse.com/articleindex/article.asp?id=32618> (quote from B. Jones).

¹⁸ See generally Joel B. Turner, *Liability of Agent(s) of Buyer of Bloodstock for Taking Undisclosed Kickbacks from Sellers or Consignors*, in 21ST ANNUAL NATIONAL CONFERENCE ON EQUINE LAW § E(a) (Univ. of Ky. College of Law, Office of Continuing Legal Education, 2006). This article serves as a general guide to common law agency law in Kentucky and provided many of the resources utilized in Part I of this Note.

a stakes race. Since the buyer knows little about the horse industry, he employs an agent, presumably with expertise in the thoroughbred industry, to negotiate the purchase of Silver Horse. Assume each agent will receive a commission at the conclusion of the sale from her principal. Typically, this commission ranges between five and ten percent of the purchase price of the horse.¹⁹ Once the parties reach an agreement on the sale price of Silver Horse, the buyer's agent should receive the percentage of the purchase price from the buyer, and the seller's agent should receive her percentage of the purchase price from the seller. This simple transaction implicates an abundance of legal issues and fiduciary duties. This section provides a general overview of law that was in place prior to the passage of the Act and the legal problems that an agent could face in the event that her conduct conflicts with the legal rules discussed in this section.

A. The Basics: Fiduciary Duties under Hoge and the Restatement

The legal rules set forth in *Hoge v. Kentucky River Coal Co.*²⁰ govern the relationship between a principal and his agent in Kentucky. The legal relationship between a principal and an agent is one based in contract law, where the agent is under an obligation to perform a service for the principal in a particular business enterprise.²¹ The relationship between an agent and a principal, however, extends beyond basic contract law to that of a fiduciary.²² As such, certain duties are owed to the principal, even if they are not specifically provided for in the contract.

According to the *Hoge* court, an agent is required to be loyal and faithful to the interests of her principal.²³ Therefore, the agent cannot act in any manner that would be in opposition to the interests of her principal.²⁴ In addition, she may not use the information acquired through her services for personal gain or in any manner that will cause harm to her principal.²⁵ Finally, the agent may not take profits, which exceed the agreed compensation for her services.²⁶ Any unauthorized profits must be turned over to the principal, even if the principal has not suffered any loss as a result of her

¹⁹ See Andrew Havens, *Finding the "Right Horse." The Role of the Bloodstock Agent*, OWNER'S CIRCLE, available at www.toconline.com/communication/archives-buying.php (last visited Apr. 18, 2007).

²⁰ *Hoge v. Ky. River Coal Co.*, 287 S.W. 226 (Ky. 1926).

²¹ *Id.* at 227.

²² *Id.* at 228.

²³ *Id.* at 227.

²⁴ *Id.*

²⁵ *Id.*

²⁶ *Id.*

agent's profits.²⁷ The court also stated that an agent's violation of fiduciary duties is an act against public policy.²⁸

The fiduciary duties announced in *Hoge* directly correlate with provisions in the *Restatement (Second) of Agency*. The general duty of loyalty announced in the *Restatement (Second) of Agency* § 387 provides that in all matters relating to the agency, an agent is to act for the benefit of his principal alone.²⁹ This is consistent with the basic tenet announced in *Hoge*, that an agent must be loyal and act in good faith in all matters regarding his agency.³⁰ The *Restatement (Second) of Agency* § 391 also speaks directly to the prohibition against agents acting adversely to the interests of their principals.³¹ This section provides that an agent may not act on behalf of any adverse party without his principal's knowledge.³² In an illustration to section 391, a principal employs an agent to sell his house with a commission of five percent to go to the agent.³³ The buyer has employed the same agent to find a house for him.³⁴ The principal is unaware of the agent's other relationship.³⁵ As one might imagine, the agent urges the principal to sell the house to the buyer at the price offered. The agent has breached his duty to the principal.³⁶ This situation is directly applicable to our hypothetical transaction. If the prospective buyer of Silver Horse also employed the seller's agent without the seller's knowledge, the seller's agent will have breached her duty of loyalty to the seller under the rules of both the *Restatement* and *Hoge*.

The *Hoge* court also stated that an agent may not use or disclose information for personal gain or to the detriment of his principal.³⁷ This rule is supported by the *Restatement (Second) of Agency* § 395, which forbids an agent from disclosing confidential information when disclosure would be for her own gain, when the disclosure is "in competition" with her duties to

²⁷ *Id.*

²⁸ *Id.* at 228.

²⁹ RESTATEMENT (SECOND) OF AGENCY § 387 (1958).

³⁰ *Hoge*, 287 S.W. at 228.

³¹ RESTATEMENT (SECOND) OF AGENCY § 391 (1958).

³² *Id.*

³³

P employs A to find a purchaser of his house at the highest obtainable price, A to have a commission of 5 percent. Unknown to P, A has been employed by T to find a suitable house for him at the lowest possible price. A introduces P to T and, without disclosing his relations with T, urges P to sell at the price offered by T. This is a breach of duty to P.

Id. at cmt. d, illus. 2.

³⁴ *Id.*

³⁵ *Id.*

³⁶ *Id.*

³⁷ *Hoge v. Ky. River Coal Co.*, 287 S.W. 226, 227 (Ky. 1926).

her principal, or when the disclosure would be "to the injury of [her] principal."³⁸ This situation might arise in any number of ways in the horse business. For example, assume that the seller's agent knows that the seller had poor sales figures at the Keeneland September yearling sale. As a result, the seller is unable to make his loan payments to the bank and is willing to take a lower price for Silver Horse. Further, assume that seller's agent discloses this information to the buyer or buyer's agent in exchange for a secret commission payable to him upon the closing of the sale for Silver Horse at a reduced price. This is a clear breach of fiduciary duties under both *Hoge* and the *Restatement*.

