Chapter 6

Risk Management

The last chapter noted one key factor determining the types of financing available to a producer association is the level of risk associated with investing in or lending to it. This chapter considers the idea of risk and how it affects your operation. The chapter discusses risk management strategies and the legal issues raised by these different strategies. The chapter concludes with a special form of risk management for farmers-crop insurance policies.

What is risk?

Risk occurs when there is the possibility of loss or injury. When thinking about risk, two factors to consider are how severe the loss may be and how frequently the loss may occur. All of us experience risk everyday – risk of bodily injury, risk we will lose our job, or risk of major property damage to our house. Because of the nature of raising crops and livestock, farming has its own special types of risk. Nature is the riskiest factor on the farm, but many others exist, such as injury to employees or visitors, product liability if someone becomes ill from something you sell, contamination of your crop by chemicals or certain types of pollen, loss of a market, or price declines. The ways to manage risk vary according to different regions of the country, different crops grown, and different production practices used. With so much depending on how you deal with risk, it is a good idea to have a risk management strategy.

The USDA Risk Management Agency in *Introduction to Risk Management* (www.rma.usda.gov/pubs/1997/riskmgmt.pdf) points out one of the most important elements in managing your risk is determining your goals for the business. What do you want the business to look like? How much income do you hope to earn? Are you risk averse, meaning you are more prone to avoid risk, or are you willing to take a risk if there is a good chance of a substantial reward? Until you and the other people involved in your project answer these basic questions, you will not be able to determine your best risk management strategy.

What do joint producer organizations have to do with risk management?

Joining a producer association can itself be a risk management strategy. By deciding to become part of a producer group, you are managing the risk of not being able to access a market by yourself. Producer associations can also help you deal with price risks or the risk of not having needed inputs. Entering into a relationship with a producer association may also increase some risks. If you sign a contract to deliver something to the joint producer association, you may increase your risk of loss in case you are not able to produce the crop or animals and you have to pay to replace the product.

Who should be concerned about managing risk, the farmer or the producer association?

The key to determining who bears risk is finding out who will suffer a loss if something bad happens. In almost all marketing contracts, where the farmer owns the crop or livestock until it is sold, the farmer bears the risk of loss. This means if the crop is wiped out, the farmer will not get paid. Conversely, if a cooperative purchases the products and holds title to them, the coop will suffer the loss if the products are damaged. Issues sometimes arise as to exactly when title passes from the farmer to the buyer. Does title pass when the farmer loads the goods on the truck, or when the goods are delivered to the final destination? To avoid confusion, the best thing to do is to make it clear in the contract.

It is not surprising the owner of crops or livestock bears the risk of loss in cash market sales or in marketing agreements. What is surprising is that even in production contracts, where the grower is raising crops or livestock owned by someone else, the grower may still bear at least part of the risk of loss for the crop or livestock. For instance, some poultry production contracts discount the amount the grower is paid if a certain number of the chickens die in the grower's barn. The grower may also have responsibility for disposing of the dead chickens, a cost the grower must absorb if the birds die.

Joint producer associations also bear risk. If an association agrees to deliver a product to someone on a specific day, the association needs to determine what happens if it is unable to keep the promise. Sometimes the association will have to go into the market to find replacement products. For some specialty and niche products this may not be possible. In this case, the association may bear the risk of liquidated damages provided for in the contract. Liquidated damages are a specific sum a party must pay for failing to perform under the contract. The other risk born by the association in this situation is the loss of customers. The grocery store or restaurant may not want to deal with a supplier who is not reliable. Of course the joint producer association bears other typical business risks, such as product liability and employee injury.

Because both the farmer and the joint producer association sometimes have risk, the rest of this chapter examines the risks that these parties might have and some of the strategies to manage them. A special emphasis on the federal crop insurance program is provided at the end of the chapter.

UCC and risk of loss

The Uniform Commercial Code (discussed more fully in chapter seven) provides the general rules for when the risk of loss transfers from the buyer to the seller. It provides:

§ 2-509. Risk of loss in the absence of breach

(1) If the contract requires or authorizes the seller to ship the goods by carrier:
(a) if it does not require the seller to deliver them at a particular destination, the risk of loss passes to the buyer when the goods are delivered to the carrier even if the shipment is under reservation (Section 2-505); but
(b) if it does require the seller to deliver them at a particular destination and the goods are there tendered while in the possession of the carrier, the risk of loss passes to the buyer when the goods are there so tendered as to enable the buyer to take delivery.
…
(3) In any case not within subsection (1) or (2), the risk of loss passes to the buyer on the buyer's receipt of the goods.
(4) The provisions of this section are subject to contrary agreement of the parties and to Sections 2-327 and 2-510.

This section provides a default rule when a contract authorizes the seller to ship the goods. If the contract specifies the place of delivery, the risk of loss does not pass until the goods arrive at the place. If the contract does not specify a particular place of delivery, then the risk of loss transfers to the buyer when the goods are placed in the carrier's possession. Importantly, the contract can modify this default rule to whatever the parties desire.

Four types of risk to manage.

The following list covers some of the typical risks associated with farming and selling food, as well as strategies to manage these risks. Much of the information provided here can be found in USDA-RMA publication, *Introduction to Risk Management* www.2.rma.usda.gov.pubs/1997/irm_intr.html

1. **Production risk**. This is probably the first thing people think of for risks on the farm. What happens if the yield is low or the animals contract a disease? Who will bear the loss? Insurance is the most typical risk management approach to deal with production risk, but insurance may not exist for the particular crop or animal you are growing. Crop insurance is discussed separately later in this chapter. Farms may also consider diversifying the operation so if one crop does poorly, the farm still has other sources of income.

