

Using LLCs in Agriculture: Beyond Liability Protection

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Historical Background of the LLC

- Exists by virtue of state statute
- First LLC statute passed in Wyoming in 1977
- By 1996, all fifty states and the District of Columbia adopted
- All states permit formation of LLCs to conduct any lawful business purpose
 - Some states prohibit LLCs formed for banking, insurance, or certain other sectors
- In 1988, IRS ruled to allow a Wyoming LLC
- Now, LLCs must “check the box” for federal tax purposes
 - IRS Form 8832



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Basic elements of an LLC

- State laws are default rules
 - Power of members; power of managers
 - Default management structure
 - Charging order
- Private parties may modify
- The operating agreement
 - Foundational contract among owners

LLCs and Agriculture

- LLCs benefit small closely held agribusinesses
- Agribusinesses utilize LLCs for:
 - control over management
 - limited liability
 - flexible transition planning options

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Our Research with the Ag & Food Law Consortium

- “*The Use of the Limited Liability Company in Agriculture*”
- Focusses on the Midwest region to contrast differences
- Comparison of enabling legislation from state-to-state
- Uniform versus non-uniform states
- Member protections
- Series LLCs
- Sole member LLCs



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LLC STATE STATUTES ACROSS THE U.S.



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LLCs in the Midwest

- Every state in the Midwest protects LLC members from the LLC's debts, whether from tort, contract, or otherwise
- Among ULLCA and non-ULLCA states, personal liability protection is ubiquitous
- Overwhelming uniformity between states
- Single-member LLCs

Single Member LLCs in the Midwest

- ULLCA provides for sole member LLCs
 - Operating agreements permissible
 - Charging order against a sole member includes sole member's entire interest (not just transferrable interest)
 - Foreclosed interest results in member being disassociated
- States which permit sole member LLCs
 - All states in the Midwest now permit single member LLCs
- Recent amendments to state laws

Single Member LLCs: The IRS

- If a single member LLC does not elect to be treated as a corp, will be a disregarded entity
- Disregarded entity LLC will generally file:
 - Schedule C (sole proprietorship)
 - Schedule F (profit or loss from farming)

RECENT TRENDS: SERIES LLCs

Series Limited Liability Company (SLLC)

- SLLC in existence since 1996
- Creates a group of series, or cells, that serve to shield the master
 - Hub/spoke construction with the master series as the hub
- As of 2013, eight states have adopted the SLLC
- May be burdensome for agribusiness
- Note: no provision in ULLCA for series LLCs

Series Limited Liability Company (SLLC)

- Possibly for agribusinesses with many assets
- Not so good for smaller farm operations
- “A business which does not have the characteristics appropriate for an SLLC should stick with the time-tested LLC entity.” – Nathaniel Vargas Gallegos, *An Agribusiness Application for the Series Limited Liability Company*

IMPOSING LIABILITY: LIMITED LIABILITY COMPANIES

Piercing the corporate veil: is there growing liability for farmers with LLCs?

- Serves as a safety valve for excessive limited liability
- Changing jurisprudence—applying corporate law's veil piercing rules to LLCs
- Project focus: statutes and court cases in the Midwest
- For farmers in an LLC, it is important to know that an LLC is an imperfect shield that does not always protect personal assets

Is piercing the veil a sound approach to issues of liability?

- Courts are now routinely applying doctrine of veil piercing to limited liability companies.
- Is veil piercing rare, unprincipled, and arbitrary?
- Should the concept be abolished?



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STATUTES AND CASE LAW: LLC PROTECTIONS AND DEFICIENCIES



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Ohio prohibition on personal liability for LLCs

- R.C. 1701.48(A): “The debts, obligations, and liabilities of a limited liability company, whether arising in contract, tort, or otherwise, are solely the debts, obligations, and liabilities of the limited liability company.”
- R.C. 1701.48(C): The failure of a limited liability company or any of its members, managers, or officers to observe any formalities relating to the exercise of the limited liability company's powers is not grounds for imposing personal liability



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Piercing the Corporate Veil (Ohio)

The seminal case: *Belvedere Condominium Unit Owner's Association v. R.E. Roark Companies, Inc. et al.* (1993). A corporate form may be disregarded and individual shareholders held liable for wrongs committed by the corporation when:

1. Control over corp. was so complete that the corp. has no separate mind, will, or existence of its own,
2. Control over the corp. was to commit fraud or an illegal act against plaintiff
3. Injury or unjust loss resulted to plaintiff from such control and wrong



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Is Ohio facing the first wave of LLC veil-piercing cases?

- Some Ohio appellate courts subject LLCs to the same veil piercing test as a corporation
- Premier Therapy, LLC v. Childs (2016)
 - “[A] limited liability company is subject to the same veil piercing test as a corporation.”
 - Seventh District
 - Jurisdiction declined by Ohio State Supreme Court



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New Jersey LLC Veil Piercing

- *Coty US LLC v. 680 S. 17th Street LLC* (2015)
 - Equitable remedy of veil piercing is applicable to a LLC, as long as it is not based solely on a LLC’s failure to follow formalities.
 - New Jersey is a ULLCA state. The ULLCA prohibits the piercing of a corporate veil based on failure to observe corporate formalities.