The *Hoge* court also stated that an agent may not take profits beyond the compensation agreed upon between himself and his principal and must account for all profits to his principal.³⁹ Similarly, the *Restatement (Second) of Agency* § 388 provides that when an agent makes a profit in connection with his employment as an agent he must give that profit to his principal.⁴⁰ Accordingly, if the buyer's agent receives any money in connection with the sale of Silver Horse from anyone other than the buyer, he is obligated to pay that money to his principal.⁴¹

The major defense available to an agent who has taken an undisclosed commission under the *Restatement* is the defense of custom. The *Restatement* provides that if a custom exists whereby an agent can act for an adverse party then the agent will not violate the duty of loyalty.⁴² The custom must be sufficiently widespread so that a principal would be aware of its existence.⁴³ However, when an agent is acting for two principals, "the agent is subject to the duty of fair dealing stated in Section 392."⁴⁴

38 RESTATEMENT (SECOND) OF AGENCY § 395 (1958).

39 *Hoge*, 287 S.W. at 227.

40 RESTATEMENT (SECOND) OF AGENCY § 388 (1958).

41 *See id.* at cmt. a.

42 *Id.* § 391 cmt. a.

Effect of custom. The terms of employment may give a privilege to the agent to act for adverse parties, and such terms may be shown by a prior course of dealing between the principal and agent or by custom of which the principal should be aware. A custom that an agent can properly act for an adverse party is usually so unreasonable that, in the absence of knowledge by the principal, he is not affected by it if the agent is to exercise any discretion or is employed to give advice to the principal.

Id. (internal citations omitted).

43 *Id.*

44 *Id.* Section 392 provides the following:

An agent who, to the knowledge of two principals, acts for both of them in a transaction between them, has a duty to act with fairness to each and to disclose to each all facts which he knows or should know would reasonably affect the judgment of each in permitting such dual agency, except as to a principal who has manifested that he knows such facts or does not care to know them.

Custom may serve as a potential defense to suits arising from horse sales. Agents and sellers might claim that undisclosed payments and dual agency are common in the sale of horses. Under the *Restatement*, if it were a custom in the horse industry, a court could conceivably allow an agent to act for adverse parties without violating the duty of loyalty. However, the *Restatement* does not instill much confidence in the viability of this defense. The comments to section 391 proclaim that “a custom that an agent can properly act for an adverse party is usually so unreasonable that, in the absence of knowledge by the principal, [the principal] is not affected by it”⁴⁵ These comments do not bode well for the defense of custom to undisclosed dual agency in the horse business.

Finally, although not specifically addressed in *Hoge*, third parties who interfere with a principal/agent relationship are in violation of sections 313 and 312 of the *Restatement (Second) of Agency*.⁴⁶ Section 313 states that any party to a transaction who knowingly employs the agent of the other party to the transaction to act on his behalf in such transaction is liable to the other principal.⁴⁷ The safe harbor provision allows that the third party to escape liability if he “reasonably believes” that the other principal has agreed to the arrangement.⁴⁸ In addition to subjecting third parties who hire the agent of another to liability, section 312 envisions a situation where, without employing another’s agent as one’s own agent, one intentionally “cause[s] or assist[s]” an agent to violate his fiduciary duties to his principal.⁴⁹ In that instance, the violating party would be liable to the principal.⁵⁰ These provisions work together with the election of remedies provision, *Restatement (Second) of Agency* § 407,⁵¹ which states that even though a principal has recovered from a third party, the principal may still pursue the agent to retrieve the profit he individually received. Applying these principles to the prototype, assume the seller has given a secret kickback to the buyer’s agent to get a favorable price for Silver Horse. The buyer can rescind the contract and recover from the seller the purchase price, or he can sue the seller for damages.⁵² Furthermore, the buyer may always recover from the buyer’s agent the amount of the kickback.⁵³ In the event that the seller’s agent had been the one who gave the secret kickback to the buyer’s agent,

Id. § 392,

45 *Id.* § 391 cmt. a.

46 *Id.* §§ 312–13.

47 *Id.* § 313 (1).

48 *Id.*

49 *Id.* § 407.

50 *Id.* § 312.

51 *Id.* § 407.

52 *Id.* § 407(1).

53 *Id.* at cmt. on subsection 2.

the seller would still be liable since principals are generally liable for the acts of their agents.⁵⁴

B. The General Prohibition Against Dual Agency and its Exception

Kentucky courts have firmly established that the practice of dual agency, whereby an agent simultaneously represents both the buyer and seller, constitutes a breach of fiduciary duties. Over one hundred years ago, in *Lloyd v. Colston & Moore*, Kentucky's highest court ruled that an agent representing the seller could not become an agent representing the buyer in the same transaction.⁵⁵ In *Lloyd*, a real estate agent endeavored to represent both the buyer and the seller in the exchange of a drug store for vacant lots.⁵⁶ In the court's opinion, since the object of each agent on either side of the transaction was to obtain the best bargain for their principal the "temptation to violate [the agent's] duty to one or both is too great."⁵⁷ Clearly, the prohibition against dual agency contained in the Act is not a radical new idea.

*Beasley v. Trontz*⁵⁸ clarified the general prohibition against dual agency by stating that one could become an agent for both buyer and seller if both parties were aware of and consented to the arrangement.⁵⁹ *Beasley* is the only published Kentucky case that deals specifically with undisclosed dual agency in the sale of a horse. In that case, a seller employed a bloodstock agent⁶⁰ to find a buyer for a mare and foal.⁶¹ The buyer had a pre-existing agency relationship with the bloodstock agent, and the agent refused to reveal the identity of the buyer to the seller.⁶² While the agent admitted that he was acting as an agent for both parties, he still considered himself to be "doing a fair job for both of them."⁶³ Nevertheless, the court stated that if the jury found that the agent had simultaneously acted for both the buyer and the seller, the seller would be entitled judgment as a matter of

54 *Id.* § 265(1) ("A master or other principal is subject to liability for torts which result from reliance upon, or belief in, statements or other conduct within an agent's apparent authority."); see also *Liberty Nat'l Bank & Trust Co. v. Gruenberger*, 477 S.W.2d 503, 505 (Ky. 1972).

55 *Lloyd v. Colston & Moore*, 68 Ky. (5 Bush) 587, 588 (1869).

56 See generally *id.*

57 *Id.*

58 *Beasley v. Trontz*, 677 S.W.2d 891 (Ky. Ct. App. 1984).

