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Legal Framework for Risk Management

From the Train the Trainer Handbook:

Legal Framework for Risk Management

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Introduction

Nobody likes to think about worst-case scenarios. But the time to think about, and prepare for, problems is before they happen. Today's farmers are exposed to a variety of risks (e.g., volatile agricultural markets, property losses, liability claims, and criminal prosecutions for environmental damage), and risk management is as important a priority as deciding what crops to plant and animals to raise. The following is a brief overview of risks to be managed by farmers.

Hybrid Cash Contracts: To protect themselves from volatile agricultural markets, farmers often use hybrid cash contracts such as hedge to arrive, minimum price, and so-called flex contracts. But some farmers do not understand the legal risks associated with hybrid cash contracts. Many of these contracts for the trading of grain and feed are entered into over the telephone with written confirmation to follow. Disputes can arise over whether the written confirmation matches the oral agreement reached by the parties. A farmer who fails to object to a written confirmation of a trade has accepted the terms contained in the written confirmation even if the terms are contrary to the parties' oral agreement. The enforceability of hybrid cash contracts and the duties and liabilities of the parties are controlled by state and federal laws. A number of states have specific statutes governing deferred payment or deferred price contracts between grain dealers and producers. Some states mandate that agricultural contracts contain arbitration or mediation clauses.

Hedge-to-Arrive (HTA) Contracts: The HTA contracts controversy has resulted

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in financial losses for farmers (producers), grain dealers (elevators), and some agricultural lenders. Corn belt losses may exceed \$1 billion. The controversy centers around the legality of so-called flex HTAs that allow farmers to roll the delivery date of crops to sometime in the future in order to sell a current crop in the spot market at a favorable price. Unfortunately, because of hedging by grain dealers and market fluctuations, when a farmer is asked for physical delivery of a crop on the date stated in the roll forward agreement, the farmer may face huge losses. To avoid losses, some farmers have refused to deliver their crops.

Grain dealers have sued farmers under HTA contracts alleging breach and seeking specific performance and money damages. Farmers have countered with defenses of misrepresentations by plaintiff grain dealers, absence of contractual obligations to physically deliver crops, that HTA contracts are illegal under the federal Commodity Exchange Act (CEA) as off-exchange futures contracts, and RICO claims.

Property Insurance: The typical farm property policy covers the farm dwelling - as long as it is mainly used as a residence. To have unattached items (detached garages, barns, trees and shrubs) covered, they must be specifically itemized. Farm structures rented to others need separate coverage.

Furniture, household utensils, clothing and other personal items are covered. But policies often set limits on how much specific items are insured, such as \$1,500 on jewelry. Home computers, entertainment systems and other high-value items may need to be itemized to be fully covered.

The better property policies provide money for additional living expenses if a family is forced to leave the home because of a covered loss. A good policy should pay a family's normal living expenses until the home is repaired or replaced.

Farmers are often described as being cash poor but asset rich. Basic farm assets such as equipment, crops and animals need to be adequately covered by property insurance. The standard farm property policy can contain gaps in coverage for such items as borrowed farm equipment; motor vehicles, even if used on the farm; livestock used for sporting or show events; and crops and livestock damaged in transit; livestock while in public stockyards, sale barns or yards, packing plant or slaughter houses.

Farmers must decide whether to purchase federal subsidized crop insurance or rely on unsubsidized private insurance. There are significant differences between the policies as to deductibles, covered perils, and coverage for growing or harvested crops in transit. Knowing what is and is not covered, as well as how to close insurance gaps, is the key to protecting valuable assets.

Medical, Disability, Long-term Health Care Insurance and Life Insurance:

No farmer is adequately insured against life's misfortunes without securing the following policies.

Medical Insurance: Medical expenses due to a serious illness or injury can wreak economic havoc on a family. Individual policies are available for hospital stays, surgical expenses and non surgical care. A good comprehensive policy will also cover prescription drugs and necessary equipment for treatment (wheelchairs, artificial limbs, etc.).

Long-term health care insurance: This kind of policy pays a daily or monthly benefit for medical or custodial care in a nursing home or, in some instances, for in-home care. Be sure to understand whether a policy offered to you contains a home-health option. If it does, determine whether the benefits for home health care equal those for nursing home care.

Before choosing a plan, investigate whether the policy contains inflation protection or the option to add it later. The best inflation protection provides a built-in annual increase in benefits to offset inflation.