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Minnesota LLC Veil Piercing

- Minnesota provides for LLC veil piercing by statute
- Minnesota Statute 322B.303(2) provides:
 - “Piercing the veil. The case law that states the conditions and circumstances under which the corporate veil of a corporation may be pierced under Minnesota law *also applies to limited liability companies.*”



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Connecticut LLC Veil Piercing

- Commissioner of Environmental Protection v. State Five Industrial Park, INC., et al (2012)
 - Connecticut permits reverse veil piercing of LLCs
 - Reverse veil piercing: imposing liability a corporation for actions of shareholder
 - Could an LLC be liable to satisfy a judgment against a member?
 - See *also* Litchfield Asset Management Corp v. Mary Ann Howell et al (2002) & Bastan v. RJM & Assoc., LLC



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California LLC Veil Piercing

- River Rock Development v. Young J. Paik et al (2010)
 - California recognizes that LLCs formed in another state (foreign LLCs) are subject to veil piercing under the alter ego liability theory
 - Arizona law governed California's review of liability

Wyoming LLC Veil Piercing

- Greenhunter Energy, Inc v. Western Ecosystems Technology, Inc. (2014)
 - Single member LLCs may be pierced
 - Greenhunter was severely undercapitalized, and LLC and personal funds were comingled
- See *also* Kaycee Land & Livestock v. Flahive (2002) & Ridgerunner, LLC v. Meisinger (2013)

Wyoming LLC Veil Piercing

- Wyoming recently added two sections to its code section regarding LLCs
- 17-29-304(c) For purposes of imposing liability on any member or manager of a limited liability company for the debts, obligations or other liabilities of the company , a court shall consider only the following factors no one (1) of which, except fraud, is sufficient to impose liability :
 - (i) Fraud;
 - (ii) Inadequate capitalization;
 - (iii) Failure to observe company formalities as required by law; and
 - (iv) Intermingling of assets, business operations and finances of the company and the members to such an extent that there is no distinction between them.

Veil-Piercing and Agriculture

- Implications for agriculture
 - Corporate formalities
 - Single member LLCs
 - Risk of undercapitalization or furtherance of fraud

Limitations of Single Member LLC

- LLCs protect you from business partners and employees
- LLCs do not protect you from yourself
- Sole proprietor farming operations without employees may not gain much liability protection from a single member LLC
 - Will benefit from protection for visitors (agritourism)
- Liability Insurance should always be the primary liability management tool



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Using LLCs for Family Farmland

- Land holding LLCs are an excellent method to hold farmland
- Used most often when multiple family members will own land together
- Reduces the risk of land leaving the family due to death, divorce, creditors, partition
- LLCs are designed with transfer restrictions and buy-back provisions giving family members the right to buy ownership interest before it can leave the family
 - Often include discount on purchase price and financing for purchase price

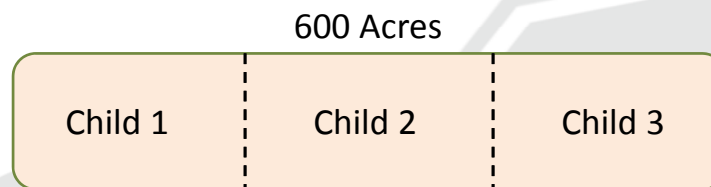


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Land LLC Example

- Mother and Father own 600 acres
- They want their three children to inherit the land together
- Mother and Father want to ensure that land cannot be transferred outside of the family without the consent of the family

Scenario 1 – Joint Ownership



Risks:

- Any child has partition rights
- Any successor owner has partition rights
- No structure or rules for managing land

Scenario 2 – Joint Ownership

Child 1
200 Acres

Child 2
200 Acres

Child 3
200 Acres

Risks:

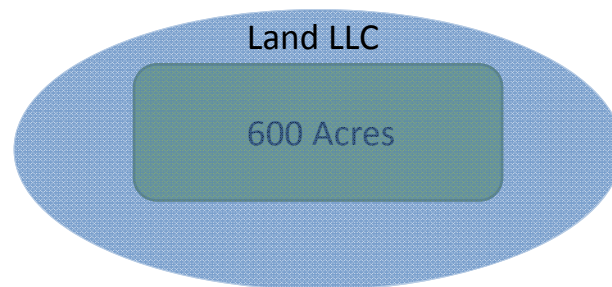
- Can the land be divided equally?
- Any child can sell his/her land outside of family



