SOUTHERN RISK MANAGEMENT EDUCATION CENTER
2013 Risk Education Publication Series*

DIVISION OF AGRICULTURE
RESEARCH & EXTENSION
University of Arkansas System

Legal Risk Management Issues

Jesse J. Richardson, Jr.

Introduction

This publication seeks to build upon the Legal Risk White Paper authored by Harrison Pittman in the fall of 2010. Basic legal risks have not changed drastically since that earlier white paper. Landowner liability, contracts and leases and business organizations remain essential concerns for most producers. However, other legal risk issues have emerged as vital to producers in the South.

Agricultural risks have been classified as production risk, marketing risk, financial risk, legal risk and human resources risk (USDA RMA, 1997). Legal issues overlap and intersect with the other risk areas. The five main areas of legal risk in agriculture involve tort liability, contractual arrangements, business structures, tax and estate planning and statutory compliance. This publication addresses each of these issues, but does not purport to cover any of these issues comprehensively. Rather, this brief outline provides a summary of major, selected legal risk issues facing agricultural operations in the South. Readers should not rely on this publication for legal advice, but should use it as a resource to raise questions about the legal risks facing their farm and/or agricultural operation. The publication closes by highlighting some specific legal risks for targeted producer segments to consider.

Fundamental Legal Risk Issues

Tort liability

Tort means "twisted action" in Latin and refers to a private or civil wrong other than breach of contract. An accident can be classified as "tort" when there is a person or entity legally responsible for the accident. For example, if a customer at a farmers' market falls and is injured, a tort may have occurred. If the owner of the farmers' market was careless and allowed dangerous conditions to exist, the owner may be held liable for the accident.

Landowners, producers and marketers may be liable for injuries to employees, customers, trespassers or third parties. Property damage may also be recovered. Although all producers and marketers face potential tort liability, the risk increases when customers are allowed on the property (for example, u-pick or agritourism) and with direct marketing operations. Tort liability, including landowner liability for injuries to persons on the property (whether invited or not), remains the most fundamental legal risk topic in agriculture. Educational workshops and publications on this topic continue to be in high demand.

In addition to understanding the general tort liability principles, producers should recognize activities that increase the risk. Steps can then be taken to reduce, shift or avoid the risk. Proactive measures such as liability assessments and standard operating procedures can reduce these risks.

Product liability is an emerging area of tort liability. Product liability refers to liability for the sale of faulty products. In agriculture, contaminated food most often forms the source of product liability. Three factors make product liability an increasing concern. First, the number of claims and lawsuits has increased significantly in recent years. Second,

SRME02FS

Materials developed by The Southern Risk Management Education Center (SRMEC) are made available through a grant from USDA-NIFA and authorized by Section 133 of the Agricultural Risk Protection Act of 2000. SRMEC is a regional center of Extension Risk Management Education established to carry out the program Partnerships for Risk Management.

USDA United States Department of Agriculture National Institute of Food and Agriculture

injured parties increasingly receive large amounts of compensation. Finally, the number of direct marketing operations is increasing, with a related increase in risk. It should be noted that the passage of the Food Safety Modernization Act has elevated farmer actions documenting farmer efforts to ensure safe products from an industry standard to regulatory compliance.

Liability insurance proves vital to any agricultural operation. However, different types of coverage and the various options make understanding liability insurance difficult. Education programs should focus on these issues and specific processes that farmers can engage to mitigate and minimize some of the possible legal risk exposure.

Recently, states have passed a myriad of landowner, farm operator and agritourism liability acts that purport to provide protection to landowners and operators. However, these provisions often give producers a false sense of security and result in confusion. Education is needed with respect to these new laws highlighting the specific protections, if any, these laws provide agriculture operations.

Contracts and leases

Contracts, including leases, are part of everyday life for anyone engaged in agriculture. State and federal laws establish special rules in some agricultural contexts – the Uniform Commercial Code and the Perishable Agricultural Commodities Act come to mind immediately. Producers need to be aware of these rules to limit risk.

More importantly, however, a large number of, perhaps even most, agricultural contracts and leases are oral. Failure to reduce contracts and leases to writing increases legal risk significantly. This issue is particularly troubling with respect to leasing for at least two reasons. First, many producers rely on leased property. Second, the statute of frauds requires that agreements be in writing for certain contracts, including contracts that cannot be performed within one year. This means that leases of more than one year must be in writing to be enforceable. The drawbacks of short-term leases, both for the landowner and the producer, add to the concern about oral leases.

A myriad of issues must also be addressed by landowners and renters, including allocation of federal program payments and responsibilities, maintenance of fences and buildings and hazard insurance. Verbal agreements often fail to adequately cover these issues. Lease agreements often resemble legal partnerships. Partnerships entail increased legal and financial risk to the partners. Although a written lease cannot guarantee that the law will not treat the parties as a partnership, the lease can address this issue and reduce the risk.

