Welcome to the Tennessee Value-Added Beef Webinar Series
Made Possible By:

Today’s Topics & Presenters

• Circling the Wagons
  – Managing the Legal Risk of Direct Marketing Beef
  Rusty Rumley,
  Staff Attorney, National Agricultural Law Center
  Hal Pepper,
  Financial Analyst, CPA
  Megan Bruch,
  Marketing Specialist, CPA

Session Overview

• Introduction to risk, risk assessment and risk management
• How business structure may be used as a tool to manage legal risk
• How product liability insurance may be used as a tool to manage legal risk

Session Objectives

• Increase awareness of strategies or tools to manage legal risk
• Increase legal risk assessment and implementation of tools to manage legal risk

Risk is...

The uncertainty regarding likelihood or magnitude of loss, damage or injury

Types of Risk

1. Legal
   – Laws/regulations
   – Injury to customers or employees
2. Human Resources
   – Death, divorce, disability and disagreement
   – Employee turnover
3. Business Interruption
   – Weather, natural disasters, other
4. Production
   – Weather, disease, pests, errors
5. Marketing
   – Ability to entice customers
   – Increased competition
6. Financial
   – Ability to meet cash flow, obtain affordable credit, grow equity
   – Damage or loss to personal property
Risk Management Methods

1. Avoid Risk
   - Choose not to engage in a specific activity
2. Reduce Risk
   - Implement preventative measures/procedures
3. Transfer Risk
   - Transfer to another party – typically with insurance
4. Accept Risk
   - Prepare for loss or damages – create emergency fund

Risk Assessment & Management for Your Business

Example Methods to Reduce Risk

- Familiarize yourself with laws and regulations and follow requirements relevant to your operation
- Develop and implement
  - Safety measures and procedures for customers and employees
  - Emergency response plan
  - Incident reporting system
  - Food handling procedures
  - Product recall procedures

Example Methods to Transfer Risk

- Obtain insurance
  - Property, liability, health, disability, life, crop, etc.
- Learn and follow insurance requirements and claim procedures

Example Methods to Accept Risk

- Develop a business analysis and management system
- Choose a beneficial business structure
- Monitor market conditions
- Create an emergency fund to pay insurance deductibles and other potential losses
Step 1 – Risk Assessment

- Identify specific risks associated with your business
- Consider all types
  - Legal
  - Human Resources
  - Business Interruption
  - Production
  - Marketing
  - Financial

Step 2 – Risk Assessment

Analyze likelihood of injury
- Can rate on scale of 1=Low to 5=High

Analyze magnitude of potential loss
- Can rate on scale of 1=Small to 5=Large

Step 3 – Risk Management

- Decide which general methods of risk management are appropriate
  - Avoid, Reduce, Transfer or Accept

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Step 4 – Risk Management

Decide which specific strategies you will take to manage risk

Estimate costs

Step 5 – Risk Management

Implement risk management strategies
Step 6 – Risk Management

Evaluate effectiveness of risk management strategies implemented

Then return to Step 1

(Refer to Risk Assessment and Management Worksheet Handout)

Limiting Liability with Business Organizations

Rusty Rumley
Center Staff Attorney

479-575-7646 • nataglaw@uark.edu

The Business Structure

- What is so Important about a Business Structure?
  - Liability Protection – separating assets so that a creditor or plaintiff cannot take everything you own
  - Fairly cheap to use
  - Easy to set up
  - Great estate planning tool

BUSINESS ORGANIZATION OPTIONS TO PROTECT YOUR PERSONAL AND BUSINESS ASSETS.
How Business Entities Work to Protect You

Know what business entities provide protection:
- **No protection** - Sole Proprietorship and General Partnership
- **Some partners protected** – Limited Partnership
- **Full protection** – Limited Liability Companies and Corporations

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How Business Entities Work to Protect You, continued

Why the differences in protection?
- Some business entities function as a separate legal entity (like another person) and others do not.

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How to use a Business Entity

- Creating a business entity is not enough to provide any protection
- Creating a business entity is like buying another basket…

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Respect the Business Structure

- At the end of the day, Courts will only respect your business structure as much as you do.
- What does this mean?
  - You HAVE to keep the business separate from your personal life and from other businesses that you run.
  - Keep separate bank accounts, business records, etc…
  - Don’t use business funds for the family vacation

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Issues we’ll cover for each one

- Liability of Owners
- Legal Status
- Formation
- Management
- Taxation
Types of Business Structures

- Sole Proprietorship
- General Partnership
- Limited Liability Corporation
- Corporations
  - Subchapter “S”
  - Subchapter “C”

Sole Proprietorship

- Liability of Owners
  - 100% liability for the business debt
  - Creditors will be able to reach your personal assets as well as what you invested into the business.
  - This means that property such as your land, your home, your personal bank accounts are at risk!

