The Ins and Outs of RACING PARTNERSHIPS

By Mary Forney

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Many people envision all Thoroughbred owners to be cut from the same cloth: wealthy individuals with plenty of time and money to burn. After all, racehorses can be expensive to buy and even costlier to maintain. In reality, racehorse owners come from all walks of life, and include people at all income levels who share a common bond – a love for the horses and the excitement of the sport.

In recent years, the growth of racehorse partnerships has made ownership even more accessible. Even though one may not own 100 percent of a racehorse, many have discovered they still have access to and acceptance among those who do. Take for example John Peisner, part owner of several runners in partnerships with "Class Racing," including Rattlesnake Joe, Direct Mail, and Cinderella Kid. "I get treated the same way on a 10 percent horse as I do on a 100 percent horse," Peisner said.

Peisner's story is similar to those of a growing number of investors in racehorse partnerships. A long-time horseracing fan, he decided to get involved as an owner a year and a half ago, "with a small percentage – to get our feet wet," he recalled. Peisner had friends who had been owners for a long time, but he still did his homework, talked to other owners, and researched partnership websites. Admittedly, Peisner was luckier than many newcomers. Within a year, he owned varying percentages of eight racehorses and had eight wins – including two at Del Mar.

The fact is that there are many well-run partnerships bringing lots of new owners into the game. Not every one is a success story, however, but there are ways to tip the scales in your favor. In this article, we will provide an overview of differing types of partnerships, and identify some important points to consider before investing in any partnership.

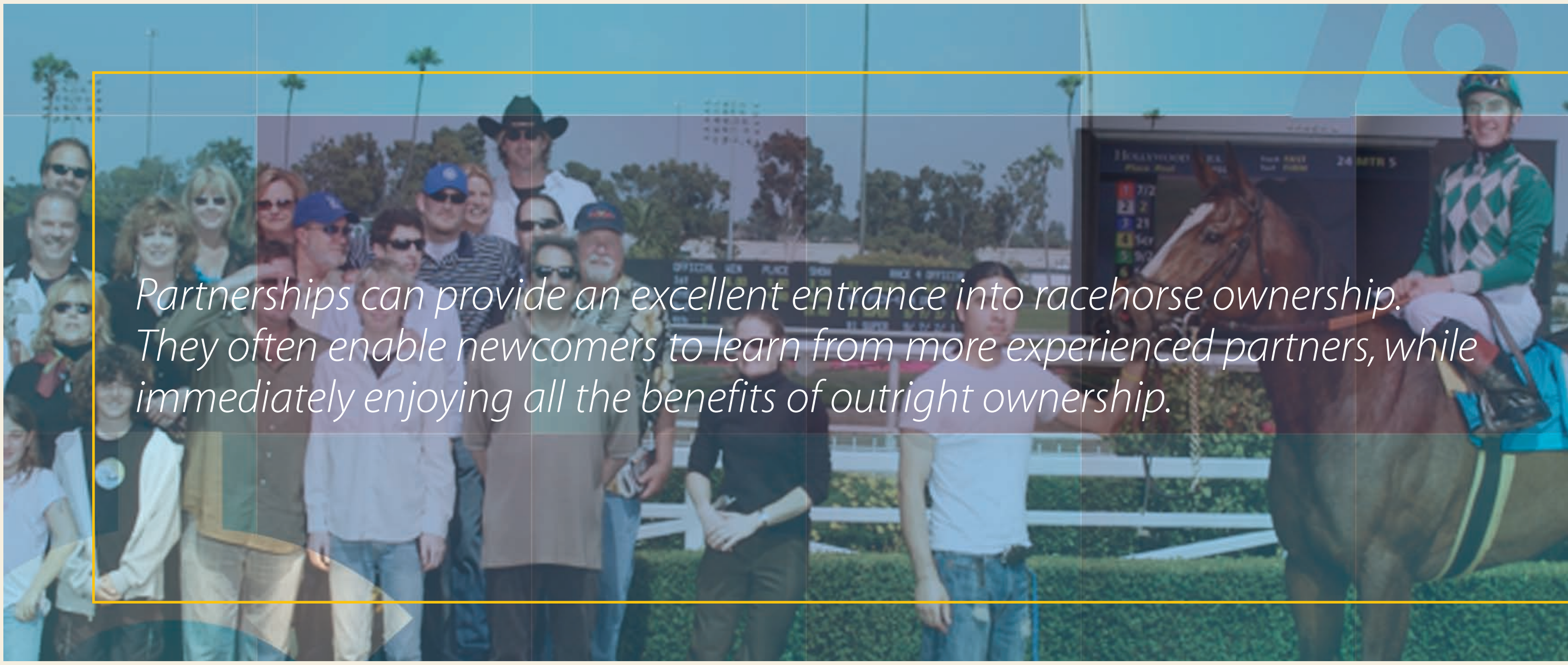
Partnerships can provide an excellent entrance into racehorse ownership. They often enable newcomers to learn from more experienced partners, while immediately enjoying all the benefits of outright ownership.