59 *Id.* at 894.

60 A bloodstock agent "[m]ay be an expert in breeding, a trainer, or anyone the buyer chooses to act on his behalf. Some work primarily for one buyer; others represent several clients. . . . Acting in a private sale, the agent finds potential purchasers and makes an offer. He may be paid a fee, usually 5 percent from the buyer." Janet Patton, *Anatomy of a Horse Sale*, LEXINGTON HERALD-LEADER, Mar. 26, 2006, at A1.

61 *Beasley*, 677 S.W.2d at 892.

62 *Id.* at 894.

63 *Id.*

law.⁶⁴ The court further clarified that the seller's agent need not receive any commission from the buyer to be liable to the seller for breach of fiduciary duties because it was a breach of his fiduciary duties to represent another party in the same transaction without his principal's knowledge.⁶⁵ By obtaining written consent to the arrangement from both parties, the entirety of any agent's problem in situations such as these can be resolved.

C. *Fraud in the Sale of Horses*

In addition to the remedies of rescission and restitution available to principals who have fallen victim to undisclosed dual agency, a principal may seek punitive damages for fraud.⁶⁶ To sustain a claim of fraud a plaintiff must prove all its elements by clear and convincing proof.⁶⁷ The elements were set out by the court in *Keck v. Wacker*. According to *Keck*, a plaintiff must first demonstrate that the defendant made a material misrepresentation with knowledge or recklessness as to its falsity. Second, the plaintiff must establish that the misrepresentation was false. Third, the statement must have been intentionally made to cause the other party to act. Fourth, the plaintiff must have acted in reliance on the statement. Lastly, the statement must have harmed him.⁶⁸ The court also stated that in order to warrant punitive damages, the statement must be made "willfully, maliciously, wantonly, or oppressively," and "the conduct must be outrageous."⁶⁹ Interestingly, the *Keck* court stated that even if the agent's acts were fraudulent in selling the mare, the seller might not be liable for punitive damages unless he had taken part in the acts or had been negligent or careless in employing his agent.⁷⁰ This suggests a limit on the basic rule found in the *Restatement (Second) of Agency* § 265, which declares that a principal is liable for the acts of his agent done while acting within the agent's apparent authority.⁷¹ Therefore, it is unlikely that a buyer who has relied on a fraudulent statement by a seller's agent will be able to recover punitive damages from the seller himself, unless the buyer can prove that the seller participated in the fraud or was negligent in his employment of the agent.

The Kentucky Court of Appeals upheld an award of punitive damages in *Chernick v. Fasig-Tipton, Kentucky, Inc.*,⁷² in which a mare was sold at auc-

64 *Id.*

65 *Id.*

66 *See* KY. REV. STAT. ANN. § 355.2-721 (West 2006); *Keck v. Wacker*, 413 F. Supp. 1377, 1383–84 (E.D. Ky. 1976).

67 *Keck*, 413 F. Supp. at 1383.

68 *Id.*; *see also* *Keeneland Ass'n, Inc. v. Eamer*, 830 F. Supp. 974 (E.D. Ky. 1993).

69 *Keck*, 414 F. Supp. at 1383–84.

70 *Id.* at 1384.

71 RESTATEMENT (SECOND) OF AGENCY § 265 (1958).

72 *Chernick v. Fasig-Tipton Ky., Inc.*, 703 S.W.2d 885 (Ky. Ct. App. 1986).

tion without the sellers disclosing the vital fact that she had slipped (spontaneously aborted)⁷³ twins prior to the sale and was most likely unfit for breeding.⁷⁴ The court found that because the sellers had been aware for many months before the sale that the mare had this defect, “which made her unsound for the purposes of breeding,” an award of punitive damages was appropriate.⁷⁵ The failure to disclose this information amounted to a deliberate misrepresentation regarding the mare.⁷⁶ Furthermore, because the auction’s sales catalog contained an affirmative warranty that the status of the mare was complete and truthful, the sellers had an affirmative duty to disclose this mare’s defect.⁷⁷

Chernick provides a useful example of the type of egregious acts that are necessary to prove fraud. If the buyer of Silver Horse is unaware that his agent is also acting as an agent for the seller, the buyer should be able to sustain a claim for fraud against the agent because a material fact about the sale—the dual agency—was not disclosed to him.⁷⁸ The Act requires disclosure of not only the dual agency arrangement but also of the kickbacks or any kind of payment received from anyone other than the agent’s principal.⁷⁹ Thus, the Act confers an affirmative duty to disclose these agreements to the agent’s principal. As a result, a claim for fraud in these situations is more likely to be successful.

Additionally, the *Chernick* court discussed the potential liability of the sales company, Fasig-Tipton, despite the fact that the plaintiff did not assert a claim against the auction company.⁸⁰ The court established the auction company’s fiduciary duties toward the buyer, holding that Fasig-Tipton had a fiduciary duty to use ordinary care “to ensure that its catalog and/or announcements were as accurate and comprehensive as possible.”⁸¹ The court continued, “[t]he conduct of one of the Commonwealth’s foremost consignors of breeding stock is not to be reviewed at a level lower than that of strict scrutiny.”⁸² Thus, the court will impose this limited fiduciary duty on auction companies in the horse business. The court recognized that an

73 *Id.* at 885.

74 *Id.* at 888–89.

75 *Id.* at 888.

76 *Id.* at 889.

77 The presence or absence of a warranty may change the outcome of a fraud case. The result differed in *Cohen v. North Ridge Farms, Inc.*, 712 F.Supp. 1265 (E.D. Ky. 1989), where the alleged defect of the yearling was not one listed in the Conditions of Sale warranty and was specifically disclaimed “as is.” The buyer was on notice that he was buying the yearling “as is” and therefore had no fraud claim. *Id.* at 1272.

78 Joel B. Turner, *Liability of Agent(s) of Buyer of Bloodstock for Taking Undisclosed Kickbacks from Sellers or Consignors*, UNIV. OF KY. EQUINE LAW SEMINAR ea-7 (2006).

