



EquineSurety.org

Eliminating Horse Fraud

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The Horse Lease: Avoiding Common Pitfalls in Drafting an Effective Lease Agreement

What is a Lease Agreement?

A lease is a legally enforceable agreement usually between two parties that defines the relationship between the owner (“lessor”) and the party or parties intending to rent (“lessee”) the property in question. A lease specifies the subject matter of the lease, outlines the terms upon which the property is made available by the owner to the lessee, and defines what will happen to the property upon either successful or unsuccessful completion of the lease.

Leases are often more difficult to draft than sales contracts. And that also goes for horse leases. The reason for the difficulty is that a horse lease contemplates an ongoing relationship in which the use of the horse is transferred to another person, but the ownership of the animal remains with the “lessor” or the person leasing out the horse.

In a sales contract, the horse is sold, and title to the horse goes to the new person. Obviously there can be problems with a sales contract, particularly around the area of fraud or misrepresentation. But because a sales contract is a one time occurrence, and doesn’t envision a continued relationship around that horse, a sales contract is easier to draft.

Why are Horse Lease Agreements Special?

Horse leases are even more complicated to draft than a standard lease agreement for, say, an apartment. Unlike an residential real estate lease or a commercial building lease, a horse is a living, breathing animal that can get sick, can increase substantially in value under the lessee (the person paying for the privilege of using the animal), or can decrease in value under the lessee.

In addition, because it matters who trains the horse and where the horse is kept during the lease, horse leases might have provisions that focus on the minimum quality of trainer who

might be permitted to work with the horse, or the fact that other riders are not permitted on the horse, or the minimum level of barn care demanded by the horse's owner during the lease.

All of these facts about horses make horse leases more complicated than your standard lease of an automobile, real estate, or equipment.

But one other element factors in: People develop deep affections for horses, even if they're merely leasing the horse and not purchasing it. And, given that many leases involve the use of a horse so that a parent's child can show, the emotional elements, while not governed by the lease itself, affect the way people draft and think about horse leases.

Drafting a Horse Agreement. Don't Go It Alone

In my practice, I've seen plenty of horse leases, many of which have been drafted by the people leasing the horses themselves. In some cases, the owner or the lessee looks on Google for an example of a lease, and uses that.

The major problem with these sorts of leases drafted by the parties is that the lease ends up being what I like to call "hopeful," but with provisions of dubious enforceability.

At the time the lease is drafted, both parties are excited. The owner is excited about leasing the horse, and making some income off the horse. The lessor is excited about getting a nice pony horse that either she or her child can show. Good feelings rule the day. Sometimes the parties are friends, or at least friendly. So there is a great deal of optimism built into the lease and the context surrounding the lease.

Both parties realize that they should have a "lease," but not enough care is invested in drafting a lease that contemplates many of the contingencies, even very likely contingencies, that could occur.

Or one party may be worried that if that party asks for too much in the lease, the other party won't agree to it. So that party leaves parts of the lease silent in an attempt to not scare away the other party.

An Effective Lease is Not a Hopeful Lease.

The point of a lease, however, is that it should contemplate as many possibilities as can reasonably be anticipated, and provide mechanisms by which both parties can resolve those circumstances.

A lease is meant to deal with problems that arise because one or both parties have failed to do something under the lease. Furthermore, the meaning of each and every provision in the lease should be obvious and written in plain English.

A lease agreement is meant to clarify obligations, so that when one party demands something, a neutral party – maybe a judge or a lawyer – can look at the lease and decide who gets what.

Don't bother drafting a lease that leaves terms ambiguous, envisions a best case scenario, or is silent what to do when a common occurrence in fact happens. Such a lease won't be of much use when you need it.

Foreseeing Possibilities vs. Drafting an Ironclad Lease

It is possible to go overboard in a lease. It would be possible to draft an ironclad lease, with mechanisms to resolve every conceivable possibility. To take a farfetched example, you could have a lease that says what happens to the horse if the Martians invade.

But at some point, the parties need to be reasonable about the lease and what it can possibly anticipate.

The problem, however, with many leases is not that they're too descriptive or too complicated. It's that they're not detailed or specific enough. They're too sketchy, general, and ambiguous.

Let me give you an example. I recently reviewed a lease that had an insurance clause that read: "Lessee shall at lessee's own expense at all times during the term of this lease maintain in force a police of insurance by a respectable insurance carrier."

This provision is nonsense. First, there is clearly some value to the horse. But the insurance clause doesn't give the minimum policy amounts. Presumably insuring with mortality coverage that would pay out \$1,000 would satisfy the provision of the contract. That's probably not what the owner intended, but she didn't take time to write something more specific.