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Scenario 3 – Land LLC



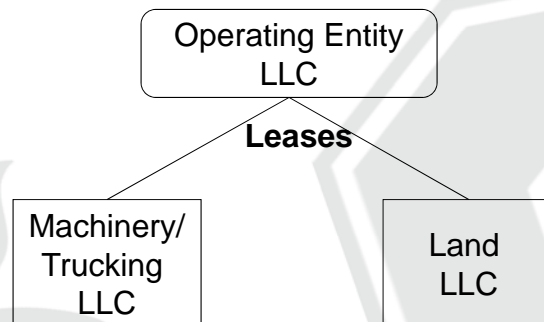
- Place land in an LLC
- 3 children will own the LLC together
- No child or successor owner has partition rights and cannot force sale of land
- LLC has rules as to how land will be managed and decisions made
- Can be passed down to future generations who will be subject to the same transfer restrictions

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Land LLC

- Typical transfer restrictions for owners
 - Cannot transfer ownership to anyone other than family members
 - If ownership is forced to transferred due to divorce, death, creditor, ...
 - Other family member owners have first chance to purchase ownership
 - Buy at a discounted price (10%-30% discount)
 - Purchase price paid over 10 - 20 years
- A well designed LLC can make it very difficult for land to leave the family without the consent of the family

Should You Consider a Multiple LLC Plan?



Multiple Entity Plan

- Set up multiple LLC's for the operation
- Advantages
 - Makes easier for next generation to come into farming operation
 - Often works well with estate plan and off-farm heirs
 - Separates land from liability



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Bringing Next Generation into Farming Operation

Farming Operation

- \$500,000 grain
- \$500,000 machinery
- \$1,000,000 land



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Bringing Next Generation into Farming Operation

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graph TD
    A[Operating Entity LLC  
$500,000 Grain] -- Leases --> B[Machinery/  
Trucking LLC  
$500,000]
    A -- Leases --> C[Land LLC  
$1,000,000]
    
```

Reducing value of operating entity makes it easier for next generation to come into operation

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Farming v. Non-Farm Heirs

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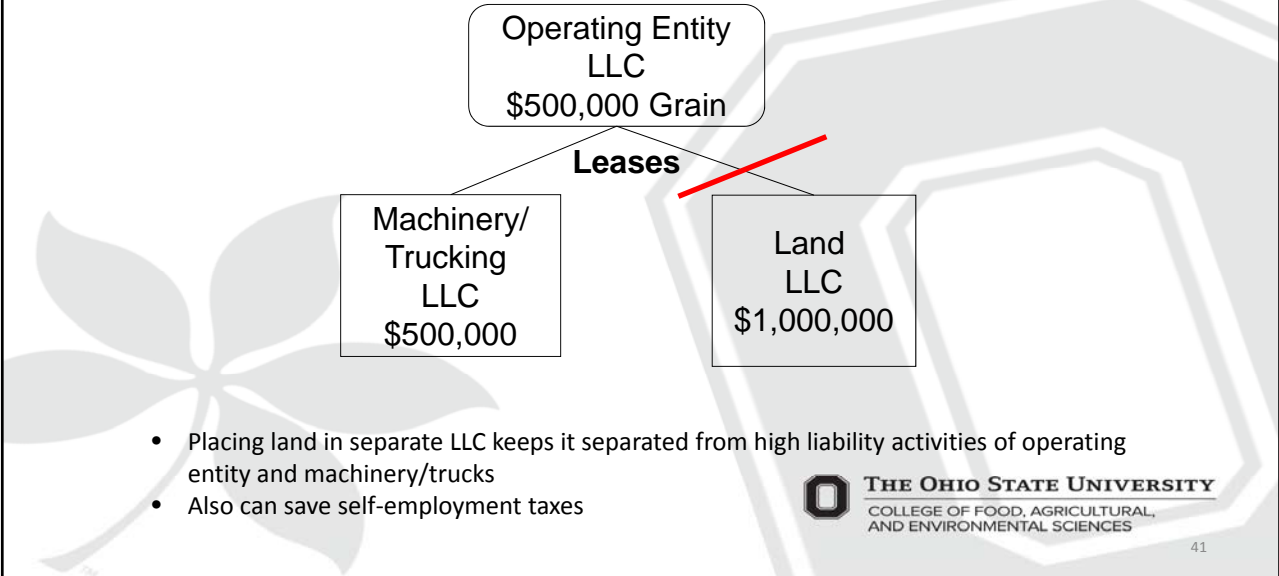
graph TD
    A[Operating Entity LLC  
$500,000 Grain] -- Leases --> B[Machinery/  
Trucking LLC  
$500,000]
    A -- Leases --> C[Land LLC  
$1,000,000]
    D[Farming Heir Inherits] --> A
    E[Off-farm heir can inherit ownership in land LLC] --> C
    
```

- Ownership in land LLC is good asset for off-farm to inherit
 - Long-term lease back to farm heir
 - Cannot force sale of land
 - Cannot interfere with farming operation

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Separate Land from Liability



- Placing land in separate LLC keeps it separated from high liability activities of operating entity and machinery/trucks
- Also can save self-employment taxes

Questions?

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