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Legal Aspects of Swine Production Networking

J. David Aiken¹

Some Nebraska swine producers may wish to consider entering into joint production operations with other producers. This might be to physically separate the farrowing, nursery and feeding operations. Some industry observers believe that networking may allow smaller producers to collectively achieve economies of scale and other production advantages often available only to larger producers.

Producers considering entering into joint livestock production arrangements should consult an attorney. Liability and income tax considerations, and Initiative 300 must all be considered in legally structuring joint livestock production operations to meet the special needs of each group of producers. This article provides a brief overview of some legal issues involved in structuring joint livestock operations, particularly the role of a family farm limited liability company in networking. This information does not constitute legal advice but is provided for educational purposes only.

Liability concerns. If neighbors enter into joint livestock production, each of them risks making all their farm (and perhaps personal) assets available to the joint operation's creditors. For example, unrelated neighbors Smith and Jones decide on a handshake basis to establish a joint livestock enterprise. Smith contributes 10 acres, a confinement facility and labor to the enterprise, while Jones contributes 100 sows, feed and labor. Both Smith and Jones have cropland outside of and legally separate from their joint livestock operation.

Legally Smith and Jones are considered to have established a partnership, even though they have no formal written partnership agreement. As partners, all the assets owned by Smith and Jones in their own name (or jointly with their spouses or other family members) are legally available to satisfy any financial or legal obligation of the Smith-

Jones livestock partnership. Suppose Smith and Jones borrow money from Local Bank to purchase more sows. If there is not sufficient cash or other assets in the Smith-Jones livestock operation to pay the loan when due, Local Bank could foreclose on either Smith or Jones' cropland to pay the livestock loan, even though the cropland is not part of the Smith-Jones livestock operation.

Limited liability. Normally participants in joint business operations, like the Smith-Jones livestock partnership, seek to limit the assets (cash, land, livestock or other property) at risk in the business to the assets they have actually contributed to the business. This is to avoid having property from outside the business being foreclosed upon to satisfy a business debt, as happened to Smith and Jones above.

Legally limiting this liability risk can be accomplished by operating the business in a legal entity which gives limited liability to all business participants. In Nebraska all business participants can obtain limited liability either in a corporation or in a limited liability company (LLC).

Initiative 300 (I300) restricts corporations that are legally authorized to engage in agricultural operations (including livestock production) to family farm corporations. To qualify as a family farm corporation (FFC), all of the following requirements must be met:

1. a majority of the FFC's stock must be owned by family members;
2. a family member must either:
 - i. live on the farm or ranch, or
 - ii. provide daily labor and management; and
3. no non-family farm corporations or limited partnerships may be FFC stockholders.

LLCs are a new form of business entity in Nebraska and are a cross between a partnership and a corporation. Statutes authorizing the establishment of LLCs were adopted in 1993. LLCs

combine the operational flexibility and informality of a partnership with the limited liability protection of a corporation. LLC statutes restrict the LLCs that are legally authorized to engage in agricultural operations (including livestock production) to family farm LLCs. In family farm LLCs:

1. all LLC members must be family members and
2. one family member must either:
 - i. reside on the farm or ranch, or
 - ii. provide daily labor and management.

Family farm corporation networking. FFCs may provide a way for neighbors to network livestock operations, as long as family members own a majority of corporate stock and a family member lives on the farm or provides daily labor and management. Thus Smith and Jones could incorporate and meet FFC requirements if either Smith or Jones met all the FFC requirements for the Smith Jones corporation. For example, Smith (or Jones) could own 51% of the stock and live on or work and manage the farm. If three neighbors were involved, one of the three would have to meet the FFC requirements of owning at least 51% of the stock and living on or working and managing the farm. The corporate stock could not be divided 50-50 between two neighbors or 1/3-1/3-1/3 between three neighbors (unless the neighbors were also related).

The decision to establish a corporation has important legal and tax implications. While some employee benefits may be deductible in a corporation, capital gains tax may be due on appreciated assets (such as land) contributed to the corporation if the corporation is dissolved. In addition, considerable formality is required for corporation operations, including family farm corporations. Shareholder and board of director meetings must be held, records of all meetings must be maintained, and the business must be run through the corporate officers. If these corpo-



rate formalities are ignored, both limited liability and corporate tax deductions may be lost. The decision to incorporate is important and can be made only after carefully considering of all advantages and disadvantages.