Business organizations

Choice of business entity should consider liability, taxation and ability to raise business capital. For small family businesses, raising capital is usually not accomplished through public offerings or similar steps. However, business organizations are often cited as one of the most important ways to reduce financial and legal risk in agriculture. In addition, business organizations are an important issue in tax and estate planning. In reality, however, the limited liability presented by business organizations is often illusory.

Lenders will require the owners of a business to guarantee loans, and suppliers often demand similar guarantees. With respect to legal risk, any assets within the business organization remain exposed to liability. With many producers, the primary asset is real estate; real estate is in the business organization. If the business is subject to liability, the primary asset is exposed and may be lost. In addition, if the primary owners of the business fail to treat the business assets and personal assets separately, personal assets are exposed to business liability. Unlawful or dangerous actions by the owners of the business may also expose personal assets.

Some people believe that a complex maze of business organizations can be constructed that will guarantee immunity from legal liability. Such actions are generally futile.

Limited liability companies in particular seem to be considered by some as almost “magical.” However, the business entity itself does not make the operator a better manager or make the business more profitable. Business owners are much better served by purchasing liability insurance. Although good business planning and choice of an appropriate business entity can minimize tax liabilities and ease the transition of the business to the next generation, liability protections are minimal.

One hazard to avoid with respect to business entities is the “accidental partnership.” Producers often join forces to, for example, purchase inputs in bulk to reduce costs. Producers also sometimes combine their products for sale to increase efficiency. These arrangements sometimes resemble partnerships, as do some lease agreements.

In a partnership, each partner is personally liable for the debts of the partnership. For example, if one producer has an accident while picking up inputs, all of the involved producers are personally liable if the arrangement is deemed a partnership. In these situations, producers should ensure that the relationship between the parties is spelled out in writing and that steps are taken to ensure that the legal relationship is not a partnership. Leases often contain a provision stating the relationship is one of a landlord and tenant, not a partnership.

Business agreements are often more important than the actual business entity the operator chooses. Business agreements include the documents that organize the business, like articles of incorporation and by-laws, but also refer to agreements among the business owners. These agreements may be in the form of a shareholder agreement, operating agreement or buy-sell agreement.

Whatever the label, these agreements can set out rules for how the business will operate in the future. Provisions may include limitations on ownership (for example, limiting owners to lineal descendants of the original owner), buy-sell agreements that can establish, among other things, the terms of payment and valuation of the business interests and control of the business.

Farm transition

Choice of an appropriate business entity can aid in transitioning the farm operation to the next generation or to a non-family member. Many farmers in the South fail to do adequate farm business transition planning to allow for this transition. If a plan is not in place and one of the 5 D’s – death, disability, divorce, disagreement and disaster – occurs, the farm, and the land, may be lost. Therefore, farm transition planning (also referred to as farm business succession planning) addresses both financial and legal risk. With the average age of the primary farm operator in the South increasing, farm transition planning represents a major educational and functional need. However, there is often a lack of resources to educate and aid the farm business owner in this task.

The business agreements discussed with respect to business organizations can include strategies to deal with the 5 D’s and prevent chaos or a forced sale of the business to address liabilities. The agreements can prevent dissolution of the business due to death or divorce of the owner, or disagreement between the owners. Control of the business and ownership of the assets can be separated. In short, business agreements minimize legal and financial risk and ease the transition of the business.

Farm transition also involves many “soft” issues, the most important of which is communication. Farm families may need to employ different techniques, or even hire a facilitator, to help transition the farm to the next generation.

Estate planning is one part of farm transition planning, but farm transition planning draws from business planning and other areas. For many operators, land is the primary asset of the business. The prevalence of large land holdings in agriculture often complicates estate planning.

Land use issues

Land use issues increasingly impact agricultural businesses in the South. With increasing prominence of urban agriculture and local foods, land use planning and zoning issues become even more important. Can I keep chickens in my urban yard? How about bees?

However, land use planning and zoning issues are not limited to urban areas. Land use regulation impacts retail sales, agritourism and concentrated animal operations, among others. Vineyards may wish to host wine tastings and weddings. Agritourism operations may involve music concerts and large numbers of cars and people. A homeowner may grow vegetables to sell excess production to others in the area. All these situations present the possibility of conflict with neighbors, as well as land use regulations that may limit or prevent the activities on the property.

New types of activities on agricultural land raise the issue of how "agriculture" or "agritourism" is defined. Court cases have examined whether a rodeo or a music concert is included within the definition. Issues are raised as to whether wind turbines and solar panels are "agriculture" or are even appropriate on agricultural lands.

These land use planning and zoning issues are receiving increasing attention from local governments, agribusiness operators and citizens. Operators increasingly need to be aware of local land use regulations and how to navigate the complex system of permits and permissions.

Water availability

The availability of water impacts production risk, financial risk and, increasingly, legal risk. As the demands for water increase, mainly through increasing development, and droughts become both more frequent and more severe, legal fights over water are becoming more common, even in the East. In the Southern region, water was plentiful in the past, but these factors, along with climate, have made water scarce.