- Legal Status
  - Not a separate legal entity
  - You would be sued directly.

Sole Proprietorship

- Formation
  - No formalities are required...if you start a business by yourself then this is what you have.
  - Formed or dissolved at the discretion of the individual who owns it
  - Only 1 person, or it becomes a partnership

- Management
  - Easy decision making – only one person to consult!

- Taxation
  - Income is taxed on the individual’s tax return (1040)
  - Schedule C

General Partnership

- Definition
  - An association of two or more “persons” who agree to carry on as co-owners of a business for profit.
  - No intent is necessary to form a general partnership and it is possible to create one without intending to.

In Re Simmons (Arkansas 2007)

- Simmons farming operation was in financial trouble and filed for Chapter 7 which would discharge many of the debts.
- Simmons’ son, and general partner, produced a forged personal guarantee on a loan that Simmons had no knowledge of at the time (he later found out about it)
- Court held that the Son’s actions imputed fraud to ALL partners so no discharge was allowed.
General Partnership

- **Legal Status**
  - Recognized as a separate legal entity

- **Formation**
  - No formalities are required
  - Can be formed unintentionally (only intent required is to run business for profit)...Example look at your crop share lease forms when you go home.
  - There can be a formal partnership agreement that details management responsibilities and how profits/losses will be split

General Partnership

- **Management**
  - Each member of the partnership is called a “general partner”
  - The decisions are made by all partners and all partners actively participate...any partner can bind the rest of the partners to a contract
  - Profits and losses are split evenly
    - Unless the partnership agreement states otherwise and there typically has to be a good reason for this.

Limited Liability Company (LLC)

- **Legal Status**
  - Recognized as separate legal entity

- **Formation**
  - Can be formed with 1 or more members
    - Created by delivering Articles of Organization to the Secretary of State's office
    - Must include:
      - Name of LLC
      - Address of LLC
      - Agent for service of process
    - Certain reports must be filed each year to maintain LLC status

- **Management**
  - 2 options
    - **Member Management** (small businesses)
      - All members have the right to participate in management
      - This is the more common option
    - **Manager Management** (large businesses)
      - Only designated members have management authority as provided in articles of organization
      - Profits and losses are shared equally among members unless otherwise agreed

General Partnership

- **Taxation**
  - The general partnership has the advantage of being a “pass-through entity”
  - This means the partnership itself pays no income taxes
    - Instead, income is taxed only after it is distributed to the partners.
    - This is different than the “double tax” where income is taxed when the business earns it and when it is paid out to the individual partners.
LLC

- Taxation
  - The LLC can elect to be a “pass-through entity”
  - Income is taxed only when it is distributed to the members
  - Or the LLC also has the option of being taxed as a corporation
  - Income would be taxed when the LLC earns it and again when it is distributed to the members

Corporations

- Most complex business organization

- Offer liability protection for shareholders
  - Similar to that of LLC
  - Older business organization with centuries of case law.

Corporations

- Liability
  - Shareholders are protected from creditors of the corporation in most cases

- Legal Status
  - Corporation is a separate legal entity

Corporations

- Formation
  - Articles of incorporation must be filed with Secretary of State
  - Must include
    - Name of corporation
    - Purpose of corporation
    - Stock structure
    - Fictitious name statement
    - By Laws
      - Include details of how the corporation will be run
      - Officers
      - Shareholder meetings
      - Number and terms of Directors on Board

Corporations

- Formalities
  - Record keeping requirements
  - Regular board meetings
  - Annual shareholder meetings
  - Annual filing requirements for the state

Corporations

- Management
  - Shareholders elect a Board of Directors
  - Board of Directors appoint Officers
    - Officers are responsible for day-to-day management decisions
    - Board of Directors is responsible for long term planning and management
    - Shareholders have limited management authority and vote only on extraordinary measures
      - Like selling more than 1/2 of the assets or dissolving
Types of Corporations

- **S Corporation**
  - Limited number of shareholders (100 or less)
  - “Legal persons” that are allowed to be shareholders is limited to citizens, resident aliens, estates and certain trusts
  - No corporations, non-resident aliens
  - Only one class of voting stock
  - Distribution rights to shareholders must be equal
  - No tax at the corporate level... “pass through”
  - Similar to taxation of LLC

How to choose!