John Harris, owner, breeder, and current California Horse Racing Board commissioner, has had horses in partnership since the 1950's. "It spreads out the risk involved, and creates a group of people to visit/consult with on the progress of the stable," said Harris. "It allows newcomers to the sport to learn more about it without being responsible for all the decisions."

There are many examples of successful partnerships. Ken Smole and Jane Conway, who have been racing partners since 1985, and who are scheduled speakers at the upcoming seminar, "Ownership 101: Partnerships and Syndicates" at Bay Meadows on Nov. 11, related their experiences. They have owned percentages of runners including Ten Most Wanted, Good Journey, Meteor Storm, and Helmsman.

According to Smole, the three most important reasons to join a partnership are, "spread of risk, spread of risk, and spread of risk!" He continued, "This is a wonderful sport, a wonderful thrill, but it's a high risk business, so you have to manage your risk. It's like the difference between buying individual stocks and mutual funds."

When they first entered the business they were admittedly naïve. "The partnership provided a level of experience and connection that we didn't have," said Smole. "We didn't have to go looking for a trainer, or learn how to make a partnership work." Equally important was the social aspect. "It really is a lot more fun to be sharing this with people who are involved – people who are invested the way you are and are getting the same thrills out of it," he said.



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Partnership Types

A partnership is any joint business enterprise, entered into for profit that is owned by more than one individual. It may be created by formal written agreement, based on a verbal agreement, or just with a handshake. In all cases, a "partner" invests a specified amount based on an identified percentage of ownership, is responsible for the full amount of the debt of the partnership, and shares in profits and losses according to his/her percentage of investment.

Racing partnerships range from as few as two to hundreds of partners. Most either take the form of a "general" partnership or a "limited liability company" (LLC) marketed as a "partnership." Although general partnerships traditionally have been the most common in racing, LLC's are becoming increasingly popular, primarily because of reduced financial liability exposure for investors.

Partnerships can be for an individual horse, or an entire stable of runners. One of the advantages of larger racing partnerships is the ability of investors to own fractional interests in several good/more expensive horses rather than 100 percent of a cheaper one. According to Lloyd Dix, managing partner for WGAS 10 Stable – a partner invested in horses such as Cash Included, Excess Temptations, and Drastic Tactics – their business model is based on fractional ownership. "If it's going to cost $3,000 to $4,000 a month, why on earth would you want to buy a horse for $3,000? We try to go for more expensive horses," he said, "even if it means we'll own less of them."

Although he was a lifelong racing fan, Dix only became an owner a little over a year ago, when he put together a partnership with nine of his friends. Since its inception, the stable has owned five racehorses – some in partnership with others including Harris Ranch and L.A. Dodgers pitcher Brad Penny – and boasts greater than a .28 winning percentage, with over 52 percent in the money. Dix's recipe for success is threefold:

1. Study and learn from the mistakes of other partnerships;
2. Create a business model based on fractional ownership; and,
3. Let the trainer have unfettered discretion as to where and when horses should run.

General Partnerships.

A "general partnership," such as the one Dix put together, is formed among two or more individuals who share equal duties and rights of management. Each partner is individually liable for the debts and obligations of the partnership – which may extend beyond the assets of the partnership to the partner's personal assets. Each partner has equal say in the management of the partnership, but the partners may appoint one or more "managing partners," such as the majority partner or trainer, to handle the primary management responsibilities. General partnerships are the simplest form of partnership, and by far the most common.