Litigation between states has been contentious. Conflicts include Florida, Georgia and Alabama; Arkansas and Oklahoma and Texas and Oklahoma. The United States Supreme Court recently addressed one dispute between Texas and Oklahoma.

Declining groundwater in the Arkansas Delta and the Ogalala Aquifer in Oklahoma and Texas, along with increasing urban demand for water and more frequent drought, foreshadows increased conflicts between landowners.

Two major court decisions in Texas have involved the battle for water in the Edwards Aquifer. One of these cases involved a pecan grower who was denied the water necessary for his pecan trees. These cases have garnered national attention.

Operators must ensure that they have the legal right to withdraw the water that they need for their operations. Another risk to consider is the increasing regulatory requirements in regard to water use. Leases and other contracts should carefully specify the allocation of available water between the parties. Lease and contract provisions addressing water are even more important in the context of oil, gas and mineral leases. The law of many states presumes that the company extracting the oil, gas or minerals may use whatever water is "reasonably necessary" to extract the natural resources. With the increase of hydraulic fracturing, which demands large amounts of water, agricultural water is being pressured from many different perspectives.

Legal Risk Issues for Specific Producers

Animal agriculture

"Animal welfare" continues to be an important consideration for animal agriculture. States have passed laws addressing the size of animal cages and enclosures, as well as other issues pertaining to the treatment of livestock.

Aquaculture also faces unique concerns, including land use and water issues. In Virginia, for example, aquaculture operations attempted to persuade the state legislature to include aquaculture under the state's right to farm act. Litigation on the zoning of aquaculture operation is presently pending in the Virginia Supreme Court.

The United States Environmental Protection Agency (EPA) has recently attempted to expand the coverage of the Clean Water Act as applied to concentrated animal feeding operations (CAFOs). Litigation is presently pending in North Carolina and West Virginia where the EPA alleges that feathers, dander and manure blown from chicken houses from exhaust fans constitute "discharge" and can be regulated by the agency. As these laws expand, growers must ensure understanding and compliance of existing regulations.

Forestry

Forestry is an important industry in the South. The issues facing forest owners include landowner liability, carbon sequestration, environmental issues, taxation, biofuels and alternative uses of forestland.

Labor issues

Labor issues are particularly important for specialty crop producers in the South. Issues include the use of youth employment, worker compensation and overtime compensation. There are state and federal laws that farm owners must comply with in regard to documenting and verifying workers on their farm.

Agritourism

Agritourism activity is increasing rapidly in the United States. The need to understand tort liability and land use issues is particularly important in agritourism. Agritourism activity liability statutes have been passed in many states in the South, but these statutes may confuse the issues more than provide protection. Operators should carefully comply with these statutes, but not decrease their vigilance or liability insurance. Liability insurance may also be expensive or difficult to obtain.

Local food system development/ sustainability

Programs like Farm to School and Know Your Farmer, Know Your Food seek to emphasize use of local food producers and have been increasing in prevalence in recent years. USDA launched the first-ever Farm to School Census in October 2013 and highlights its support for local food systems in a myriad of programs. There exists unprecedented interest in local food systems as consumers are increasing their demand for locally sourced products across the distribution system. This emerging market presents food safety, direct marketing, organic production issues and other issues that increase risk in this context.

Conclusions

Legal risk continues to increase for agricultural operators in the South. Different types of operations, increased scarcity of and demand for resources. Changing politics including potential changes to policy and regulatory environments have created an increasingly risky landscape in regard to legal issues. Operators must be more sophisticated and develop new and different ways to manage risk. Various legal and economic tools exist to hedge risk, but these tools have become more complex.

Sources

Harvard Law School Food Law and Policy Clinic, *Good Laws, Good Food: Putting Local Food Policy to Work for Our Communities* (July 2012), available at http://www.law.harvard.edu/academics/clinical/lsc/documents/FINAL_LOCAL_TOOLKIT2.pdf

Richardson, Jr., Jesse J., *Managing Liability: Legal Liability in Agritourism and Direct Marketing Operations*, Virginia Cooperative Extension (2013), available at http://pubs.ext.vt.edu/CV/CV-25/CV-25-PDF.pdf

United States Department of Agriculture - Risk Management Agency, *Introduction to Risk Management* (Revised December 1997), available at http://www.ncrme.org/docs/IntrotoRiskManagement.pdf

AUTHOR: Jesse J. Richardson, Jr., is an Associate Professor in the Department of Urban Affairs and Planning at Virginia Tech University and serves as the Legal Risk Coordinator for the Southern Risk Management Education Center located at the UA System Division of Agriculture Cooperative Extension Service.

***Ronald L. Rainey** and **H. L. Goodwin** are Co-Directors of the Southern Risk Management Education Center and serve as editors of this publication series. To learn more about risk management education programs and resources, visit the Southern Center web site (http://srmec.uark.edu) or the Extension Risk Management Education Program link (www.extensionrme.org).

Printed by University of Arkansas Cooperative Extension Service Printing Services.

SRME02FS-PD-12-13N