

Looking at Leases: Part 2

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Liability Risk Management

A written lease can help secure land access and lease terms with outside landlords, but many are unaware of how a lease can help manage liability risk. Between operating activities that come with higher than average risk, and large land bases that have high values, liability protection is an ever-growing concern for farm businesses. Without proper planning and documentation, a minor accident could leave a farm vulnerable to a costly, or even crippling, lawsuit.

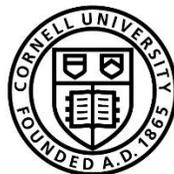
A popular strategy to mitigate liability risk on farm operations is to separate land ownership from operations. Operating assets that have a higher liability risk, such as cows, equipment, vehicles, and employees, are kept in one entity, while the majority of the land ownership is either owned in one or more separate entities, or by individuals. This method has become common practice among dairy farms. For this protection to be maintained, however, it is crucial that the two entities demonstrate that they are truly separate businesses, and operate independently of each other.

A good litigation attorney will attempt to “pierce the corporate veil” in a lawsuit, meaning that they will attempt to argue that the two entities are “one and the same,” said Steve Walker, an attorney with Scolaro, Fetter, Grizanti & McGough PC, who specializes in agricultural businesses.

If this argument is successful, then the land will be brought into the lawsuit and the equity in the land can be tapped into. In a lawsuit the suing party wants to find the deepest pockets. Therefore, a well written lease is the first step to establish the separate identities of the two entities and to show that “corporate formalities” are respected.

Cash Flow Management

Beyond just having a written lease in place, the way money is managed between the entities is also important. The land holding entity or individual has certain cash flow needs, including property taxes, and possibly debt payments. This entity or individual should maintain its own checking account, and rents should be paid from the operating entity to the land owner, rather than the farm paying those expenses directly.



This is particularly true with respect to the debt payments, Walker said. If the entity (or individual) that owns the land doesn't make debt payments because it is servicing debt out of the milk check, then a future disgruntled exiting member of the operating entity or heirs, in the event of a death, can argue that they own a portion of the land, since they helped make payments on the land out of the milk check. The solution is to pay rent so that the owner of the land has the cash to service the debt.

The exception to this payment rule is certain property taxes if applicable, as addressed in [Looking at Leases: Part 1](#).

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