A general partnership might be formed by a group of friends who want to become horse owners and who share the same goals, or by existing owners who want to bring friends or newcomers into the business. Frequently trainers put together partnerships, in which they may or may not be a partner, as it is a means for them to acquire new clients and horses to train. General partners may decide to race under a stable name – especially if there are many partners – or simply in the names the partners.

Limited Partnership or LLC (Limited Liability Company).

In a "limited partnership" the liability of each partner is limited to the extent of his or her investment. The management of the partnership is vested in a general or managing partner, with the remaining partners having no management duties. The managing partner is personally liable for the debts and obligations of the partnership should the partnership be unable to satisfy them.

There are a growing number of partnership offerings in the form of LLC's, as is easily confirmed by even a quick search of the Internet. These investment vehicles range in size and complexity from as few as five or six partners to hundreds of investors, involved at a wide range of investment levels. Some LLC's syndicate individual racehorses, while others form partnerships involving two or more horses. Such companies normally charge a management fee, and sometimes a commission on sales and purse earnings. The main attraction to this type of partnership is the ability to participate for a small investment, with limited risk.

IMPORTANT CONSIDERATIONS

Common Goals.

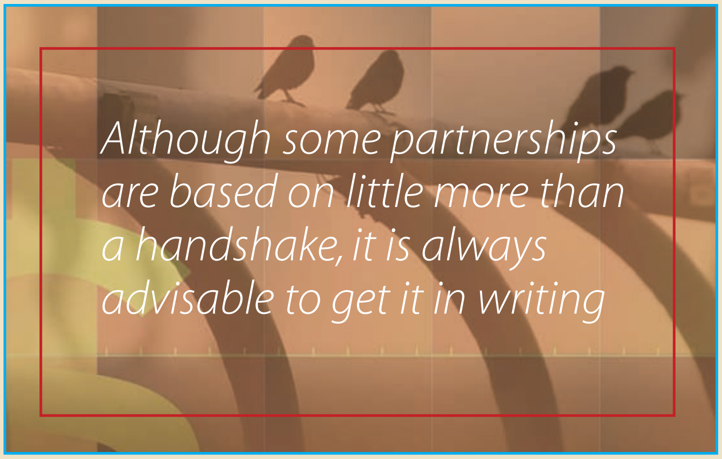
It is important to find partners, and a trainer, who share your racing goals. "Partners should decide where they want the horse to race – both as to locale and price level – and if the partnership and the horse fit those criteria," said Harris.

Smole reiterated this sentiment: "You have very little ability to influence how the horse is campaigned or run if you're not in agreement in advance about what your goals are. Try to have it established ahead of time."

It is also important to be comfortable with the people you are going to be associated with. As Smole points out, "You've got to know who you're dealing with, and you've got to be comfortable with who you're dealing with. In the law, the word 'partner' carries with it deep legal meaning."

Contracts.

Although some partnerships are based on little more than



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a handshake, it is always advisable to "get it in writing." A contract stipulates how the partnership will be funded, how racing decisions will be made, and a myriad of other issues touched upon in this article.

Limited partnerships generally prepare lengthy, detailed contracts spelling out the rights and duties involved. General partnerships, while far more common, often do not involve written agreements. This is an industry in which a person's word has traditionally been his bond. However, it is always sound business practice to arrive at some formal agreement – whether it is written or verbal – establishing exactly what each partner can expect.

Term of Partnership.

The term of a partnership can vary. A partnership may be set up for a specific duration, until death, or until one or more of the partners decides to leave the partnership or the partnership asset(s) – the horse – is lost. Unless arranged ahead of time, leaving a partnership will not relieve a partner of duties and responsibilities incurred by the partnership.

Termination of Partnership.

Upon the death or withdrawal of a partner, the partnership is legally considered dissolved. If no provision has been made otherwise, the horse/asset must be sold at public auction. On the other hand, a contract may provide that one or more of the remaining partners may purchase the interest of the deceased partner at fair market value or for a price determined by a mechanism specified in the contract. A partnership contract should also specify that a deceased partner's heirs are held harmless from any partnership obligations after the sale of the share to the other partner(s).