- Deciding which business structure to use is an important decision.
- Many factors to consider
  - Who is involved
  - What is their role
  - What are the requirements
  - What makes the most sense for my business

Bus. Orgs and Estate Planning

- There are also ways that attorneys can use business organizations to assist in estate planning as well as limiting liability.
- Probate is required to pass on property, but what about business entities that own property?

Bus. Orgs and Estate Planning

- Other advantages besides avoiding probate:
  - You can “gift” shares of a business much easier than physically dividing up assets
  - By splitting up ownership of a business between different people you can lower the taxable value of an estate.

**CONTACT INFORMATION:**

Rusty W. Rumley
Phone: (479) 575-2636
Email: rrumley@uark.edu

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Web site: www.NationalAgLawCenter.org
Phone: (479)575-7646
Email: NatAgLaw@uark.edu
Liability Insurance

Insurance policies are complicated.
Insurance should be appreciated as a business expense.

Liability insurance is a way of protecting your business in case someone gets ill from eating meat you sold them. You could be financially responsible if you are sued by them.

Every business, whether large or small, is at risk of being sued for negligence causing property damage or bodily injury and legal fees from claim settlements are always increasing.

Insurance Coverage Options

- General Farm Liability Insurance Policy
- Commercial Business Liability Insurance
- Product Liability Insurance Policy
- Product Recall Insurance Policy
- Accidental or Product Contamination Policy
- Malicious Tampering Insurance
- Combination Policies
- Excess/Umbrella/Surplus Lines of Insurance

General Farm Liability Insurance Policy
- Protects against claims for bodily injury and property damage that occur on the farm premises or as a result of farm operations
- Accidents that affect farmers, employees, guests and customers
- Covers activities considered “farming”

Commercial Business Liability Insurance
- Covers activities that a farmer also undertakes that are not considered “farming”
• Note: Many farmers believe their general farm liability policy provides them with coverage in the situation where someone gets ill from eating food the farmer sold them. In many situations, it may not!

• Product Liability Insurance Policy
  – Protects against claims of injury from food products that cause foodborne illness
  – Covers “products and completed operations”

• Combination Policies
  – General farm liability policy and commercial business coverage may be combined with a homeowner’s policy

• Excess/Umbrella/Surplus Lines of Insurance
  – Provide catastrophic loss protection when the underlying insurance is inadequate

Raw products produced by the farmer/seller may be covered under a general farm liability insurance policy.
• If you are selling processed products (like meat) you may need more than a general farm liability insurance policy.

The sale of meat from animals grown by another farmer is not covered under a general farm liability policy.

• “But I’m only selling my meat to friends and family I trust.”

When you buy an insurance policy...

- You are required to pay the premium at the time required or the policy will no longer be in force.
- You are required to report (in a timely fashion) any occurrences to the agent and company.

When you buy an insurance policy...

- You are required to report any material changes in the nature of your activities or the property which is subject to insurance.
- You are required to cooperate with the insurer in matters of subrogation.

How much insurance do I need?

- Consider the value of your assets.
- Consider the dollar amount of potential claims.
- Buyers of your product (grocery stores) may require a minimum amount of product liability insurance (Whole Foods $2 million)
- Discuss your particular situation with your insurance agent to verify coverage & needs.
- Reevaluate your coverage annually.
Make sure the proper business entity is insured. Premiums often are based largely on product sales and hazards involved. Provide annual sales updates to your insurance agent.

- Hazards and insurance needs are real. Learn to read your policy and ask your insurance agent when you have questions. You could stand to lose everything if you take your insurance for granted.
- Read and understand your policies.

**Take Home Messages**

- It is important to assess all types of potential risk to your operation and implement appropriate strategies to manage risk
- Various business structures may provide some protection for legal risk
- Consider all characteristics, advantages and disadvantages of business structures before choosing

**Take Home Messages**

- Product liability insurance is a vital legal risk management tool for value-added beef producers
- Carefully consider needs for coverage
- Work closely with insurance agent and communicate well and often

**Contact Us**

Center for Profitable Agriculture  
https://ag.tennessee.edu/cpa  
Megan Bruch’s E-mail – mlbruch@utk.edu  
Hal Pepper’s E-mail – hal.pepper@utk.edu  
(931) 486-2777

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