Second, what is a "reputable insurance carrier"? What the person who drafted this clearly meant was an insurance carrier who will be solvent and pay out if the horse is injured or dies.

A better approach would've been to be more specific about the concept of "reputable." There's a company called A.M. Best that's been rating insurance companies for 100 years. An insurance clause should have said, "The horse must be insured at all times during this lease by an insurance carrier rated at least A or better by the A.M. Best Co."

Using Escrow Accounts

Most leases for horses never involve an escrow account, and that's a shame. Think of an escrow account as a neutral account into which money is deposited, and maintained during the period of the contract. If you have a mortgage, your mortgage company probably requires you to "escrow" property taxes and insurance premiums so that when those expenses need to be paid, money is available.

Once certain conditions described in the lease have been triggered, or once both parties have mutually agreed to release the money, then funds in the escrow account will be paid out to either party, both parties, or a third party.

Why are escrow accounts preferable? Escrow accounts are preferable because then both parties know that funds are available if circumstances should warrant them.

One way that an escrow account can be particularly valuable is in the payment of insurance. Frequently, if a lease is about to be breached, it's because the leasing party has had financial troubles, and is unable to make additional payments to the owner.

In those instances, the leasing party may not have enough money to pay for the insurance. So not only is the leasing party behind on lease payments, but a \$60,000 or \$100,000 horse is out there in the world without insurance. That's a frightening prospect to any owner.

An escrow account, managed by an attorney, resolves this problem by guaranteeing that enough money has been set aside for insurance payments, and that the insurance company has been properly paid to cover the horse. In addition, the escrow agent can alert either or both parties if funds in the account dip below an amount needed to pay for insurance.

That notice becomes crucially important since the insurance company may not notify the owner in a timely fashion about the problem, and in that case, the horse may fall out of insurance.

In addition, the escrow account can contain additional funds that will pay for shipment back to the owner. Or it can hold a "security deposit" that the lessee gets back if the lessee has fully complied with the terms of the lease and returned the horse in good shape to the owner at the end of the lease.

Certainly an escrow account is not a cure-all. If parties are going to breach a contract, they will breach a contract. But an escrow account can protect both sides of the transaction, at a nominal fee.

Who Pays for What?

One recurring problem with leases is that the owner tries to shift the cost of various expenses to the lessee (the person making use of the horse during the lease period).

For instance, if the horse is leaving the owner's barn or property, the owner might put a provision in the lease requiring the lessee to pay for shipment back to the owner at the end of the lease.

Or, as with the insurance clause above, the lease might say that the person using the horse during the lease period is responsible for insurance.

Now, the owner might say, "Of course the lessee should pay. She's getting the use of my horse for the next year. Why should I pay for shipping or insurance?"

The fact of the matter is that these expenses need not be spelled out in the lease at all. If you know it's going to cost \$500 to ship the horse, simply adjust the price of the lease accordingly. You can tell the lessee, "I'm leasing you the horse for \$10,000, but I'm adding in an additional \$1,000 to cover various expenses to make the total lease \$11,000."

That's a much simpler, elegant, and effective way of getting what you want out of a lease agreement. It avoids the nickel and dime approach to a lease, makes the lease simpler to read and enforce, and more effective for both parties.

The same can be done for insurance. If the owner thinks that insurance will run \$2,000 for the year, then the owner can simply increase the price of the lease by \$2,000, and pay the insurance herself.

That approach does three things. First, it makes the lease easier to enforce. But more importantly, guarantees that insurance is maintained on the lease throughout the entire period. Third, the owner can be sure that she is the named beneficiary of the insurance policy.

Of course, the lessee can easily make the owner the beneficiary, but there's not much stopping a lessee from changing that designation midway through the lease. If the horse dies and the owner is not the named beneficiary, the owner will need to rely on the lessee to pay her for the lost horse. Or the owner will need to sue the lessee for the insurance proceeds.

Specify Damages, but Don't be Greedy!

A lease agreement should anticipate breach of the lease. A horse lease agreement is no different. What happens when the lease is breached?

Here's what a lease I recently reviewed said about breach:

“Upon material breach of this agreement, Lessor reserves the right to terminate the lease and remove the animal at her discretion.”

This provision is basically worthless. First, it's worthless from the perspective that it's redundant. Obviously when a lease has been materially breached, one of the Lessor's rights is to retake possession of the property. Adding that to a lease contract may seem like a wise thing to do, and there's nothing really wrong with it, but it doesn't represent any real added protection to the owner.