"There should be a mechanism if a partner wants to get out, that the other partners have right of first refusal," said Smole. "The bottom line," he continued, "is that – aside from giving existing partners the opportunity to acquire a bigger part of the horse – it controls who gets into the partnership. If we wanted out, and just turned around and sold our share to some 'bozo,' that wouldn't be fair to the other partners."

The Trainer.

The trainer is the one person who can make or break the ownership experience. This is especially true in a general partnership, where the trainer is often the most influential partner, so it is important to find one who not only shares your racing goals, but who is generous with his or her time and attention, particularly if you are new to the sport.

"Your expectations have to fit with the partnership's expectations," said Conway. "All the things that are important – like picking a trainer – come into play. The trainer should be doing what you expect a trainer to be doing. If not, that's not the right partnership."

Smole cautioned, "Make sure the trainer carries adequate liability insurance, because at the end of the day, if a horse gets loose and runs over three people, they will go after somebody, including the owners of the horse if they have to."

Racing Colors.

Many partnerships run under a stable name, using the stable's silks. However, others run under the names of the individual partners (often listing three partners and "et al" in the racing program), in which case it is important to establish whose racing colors the runner will carry. Frequently, when more than one partner has racing silks, the partners will agree to "rotate" silks when the horse competes.

Partnership Accounting

It is advisable for partners, either individually or collectively, to maintain books that accurately reflect income, expenditures, profits, and losses. The more detailed the accounting, the better. For example, Peisner noted that he receives "a very detailed monthly accounting breaking down each item – vanning, shoeing, etc." Said Peisner, "The whole thing is run like you would expect a business to be run."

Accurate financial records are not only important for determining tax liability, but are extremely helpful when resolving disputes, should one arise among partners. Accordingly, one partner should be assigned to keep the books for the partnership, and should issue periodic accountings, usually on a monthly basis. If the books are maintained on behalf of the partnership, each partner has the right to inspect them at any time. Alternatively, some partnerships hire an outside accountant, usually when the investment is great and the return warrants it be done so.

Tax Implications.

Both federal and state tax laws treat partnerships as "pass through" entities; that is income and expenses are passed through to the individual partners each year on a Form K-1. Each partner then reports the income on his or her personal income tax return. Partners pay taxes only for those revenues that they actually earn, and are not responsible for taxes incurred by the other partners. It is important for all owners to be familiar with applicable State and federal tax regulations, including IRS Code Section 704(c).

In our opinion, every successful racing partnership begins with a sound business plan, based on realistic expectations. Stu Lerner, whose partnership interests have included Thor's Echo and Dancing Edie, fully agrees. A racing fan and handicapper with a lifelong dream of owning a Thoroughbred, Lerner decided, with his wife, Jeanne, to invest in a racehorse after hearing a partnership advertisement on a popular racing radio show.

"We decided how much we could put in without impacting our savings – knowing we might never see the money again," said Lerner. "We got 10 percent of a horse, and figured we could afford two years of training expenses." Although his first investment, Lora's Dream, never won for them, she was in the money a few times before they sold her six months later. They immediately reinvested the money in two more horses. In his second race for the partnership, Thor's Echo won impressively, and the offers to buy him started pouring in. He was eventually sold for $350,000.

Dancing Edie's story was even more spectacular. After her third-place finish in the Grade I Del Mar Oaks, her seventh start for Lerner and the partnership, she was another hot commodity. Lerner decided to retain his interest when a majority share of the partnership was sold to J. Paul Reddam.

Lerner considers his racing partnership experience "a wonderful odyssey." It is an odyssey that is within the reach of anyone with a sound plan and the willingness to do a little "homework."

TOC provides prospective owners a number of the tools necessary for getting started in the business, including an ongoing series of educational seminars. Anyone interested may also pick up a copy of TOC's free "Partnership and Syndicate Directory," which includes names, contact numbers, and general information about the many partnerships that operate racing stables in California. Similarly, TOC has sample partnership agreements available, as well as various CHRB forms for licensing partnerships. All of these materials are available at TOC offices located at each California racetrack, or may be requested by phone at (626) 574-6620 or through email at TOC@toconline.com.