79 KY. REV. STAT. ANN § 230.357(3), (4) (West 2006).

80 *Chernick*, 703 S.W.2d 885, 890.

81 *Id.*

82 *Id.*

important public policy issue is in play whenever a lawsuit involves the horse industry. Although this Note addresses only private sales of horses, Kentucky law also imposes certain fiduciary duties upon auction companies, in addition to those imposed upon agents and their principals.⁸³

D. Kentucky Statutes Regarding Commercial Bribes and Conspiracy

Another legal tool available to a principal harmed by his agent's acts is to seek civil liability for violation of criminal bribery and conspiracy statutes.⁸⁴ Pursuant to KRS § 518.020, commercial bribery occurs when a person gives any benefit to an agent without the consent of the principal with the intent to influence the agent to act in a way that is not in his principal's best interest or in a way that is a breach of the agent's fiduciary duties.⁸⁵ Under KRS § 518.030, an agent will be liable for receiving a commercial bribe if he receives or intends to receive any benefit from a third party with the agreement that he will act in a manner that is inconsistent with his fiduciary duties or in a manner that is harmful to his principal.⁸⁶

Applying these rules to the prototype, a commercial bribe is accomplished if the buyer's agent agrees (without the buyer's knowledge) to accept payment from the seller's agent in exchange for convincing the buyer to pay an unfair and high price for Silver Horse. In this instance, the buyer's agent would be liable to the buyer under KRS § 518.030 for losses caused by the agent in receiving a commercial bribe. Seller and seller's agent would be liable to the buyer under KRS § 518.020 for offering the bribe to the buyer's agent with the intent to cause him to violate his fiduciary duties.

The perpetration of a commercial bribe leaves the seller, the seller's agent, and the buyer's agent liable to the buyer under the Kentucky conspiracy statute, KRS § 506.040. The statute provides that any person who acts with the intent to promote or facilitate a crime is guilty of criminal conspiracy if "he agrees with one or more persons that at least one of them will engage in conduct constituting a crime . . . or agrees to aid . . . persons in the planning or commission of that crime . . ." ⁸⁷ In the example above, the buyer's agent, the seller, and the seller's agent would be liable for damages

83 See also *Keeneland Ass'n, Inc. v. Eamer*, 830 F. Supp. 974, 985–86 (E.D. Ky. 1993) (affirming the *Chernick* rule and stating that is the limit on the duties to the potential buyers at auction sales).

84 "[A] person injured by the violation of any statute may recover from the offender such damages as he sustained by reason of the violation." KY REV. STAT. ANN. § 446.070 (West 2004).

85 *Id.* § 518.020(1) (West 2006).

86 *Id.* § 518.030.

87 *Id.* § 506.040(1)(a)–(b).

caused by their conspiracy to commit a commercial bribe, since Kentucky allows civil liability for violation of any statute.⁸⁸

Kentucky law provides various other remedies exclusive of the Act for violation of fiduciary duties. The *Restatement (Second) of Agency* sets forth various rules that govern the fiduciary relationship between a principal and her agent.⁸⁹ Kentucky courts have long held that a fiduciary relationship exists within an agency relationship,⁹⁰ and Kentucky decisions⁹¹ correlate with the *Restatement* rules.⁹² A buyer or seller victimized by undisclosed kickbacks can sue for punitive damages if the elements of fraud are present.⁹³ Finally, victims of the commercial bribery statutes⁹⁴ and conspiracy statute⁹⁵ may pursue the imposition of civil liability.

II. THE IMPACT OF THE ACT ON AGENCY LAW IN KENTUCKY

A. *California Business and Professions Code § 19525: A Step Beyond the Act*

The Act is based on California Business and Professions Code § 19525,⁹⁶ which was enacted in 1994 and which states in pertinent part that no person can receive a commission “connect[ed] with the sale . . . of a racehorse . . . unless the purchaser and the seller have agreed in writing to the payment”⁹⁷ If a person receives a commission in violation of section 19525, the penalty is treble damages to the injured person.⁹⁸ The law also requires a written bill of sale in any transaction involving a racehorse.⁹⁹

Several aspects of the California legislation differ from the Act, with one dramatic difference stemming from California’s licensing requirement of agents involved in the horse industry.¹⁰⁰ Violation of section 19525 may

88 *Id.* § 446.070 (West 1974); see *Big Rivers Elec. Corp. v. Thorpe*, 921 F. Supp. 460, 462 (W.D. Ky. 1996) (stating that Kentucky law provides a civil cause of action for those injured by a violation of the criminal bribery statute).

89 See *RESTATEMENT (SECOND) OF AGENCY* §§ 391, 392, 388, 381, 280 (1958).

90 See *Hoge v. Ky. River Coal Co.*, 287 S.W. 226, 227–28 (Ky. 1926).

91 *Id.*

92 *RESTATEMENT (SECOND) OF AGENCY* §§ 387, 391, 395, 388 (1958) (enunciating some of the general duties of an agent to his principal discussed in Part I of this Note).

93 See *Keck v. Wacker*, 413 F. Supp. 1377 (E.D. Ky. 1976) (suit for fraud); *Chernick v. Fasig-Tipton Kentucky, Inc.*, 703 S.W.2d 885 (Ky. Ct. App. 1986) (same).

94 KY. REV. STAT. ANN. § 518.020 (West 2006); *id.* § 518.030.

95 *Id.* § 446.070 (imposing civil liability for criminal violations); *id.* § 506.040 (imposing civil liability for criminal conspiracy violations).

96 Jess Jackson, Panel Discussion during the University of Kentucky CLE Equine Law Seminar (Mar. 3–4, 2006) (electronic recording on file with author).