Life Insurance: Life insurance is an invaluable estate planning tool, especially if you want your family to inherit your farm or ranch operation. High federal estate taxes are the primary cause for the demise of family farms and ranches. A life insurance policy can provide the cash to pay these taxes. It can also fund a buy-sell agreement or pay operating expenses during the difficult transition period following a family member's death.

Liability Insurance: A liability policy protects a farmer against claims or lawsuits brought by persons whose property or person has allegedly been injured by the farmer's negligence. But liability policies contain critical exclusions. For example, many farmers have family members working for them. Liability policies routinely exclude coverage for family members injured by a farmer's negligence. Other non-farm employees injured by a farmer's negligence are also routinely excluded from coverage.

Farmers often engage in business pursuits other than farming, (e.g. leasing their land to individuals or organizations for hunting, fishing and camping; u-pick operations; dude ranches; or other recreational activities). Liability policies, however, exclude coverage for business pursuits other than farming. Also, state recreational use statutes do not apply to fee generating activities.

Liability Coverage and Pollution Claims: Pollution lawsuits are a major concern for farmers. The courts are beginning to erase the line between point and non-point sources of pollution, further exposing farmers to environmental claims.

In the Southview Farm case, the court held a modern confined animal feeding operation to be a point source of pollution, along with a depression in a field (a swale) and a manure spreader. Some liability policies, however, exclude coverage for pollution claims unless the pollution event is sudden and accidental .

Many of the newer liability policies entirely exclude coverage for pollution claims, forcing farmers to purchase special pollution policies. The pollution policies that are available contain unique characteristics unfamiliar to farmers, including decreasing value and claims-made clauses. The claims-made policy severely limits a farmer s pollution coverage, but can be improved with tail coverages. Some exclusions can be eliminated by endorsements to the standard liability policy or by purchasing other insurance designed to meet specialized needs. Managing liability risk begins with understanding liability insurance coverage.

Environmental Crimes: Beyond having the proper liability coverage as protection from the property and bodily injury claims of persons exposed to farm pollution (e.g., animal waste, pesticides, and herbicides), farmers must be prepared to deal with possible criminal prosecutions by state and federal agencies for environmental events. Liability insurance affords no protection from criminal penalties assessed against a farmer by a regulatory agency. Criminal prosecutions for pollution events are commonplace and are increasingly used by state and federal agencies. Unlike most other criminal acts, environmental crimes require only proof of general intent for a conviction instead of specific intent. For example, if a deer hunter accidentally kills an endangered species while hunting, the deer hunter is guilty of violating the Endangered Species Act. Even though the hunter did not have the specific intent to kill an endangered species, he had the general intent to discharge his weapon and an endangered species was killed.

Jail sentences are common in environmental crimes cases. For example, property owners have received substantial jail time for destroying as little as one acre of wetlands. Federal sentencing guidelines leave courts little discretion in sentencing violators. The cost of mounting a defense in an environmental crime case ranges from \$250,000 to \$500,000.

To avoid jail time, and/or defense costs, some farmers are forced to enter into expensive Supplemental Environmental Projects (SEPs). Courts can also use shame as a form of punishment. One swine producer was ordered to publish a letter apologizing for his crimes.

A recently proposed environmental crimes bill, H.R. 277, would increase fines up to \$1 million for individuals and \$2 million for corporations, increase jail sentences up to 20 years, provide for collection of prosecution costs from defendants, and provide for pre-conviction seizure of assets.

Compliance with the complex body of state and federal environmental laws (e.g., Clean Water Act, Federal Insecticide, Fungicide, and Rodenticide Act, and the Endangered Species Act) is the only sure protection from criminal prosecution. Organizations such as Farm*A*Syst help farmers identify and address potential environmental problems and thus avoid environmental claims or violations.

Farmers can greatly reduce their criminal liability exposure by formulating and following environmental audit procedures. Be aware, however, that audits can be used as evidence of environmental violations. A number of states have passed environmental audit privilege statutes to keep federal and state regulators from discovering audit information. The EPA, however, contends that statute audit privilege statutes cannot supersede federal law.

Many good farmers fail to keep records necessary to prove compliance. Accurate records should be kept on the applications of herbicides, pesticides and fertilizers. Proper storage and disposal methods must be followed and employees must be trained in environmental compliance.



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