Second, the provision fails to spell out who pays what. The above lease also stated that the Lessee had to pay the entire lease at the signing of the lease agreement, and that if there was default by the Lessee, the owner could keep the entire lease amount. In this case, the lease amount was in excess of \$20,000.

A default or liquidated damages provision should spell out what expenses are owed to the non-breaching party in clear terms. And it should not overreach. No court would enforce a default clause that permitted the owner to keep the entire lease amount, except in certain special circumstances.

Let's say the lease in question was entered into on January 1, 2010. Let's say that the lessee paid the owner \$20,000 on January 1, 2010 for the lease for the year. Let's say that the lessee breached on January 10, perhaps by failing to maintain proper insurance. Would the owner be entitled to reclaim the horse, and keep the full \$20,000?

Almost certainly not. The owner would be entitled to some damages, but no court would allow the owner to keep the full amount even in spite of a contract provision. The owner would be required to return a large chunk of the money to the lessee.

Beware of One-Sided Leases

Many lease agreements are written by one of the parties. Perhaps the owner uses a lease he or she found on Google, or has used in the past, or has borrowed from another horse person. Or maybe the owner knows a little bit about what a lease should say, and writes one up.

The problem for the owner is two fold. First, such leases often spell out what the lessee must pay to the owner of the lessee defaults. But, if written by the owner, they sometimes don't spell out what the owner would pay to the lessee if the owner breaches.

Let's assume that the owner got angry at the lessee, and decided to reclaim the horse during the lease period, even though the lessee was fully complying with all provisions of the lease. A lease written by the owner that fails to spell out what the lessee would get in that situation is problematic.

A court is going to construe it against the owner. Second, a court is going to look skeptically at a lease agreement that seems to be completely one-sided. While leases like that are on occasion honored by courts, judges will sometimes try to find ways to “punish” someone who drafted a contract in a way that gave that person all of the benefits and few of the penalties.

In addition, ambiguous clauses will be interpreted against the drafter. That’s because courts will assume that if the drafter of the document wanted to protect himself, he would’ve written it as precisely as possible. And if he failed to do that, he will not get the benefit of any ambiguity.

As you can see, sometimes it can pay not to be the person who drafted a lease, particularly a lease that’s one-sided, ambiguous, or badly drafted.

Holding the Other Party to the Lease

Often before things break down between parties to a lease, there are signs of impending doom. Perhaps one party has financial trouble. Or another party has expressed displeasure about how the horse is being ridden at shows.

It’s important that if there’s a provision in the lease that has been violated, the non-breaching party – the one who has been “wronged” – convey in writing that the other party must take action to fix the problem.

At the point before outright breach happens, usually both parties are still on speaking terms. They may still be friends, hoping that the other party can get his or her act together and honor the terms of lease. They may want to give them a little leeway.

And it’s fine to express those sentiments, but not to the point that you give up rights under the lease. For instance, some leases specify that the entire lease amount must be paid “up front” at the signing of the lease.

It may turn out that the leasing party doesn’t have the whole \$20,000 in one lump sum. And so a verbal agreement is entered into whereby the leasing party agrees to pay in installments.

Verbal agreements, including verbal modifications to a written lease contract, may be perfectly valid. However, they are verbal, and so at a later point, parties may disagree about what was said.

But more important, verbal agreements that undercut an express term of the contract may make that term unenforceable. If you write in the contract that you want to be paid in 12 monthly installments, but you let the leasing party skip the first four months, you may have undercut the requirement in the lease that the person pay you monthly.

There may be perfectly legitimate, non-legal, but good business reasons to allow the person some leeway. You want to memorialize them in a written email or letter, and to get the other party's acknowledgement about the change in terms.

But you don't want to simply let the other party slide, hoping that he or she will fix whatever the problem is. You may find that by letting them slide, you've given up your right to enforce that provision in the future.

Conclusion

I've covered some of the major issues in horse lease agreements. But there are many other issues that I can't cover in great detail in an article like this.

Given what's at stake – significant amounts of money and a living, breathing animal whose care needs to be looked after – it's worth your while to identify a professional – a lawyer – who can help you draft a proper lease agreement.

EquineSurety has a variety of ready-made lease agreements. These are customizable, and, starting at \$250, fully adaptable to your location and needs. In addition, our escrow account services, provided at \$250 or 1 percent of the lease value, provide added convenience.

We use the latest technology, including the electronic signature service DocuSign, to make the process easy and convenient.

If you'd like to find out more about how www.EquineSurety.org can help, visit our website at www.EquineSurety.org or email us at info@equinesurety.org.