97 CAL. BUS. & PROF. CODE § 19525 (West 2006).

98 *Id.*

99 *Id.*

100 Any person who has anything to do with the racing of horses, including horse owners,

result in a suspension or revocation of the violator's license.¹⁰¹ Kentucky, however, does not require licensing of bloodstock agents, so there is no parallel penalty in the Act. HOPA, the main group lobbying for the Act, has placed licensing agents in the horse business among its new goals.¹⁰²

More important than the licensing of agents is the requirement in section 19525 that no fee, commission, gratuity, or any form of compensation be received *unless* the purchaser and the seller have agreed in writing to such a payment.¹⁰³ The Act only requires that any payment over five hundred dollars received from anyone other than the agent's principal be disclosed in writing and consented to in writing by the agent's principal.¹⁰⁴ California's legislation goes much further than the Kentucky Act in regulating the individual contractual relationship between a principal and his agent by forbidding any commissions unless there is a written agreement between the purchaser and seller.¹⁰⁵ In Kentucky, agents need not disclose the commission agreed upon between a principal and his agent to anyone outside of that contractual relationship.¹⁰⁶ By maintaining confidentiality of payments between a principal and agent, the Kentucky legislature preserved the rule that agents and principals may contract as they wish and that such agreements will be kept private.

California and Kentucky are the only states with legislation that specifically addresses the practice of undisclosed dual agency in the sale of an equine. Because only a handful of cases have been brought using section 19525, the impact of the California legislation remains to be seen.¹⁰⁷ According to former California Attorney General John Van de Kamp, the impact of the legislation has been positive and people within the horse industry are now aware that they will face potentially large penalties for violating the law.¹⁰⁸ Therefore, there is an argument to be made that although the legislation in California did not cause a "litigation explosion" that is not a measure

jockeys, drivers, apprentices, etc. must be licensed by the board. *See id.* § 19520.

101 *Id.* § 19525.

102 Jess Jackson, Panel Discussion during the University of Kentucky CLE Equine Law Seminar (Mar. 3–4, 2006) (electronic recording on file with author).

103 CAL. BUS. & PROF. CODE § 19525 (West 2006).

104 KY. REV. STAT. ANN. § 230.357(4)(a)–(b) (West 2006). In 2005, the average price for a thoroughbred horse sold at auction was approximately \$54,985. *See THE JOCKEY CLUB, 2006 FACT BOOK 22* (2006) (calculated as gross sales of \$1,239,290,425 divided by 20,720 horses sold). A five percent commission on a \$54,985 transaction equals approximately \$2,749. Private sales figures were unavailable. Judging from these figures, the average commission on the sale of a thoroughbred is well above the \$500.00 threshold set forth by the Act.

105 CAL. BUS. & PROF. CODE § 19525 (West 2006).

106 KY. REV. STAT. ANN. § 230.357(7), (8) (West 2006).

107 Letter from John K. Van de Kamp, former California Attorney General and former President of Thoroughbred Owners of California, to Rep. Denver Butler, Chair, Licensing and Occupation Committee, Kentucky General Assembly (Feb. 3, 2006) (on file with author).

108 *Id.*

of its success, and that the absence of such litigation is an indicator that the law is an effective deterrent against this behavior.

B. Does the Act Protect Kentucky's Most Valued Industry?

Some describe undisclosed dual agency as a practice carried on by those in the horse industry subculture, the "dark side" of the business that disrespects ethical practices.¹⁰⁹ Although Kentucky common law¹¹⁰ and statutes¹¹¹ provide a course of redress for a principal whose agent has participated in undisclosed dual agency, the Act creates what appears at first blush to be a firm cause of action specifically relating to the sale of horses.¹¹² The Act has three main requirements. First, every sale, purchase, or transfer of a horse to be used for racing or showing must have a *written* bill of sale signed by both parties or their duly authorized agents.¹¹³ Second, if an agent is to represent both the buyer and the seller in any transaction involving the sale, purchase, or transfer of a horse, both the purchaser and the seller must have prior knowledge of this arrangement and the agent must obtain written consent from both.¹¹⁴ Third, any payment made to an agent over five hundred dollars related to the sale, purchase, or transfer of a horse used for racing or showing from anyone other than the agent's principal must be disclosed in writing to both the purchaser and the seller, and each principal must consent to the payment in writing.¹¹⁵ However, the Act does not apply to transactions under \$10,000 when the horse is to be used for showing.¹¹⁶ Additionally, the Act extends the remedies that were previously available at common law, providing for recovery of treble damages, costs, expenses, and attorneys fees.¹¹⁷ The treble damages portion of recovery applies to any undisclosed payment over five hundred dollars and to the difference between the price paid for the horse and the actual value of the horse at the time of sale.¹¹⁸

109 See Patton & Meehan, *supra* note 2.

110 See *Lloyd v. Colston & Moore*, 68 Ky. (5 Bush) 587, 588 (1869); *Beasley v. Trontz*, 677 S.W.2d 891, 894 (Ky. Ct. App. 1984).

111 See KY. REV. STAT. ANN § 506.040 (West 2006); *id.* § 518.020; *id.* § 518.030.

112 See generally *id.* § 230.357.

113 In the case of a transaction solely for a season or interest in a stallion, the bill of sale may be signed by the syndicate manager or stallion manager. In the case of an auction the signature requirement is satisfied by an auction receipt and signature upon such receipt of the purchase or purchaser's agent. Purchaser's agent must have a written authorization from his principal in order to sign the auction receipt. See *id.* § 230.357(1)-(2).

114 *Id.* § 230.357(3).

115 *Id.* § 230.357(4).

116 *Id.* § 230.357(9).

117 *Id.* § 230.357(6).

118 *Id.*

The major defense that an agent could have advanced prior to the passing of this legislation is that undisclosed dual agency is customary in the horse industry,¹¹⁹ and therefore, the principal receives notice of these practices in advance. Under the *Restatement (Second) of Agency* § 388, an agent may receive compensation from parties other than her principal without violating her fiduciary duties if by custom an agreement to that effect is found.¹²⁰ The *Restatement* also allows the custom defense in cases of undisclosed dual agency.¹²¹ While Kentucky already acknowledges that custom is not a defense to a violation of a statute or common law,¹²² the Act explicitly disallows this defense by making it illegal to accept payments from anyone other than the agent's principal and to act as an agent for both buyer and seller without the express written consent from both parties.¹²³

Kentucky case law¹²⁴ and statutes¹²⁵ in existence prior to the Act established a solid cause of action against an agent who violated any of her fiduciary duties. The requirement that both parties consent to a dual agency arrangement is present in the case law¹²⁶ as well as the *Restatement*.¹²⁷ *Hoge v. Kentucky River Coal Co.* states that payments received by an agent must be given to his principal.¹²⁸ The rule mandating that a bill of sale be in writing was already present in Article 2 of the Uniform Commercial Code (UCC),¹²⁹ codified as KRS § 335.2-201(1), which requires that a contract for the sale of goods over five hundred dollars must be in writing and signed by the person "against whom the enforcement is sought or by his authorized agent or broker."¹³⁰ Horses fall within the purview of the UCC under "goods."¹³¹ What then, is the function of the Act if its major features were already present in Kentucky law?