Limited liability company networking. Another possibility is networking through family farm LLCs. Smith could form an individual LLC consisting of his 10 acres and building, while Jones could form his own LLC consisting of his sows. Then the two LLCs could form a partnership. However because both LLCs would have limited liability, Smith and Jones' liability exposure would be limited to the property in their respective LLCs. Note that in this case both Smith and Jones would have to provide daily labor and management for each of their LLCs to qualify as a family farm LLC.

LLCs do have some operational advantages over corporations. The corporate formalities of shareholder meetings, election of officers and directors, and maintaining records of shareholder, officer and director meetings are not required. Capital gains on appreciated property generally are not imposed if the LLC is dissolved. However, certain employee benefits that may be fully deductible only in a corporation are not fully deductible within an LLC.

In addition to networking through FFCs or family farm LLCs, combination of FFCs and family farm LLCs could network through a livestock production partnership, with each partner having limited liability as a FFC or family farm LLC. Even though partners generally have unlimited personal liability for partnership debts and legal obligations, if the partner is a limited liability entity (like a FFC or family farm LLC) then that partner's partnership liability is limited to the assets of the FFC or family farm LLC.

If you have questions about networking and how to legally structure a networked livestock operation, contact an attorney.

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Feedlot Nuisance and the Nebraska Right to Farm Act

J. David Aiken¹

Livestock operations located near private dwellings (including farmsteads) are often the subject of nuisance lawsuits because of the odor and flies generated. For many years the Nebraska Supreme Court ruled that a feedlot was legally not a nuisance as long as it was properly maintained, regardless of the feedlot's effect on neighbors. Beginning in 1975, however, the Court changed its position, ruling that feedlots could legally constitute a nuisance even if they were maintained with due care. If the feedlot is a nuisance, the operator could be required by the court:

1. to pay money damages to the neighbor,
2. to control the nuisance, or
3. to discontinue the feedlot.

In 1982 the Nebraska Right to Farm Act was adopted, which protects feedlots from nuisance lawsuits if the feedlot was there first. The Right to Farm Act, however, does not protect feedlots when they expand and a neighbor objects.

No negligence, no nuisance. For many years the Nebraska Supreme Court ruled that feedlots were not nuisances as long as they were properly maintained. In a typical 1943 decision, the Court concluded that the feedlot operator used reasonable techniques to minimize feedlot odors, and ruled that a feedlot was a nuisance only when improperly maintained or conducted, regardless of its effect on neighbors.

Feedlot a rural nuisance. This legal philosophy changed in 1976. A

Colfax county farmer sued his neighbor for maintaining a large livestock operation as a nuisance. The livestock operation was across the road from neighbor's farm house. Between 408 to 3,746 cattle were fed. The trial judge found that the neighbors were subject to "intolerable" dust, odors, and flies from the feeder's four livestock waste lagoons, and that the neighbors' property value had been reduced. However, the trial judge dismissed the case, following the "no negligence, no nuisance" rule. The trial judge determined that a feedlot could not legally constitute a nuisance in the country in Nebraska unless the feedlot was improperly operated.

On appeal the Nebraska Supreme Court reversed the trial judge and ruled that the case could go to trial. The court ruled for the first time in Nebraska that due care in the operation of a feedlot was not a defense to a nuisance suit. The fact that the feedlot was located in a rural area was one factor to consider, but was not enough alone to prevent the feedlot from legally constituting a nuisance. The court stated that a feedlot cannot be maintained in a manner to injure a neighbor even in a rural area. In short, the mere showing by the feedlot operator that he used reasonable techniques to minimize feedlot odors etc. was no longer enough to win the case for the feedlot.

Feedlot operation improved. In the second phase of the Colfax county cattle feedlot case, the Nebraska Supreme Court ruled in 1980 that the feedlot legally constituted a nuisance due to the flies and odors generated. The court gave the feedlot operator two choices,

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