119 See RESTATEMENT (SECOND) OF AGENCY § 391 cmt. a (1958).

120 See *id.* § 388 cmt. b.

121 See *id.* § 391 cmt. a ("The terms of the employment may give a privilege to the agent to act for adverse parties, and such terms may be shown by a prior course of dealing between the principal and agent or by a custom of which the principal should be aware.").

122 "We would emphatically state, however, for the benefit of those engaged in such practices, that where an 'accepted business practice' conflicts with existing law, the law whether statutory or court ordered, is controlling." *Marsh v. Gentry*, 642 S.W.2d 574, 576 (Ky. 1982).

123 See KY. REV. STAT. ANN. § 230.357(3)-(4) (West 2006).

124 See *Lloyd v. Colston & Moore*, 68 Ky. (5 Bush) 587, 588 (1969); *Chernick v. Fasig-Tipton Kentucky, Inc.*, 703 S.W.2d 885 (Ky. Ct. App. 1986); *Beasley v. Trontz*, 677 S.W.2d 891, 984 (Ky. Ct. App. 1984); *Hoge v. Ky. River Coal Corp.*, 287 S.W. 226, 227 (Ky. Ct. App. 1926).

125 See KY. REV. STAT. ANN. § 518.020 (West 2006); *id.* § 518.030.

126 See *Beasley*, 677 S.W.2d at 894.

127 See RESTATEMENT (SECOND) OF AGENCY § 391 (1958).

128 See *Hoge*, 287 S.W. at 227.

129 See UCC § 2-201.

130 KY. REV. STAT. ANN. § 335.2-201(1) (West 1958).

131 See generally *Chernick v. Casares*, 759 S.W.2d 832 (Ky. Ct. App. 1988).

III. AN ECONOMIC ANALYSIS OF KRS § 230.357

A. *Introduction to Economic Analysis of the Law*

Economic analysis of laws “attempt[s] to explain legal rules and outcomes as they are rather than to change them to make them better.”¹³² The base assumption of all economic analysis is that every actor is a rational maximizer and will act in his or her own best interests.¹³³ Thus, in analyzing a specific legal rule, one must examine how a rational person acting in his own self-interest would react to that rule and whether that outcome is socially desirable. One socially desirable goal for a legal rule is efficiency. “The efficiency theory of the common law is best . . . explained as a system for maximizing the wealth of society.”¹³⁴ This theory also extends to some statutory law as well.¹³⁵ If the goal is to maximize social wealth, a socially desirable outcome occurs when the benefits to society exceed the costs to society.¹³⁶

The sale of horses involves the transfer of property rights from one party to another by contract. The Act creates certain legal constraints on the contractual relationships involved in the sale of horses. Generally, free transfer of property is socially desirable.¹³⁷ There are, however, two main reasons why it may be economically efficient to impose legal restraints on sales: one, the sale creates externalities; and two, there is a lack of full information.¹³⁸ This Note, focusing on the need for full information, asks two questions about the economic effects of the Act. First, does this law help to facilitate fully informed horse transactions, and thus, efficient outcomes? Second, do the penalties imposed by the Act promote efficient conduct by those involved in the horse industry?

B. *The Act Facilitates Economic Efficiency for Kentuckians*

The Act aids in the completion of fully informed horse transactions. In order to have an efficient outcome in a horse sale, the benefits to the parties should outweigh the costs. Principal/agent relationships create efficiency and are often used in the horse industry. This relationship allows people with expertise in a certain area to perform a task for a principal who

132 RICHARD A. POSNER, *ECONOMIC ANALYSIS OF LAW* 27 (5th ed. 1998).

133 “The concept of man as a rational maximizer of his self-interest implies that people respond to incentives—that if a person’s surroundings change in such a way that he could increase his satisfactions by altering his behavior, he will do so.” *Id.* at 4.

134 *Id.* at 27.

135 *Id.*

136 STEVEN SHAVELL, *FOUNDATIONS OF ECONOMIC ANALYSIS OF THE LAW* 15 (2004).

137 *Id.* at 12.

138 *Id.*

would not have been able to complete the task in a quick and skilled manner. Therefore, the principal gains the benefit of an advisor with superior knowledge of horses as well as access to industry insiders with relatively low costs, a commission of five to ten percent.¹³⁹ The agent gains her commission, which will be combined with others to make up her income, with the relatively low costs of the use of her time and knowledge she already possesses. An undisclosed dual agency relationship, however, creates a situation in which not all parties to the transaction are fully informed. Lack of full knowledge creates inefficient bargains for several reasons.¹⁴⁰ First, the costs to the individual principal may be higher than the benefits he received from the agent's services, and the principal does not receive what he bargained for. Second, undisclosed dual agency results in an industry-wide cost because potential new investors are reluctant to invest in an enterprise in which they could be defrauded.¹⁴¹ The benefits received by the relative few who receive undisclosed kickbacks are less than this overall industry-wide cost, which ultimately impedes the growth of the industry.

The Act focuses on the problem of lack of information sharing between the bargaining parties and mandates fully informed transactions. The Act codifies that certain important information must be disclosed between an agent and his principal in the sale of a horse.¹⁴² It is clear from the case law and trade magazines that full disclosure to principals by agents did not consistently occur on an industry-wide basis, despite already existing agency law.¹⁴³ The Act creates a situation in which full information and disclosure is mandatory, thereby creating efficient bargains. Full disclosure between agents and their principals is a socially desirable outcome because it encourages potential horse owners to invest in the industry by ensuring full disclosure of dual agency. Full knowledge on the part of both contracting parties is desirable because it facilitates the best possible outcomes from agency relationships; the parties create an efficient bargain by using all the information available.

The second issue is whether the penalties imposed by the act will promote efficient conduct on the part of the agents as self-interested actors. Essentially, this inquiry rests on whether the treble damages, costs, and attorneys' fees imposed by the Act add costs to committing the violative acts

139 See Havens, *supra* note 19, at 21.

140 See LOUIS KAPLOW & STEVEN SHAVELL, *CONTRACTING* 65–68 (2004).

141 In a discussion panel titled "Thoroughbred Industry Forum 2006," which was held at Churchill Downs on November 3, 2006, Jess Jackson stated, "I've been at cocktail parties with former heads of [Fortune 500] companies, who . . . told me they wouldn't come into the industry because they got burnt." See Ryan Conley, *Jackson Tells Forum He is Still Pushing for Reform*, THE BLOOD-HORSE, Nov. 3, 2006, available at <http://www.bloodhorse.com/articleindex/article.asp?id=36204> (last visited Mar. 23, 2007) (alteration in original).

142 See KY. REV. STAT. ANN. § 230.357(3)–(5) (West 2006).

143 See generally *supra* notes 2, 19–95 and accompanying text; Patton & Meehan, *supra* note 2.

that are sufficient to keep the violator from committing those acts. Violations will or will not occur based on an individual's calculation of the costs and benefits of the violation, compared with alternative courses of action.¹⁴⁴ This is accomplished by examining the potential benefit from violating the Act and comparing it with the expected fine, which equals the penalties imposed multiplied by the probability that his actions will be detected.¹⁴⁵ If the costs to the agent exceed the benefits, he will not engage in the behavior. Theoretically, a fine should be adjusted upward as the probability of the detection declines.¹⁴⁶

As stated previously, disclosure of agency relationships and commissions did not consistently occur in the horse industry.¹⁴⁷ Therefore, an agent who engaged in such behaviors weighed the benefits of violating her fiduciary duties against the expected fine and chose to engage in the illegal behavior. This indicated that the penalty needed to be adjusted upward in order to change a rational actor's balancing. The Act tips the scales in favor of not committing the illegal act by imposing treble damages, costs, and attorneys' fees for violations.¹⁴⁸ To a rational actor, the costs of violating the Act should generally outweigh the benefits the agent receives from the undisclosed commission, since the potential costs could be three times the gain realized by the deception. Disclosure is relatively costless under the Act. It requires the agent to obtain written consent from the purchaser and the seller and that both have prior knowledge of the arrangement when dual agency exists.¹⁴⁹ If the agent receives payments from anyone other than the agent's principal, each principal for whom the agent is acting must provide written consent, and the payment must be disclosed in writing.¹⁵⁰ Meanwhile, the costs for violation are potentially very high,¹⁵¹ and any rational actor has an incentive to abide by the Act's requirements.

An easy way to examine how the Act affects behavior and thus outcomes is to return to the Silver Horse hypothetical. The buyer employs an agent to purchase Silver Horse at the lowest feasible price, while the seller's agent has been employed to sell Silver the Horse at the highest feasible price. If either of them agrees to take a commission or to represent

144 *Cf.* DANIEL H. COLE & PETER Z. GROSSMAN, *PRINCIPLES OF LAW AND ECONOMICS* 276 (2005). Although this section deals specifically with criminal activity, it is closely analogous with tortious activity. *See id.* at 272 ("A crime is simply a tort—a wrong-committed against both the individual victim . . . and the larger society.")

145 *See* A. MITCHELL POLINSKY, *AN INTRODUCTION TO LAW AND ECONOMICS* 81 (3d ed. 2003).

146 *Id.* at 81–82.

147 *See supra* note 143.

148 *See* KY. REV. STAT. ANN. § 230.357(6) (West 2006).

149 *Id.* § 230.357(3).

150 *Id.* § 230.357(4).

151 *See id.* § 230.357(6).

anyone other than their principal, they no longer have an incentive to act in that principal's best interest. Long before the passage of the Act, this activity was illegal.¹⁵² Before the passage of the Act, the agent was liable to his principal only for his illegal gains,¹⁵³ with slight chance of punitive damages if fraud was proven.¹⁵⁴ However, this Act creates a counter-incentive against this behavior by making the seller's agent and the buyer's agent liable to their principals for the sum of three times their own gains, as well as costs and attorney's fees.¹⁵⁵ As a result, both agents are less likely to violate their fiduciary duties, and thus full disclosure is more likely. Consequently, when Silver Horse sells for a fair price, the agents and principals have achieved efficient bargaining. The penalties imposed by the Act change the calculation of a potential violator. It added costs to undisclosed dual agency and secret kickbacks, ultimately creating a situation in which it would be economically inefficient in most cases to violate the Act.

C. The Act Addresses the Moral Hazard Problem

The moral hazard problem manifests itself when, after a contract is made, a party has an incentive to act in a way that is harmful to the other party in the contract.¹⁵⁶ In this situation, after the initial contracting is complete, "the promisee has more to gain from breach than from performance" ¹⁵⁷ For example, once people are insured, they are less likely to take precautions to prevent losses, resulting in higher insurance premiums.¹⁵⁸ The moral hazard problem can cause economic inefficiency when incentives change in a way that can hurt both parties.¹⁵⁹ One solution to the problem is access to information,¹⁶⁰ for if the parties know of the change in incentives, they may alter the contract to address the problem. However, obtaining the information needed to combat the problem is sometimes difficult because of the financial costs of obtaining information.¹⁶¹

The moral hazard problem can also manifest itself in an agency relationship. Most agency relationships in the horse business are performance-based contracts where "payment depends on productivity as measured by

152 See *Hoge v. Ky. River Coal Corp.*, 287 S.W. 226, 228 (Ky. 1926).

153 *Id.* at 227.

154 For the type of egregious acts that are required before punitive damages are awarded, see *Chernick v. Fasig-Tipton Ky., Inc.*, 703 S.W.2d 885, 888–89 (Ky. Ct. App. 1986).

155 See KY. REV. STAT. ANN. § 230.357(6) (West 2006).

156 KAPLOW & SHAVELL, *supra* note 140, at 57.

157 POSNER, *supra* note 132, at 143.

158 KAPLOW & SHAVELL, *supra* note 140, at 56–57.

159 *Id.* at 57.

160 *Id.* at 58.

161 *Id.* at 59.

some specified criterion.”¹⁶² The buyer and the buyer’s agent have an initial agency contract that provides that the agent will receive a percentage of the purchase price of Silver Horse. The contractual relationship between the buyer and the his agent shapes the agent’s incentives. Under Kentucky agency law prior to the passage of the Act,¹⁶³ the buyer’s agent had more incentive to breach his fiduciary duties to his principal and obtain undisclosed kickbacks from the seller’s agent or the seller for several reasons. Before the Act, agency law in Kentucky consisted of a amalgamation of case law, *Restatement (Second) of Agency* sections, and criminal statutes,¹⁶⁴ which thus worked in favor of the buyer’s agent. The fractured law was a potential disincentive to a plaintiff. In addition, the damages the buyer’s agent was potentially liable for were limited.¹⁶⁵ The Act changes what the incentives of the buyer’s agent are post-contract. First, it pertains specifically to the agent’s behavior of failing to disclose dual agency in the sale of a horse.¹⁶⁶ Second, it provides a clear cause of action and allows for recovery of damages much higher than was available to a plaintiff previously.¹⁶⁷ Therefore, the Act decreases the chance that the buyer’s agent will have more to gain from breaching his contract with the buyer than he will by performance of the contract.

The Act also facilitates access to information for principals, so that if an incentive does change for his agent, the principal will be aware of the change and can change the terms of the contract accordingly. Those provisions in the Act which require an agent to disclose dual agency relationships as well as any payments received¹⁶⁸ is in part a codification of *Restatement (Second) of Agency* § 381, which pertains to an agent’s duty to disclose all information to his principal which is relevant to his principal’s affairs and which the principal would desire to have.¹⁶⁹ Therefore, the Act decreases the costs of obtaining information for principals and decreases the incentive to break a contract that is endemic in the moral hazard problem.

D. Potential Shortcomings of the Act

The Act does have two possible problems, the first of which is that the statute states that “[n]o person shall be held liable under this section unless that person has *actual knowledge* of the conduct constituting a violation of

162 *Id.* at 26–27.

163 *See generally supra* notes 19–95 and accompanying text.

164 *See generally supra* notes 19–95 and accompanying text.

165 *See generally* Hoge v. Ky. River Coal Corp., 287 S.W. 226, 227 (Ky. 1926).

166 *See* KY. REV. STAT. ANN. § 230.357(3) (West 2006).

167 *See id.* § 230.357(6).

168 *See id.* § 230.357(3)–(4), (6).

169 RESTATEMENT (SECOND) OF AGENCY § 381 (1958).

this section.”¹⁷⁰ Such a high scienter requirement could create major evidentiary roadblocks for a plaintiff alleging a cause of action under this statute, since actual knowledge is an elevated culpability standard. Second, the damages portion provides that the plaintiff shall receive “[t]he difference . . . between the price paid for the equine and the actual value of the equine at the time of sale,”¹⁷¹ and the nature of the horse business is such that the actual value of a horse is difficult to determine. The value of a horse is what a willing buyer is will pay a willing seller on any given day. For example, at the Fasig-Tipton Fall Yearling Sale in 2006, a man bought a filly for \$29,000 before the horse went into the auction and sold it at auction for \$270,000 less than twenty-four hours later.¹⁷² Clearly, ascertaining the “actual value” of the horse could prove to be quite difficult. The Act is untested in Kentucky courts as of the writing of this Note, but the development of case law will reveal whether the high scienter requirement and the valuation requirements prove to be problematic for plaintiffs.

IV. CONCLUSION

KRS § 230.0357 does not contain novel concepts in the area of agency law. Rather, it serves to address the specific problems within the horse industry of undisclosed dual agency and undisclosed kickback payments. The general concepts of disclosure and the fiduciary duties owed to a principal are present as they have been in Kentucky law for over one hundred years. However, several aspects of the Act could cause a change in the industry.¹⁷³ First, by requiring written consent to dual agency and kickbacks, the Act lessens the plaintiff’s evidentiary burden to show a lack of consent. Second, by making undisclosed dual agency *per se* illegal, the Act no longer permits custom as a valid defense. Finally, by providing relief in the form of treble damages, costs, and attorneys’ fees, the Act adds costs to violations which should lead to a rational actor to refrain from the activity. Overall, the Act is economically efficient and maximizes social welfare by facilitating trade based on full information and thus, creating a more efficient market place for horse sales.

Kentucky courts have called the horse business the “Commonwealth’s most prestigious and valued industry” with an “international reputation for

170 KY. REV. STAT. ANN. § 230.357(10) (West 2006) (emphasis added).

171 *Id.* § 230.357(6)(a).

172 See Ray Paulick, *Filly Sold Before Fasig-Tipton Sale Should have been Scratched*, THE BLOOD-HORSE, Oct. 26, 2006.

173 Some people are skeptical about the effects of this legislation on the horse business. Jim Squires, owner of Two Bucks farm, stated, “No matter what law they write or how good it is, the people who do this will find a loophole to do this, just the way tax evaders find a loophole in the tax code.” See Patton & Meehan, *supra* note 2.

excellence.”¹⁷⁴ Kentucky courts, and now the Kentucky legislature, have acknowledged a clear public policy interest in protecting this most valued industry and attracting new buyers who will contribute wealth to the business. The Act specifically addresses the problems of undisclosed dual agency and undisclosed payments in the sale of horses by creating a clear cause of action for principals whose agents have violated their fiduciary duties. The requirement that consent to dual agency and commissions be in writing, along with the additional penalties imposed for violation of the Act, should result in a positive change.

174 *Chernick v. Fasig-Tipton Ky., Inc.*, 703 S.W.2d 885, 890 (Ky. Ct. App. 1986).