2. **Marketing risk.** Risks related to marketing can occur in two ways. First, there is a risk a market may not exist for your crop or livestock. This is a real risk for a some growers of specialty or niche products. For growers of commodity products, the market likely exists, but all farmers bear the risk the price will be low. To deal with market access risk, farmers need to have a marketing plan and have an idea where they will sell the crop. To deal with the

possibility of a steep price decline, farmers may be able to set the price by using forward contracts. Many commodity products also provide farmers the option of using futures contracts to manage price risk. Some of the crop insurance products discussed later also help farmers deal with the risk of low prices.

3. **Financial risks.** Financial risks can be separated into the risk of interest rate changes and liquidity risk, or the risk you will need cash in a short period of time. Interest rate risks occur when you have a loan with a variable interest rate or you know you will need to borrow money in the future and are not sure what the interest rate will be. In either case, if the interest rate goes up, you will bear greater costs. Beyond taking steps such as locking in an interest rate, this risk is largely out of your control. In a broader sense, you may be able to lower the interest rate if you take other steps to lower the lender's own risk that you will not be able to pay back your loan, such as by obtaining insurance or providing assets to secure the loan. The other type of financial risk is liquidity risk. This risk occurs when something happens on the farm or in your business that requires you to have cash on hand, as opposed to having all of your assets tied up in land or equipment. For example, if a tractor engine gives out and needs to be rebuilt, you may need to come up with the $3500 for the repair bill. If all of your assets are tied up in land and other equipment, you may need to sell something at a discount or obtain a loan with relatively unfavorable terms to pay the bill. Obviously the easiest way to deal with this risk is to keep enough money in accounts that can be easily liquidated.

4. **Regulatory risks.** Laws and

Basic risk management strategies

In his book *The Lawyer's Guide to Insurance*, Ben G. Baldwin lays out the basic strategies for dealing with risk:

1. For risk that has high frequency and high severity, the best route might be to avoid the risk altogether. For example, if you have looked into growing artichokes on your farm, but determine you risk low yields because of your farm's soil type and a high risk there will be no market for the crop, you may decide to avoid the risk and not plant the crop.

2. If you decide to accept the risk, then you should reduce it as much as possible. In other examples, you could make sure an otherwise dangerous power-take-off shaft is covered with the appropriate guards or keep visitors away from your young pony that likes to kick. These strategies lower the likely frequency of the loss.

3. A third strategy in dealing with risk is sharing the risk with someone else, such as shifting the risk of loss to an insurance company. In essence you pay the insurance company a premium every month to bear the possibility of loss.

4. Finally there are some risks you may need to absorb, such as the risk you will need to repair a new deep freeze. When the dealer sold you the deep freeze, she offered you an extended warranty for an extra fee but you decided to forego the extended warranty because you thought the likelihood you would need the warranty (frequency of loss) is low and the cost of fixing the freezer (the severity) is also low.

regulations from different levels of government can have a big impact on the success of your farm or business. If you rely on a private certifier to be able to label a product a certain way, private rules can also have an impact on your business. There is risk these rules might change in the future. This could occur with a change in how the federal government implements the commodity programs, the way the state supreme court interprets whether your operation is creating a nuisance, or the way the city writes its public health ordinances. This could also occur if a private certifier changes the definition of what it means for pork to be raised under animal welfare standards. These are just a few examples of the most difficult risks to manage because these changes are unpredictable. The best advice is to stay informed on where policy makers may be heading and prepare for the changes to the extent you think you need to.

Comprehensive farm liability policies

What is a comprehensive farm liability policy?

A comprehensive farm liability policy is a specially designed insurance policy that deals with many of the risks inherent in farming. For a thorough discussion on these types of policies, see John Copeland, *Understanding the Farmers Comprehensive Personal Liability Policy*, National Center for Agricultural Law, Research, and Information (1992). The typical comprehensive farm liability policy shifts the risks of personal injury and property damage from the farmer to the insurance company. For example, an insurance policy recently entered into by a farmer in central Iowa was divided into the following parts: 1) Liability to the public; 2) Medical payments to the public; and 3) Liability to farm employees. The policies vary, but most will only insure injuries that occur on the farmer's property or caused by activities directly related to the farming operation. One policy defines farming as "the ownership, maintenance, or use of the insured premises for the production of crops or the raising or care of livestock. Farming also includes operations of roadside stands maintained solely for the sale of any insured person's products. Farming does not include altering the characteristics of farm products through processing operations."

Are direct farm marketing businesses covered under a comprehensive farm policy?

It depends on the language of the policy. In the policy quoted above, a farmer who is selling non-processed food from a roadside stand would be covered. But a farmer who is selling processed food, or is selling food anywhere other than his own roadside stand would not be covered. As Professor Neil Hamilton discusses in his book *The Legal Guide for Direct Farm Marketing*, the main determinants for when direct farm marketing businesses will be covered is whether the activity is included in the definition of farming (for instance, a policy may expressly cover roadside stands but exclude processing food) or whether the activity is excluded because it is a separate business from farming.

For example, policies commonly exclude any injury that arises from a "business," and define "business" as "1) any full or part time trade, profession or occupation;

2) incidental activities conducted by any insured person if gross receipts are more than $2000 in the prior calendar year from the incidental activities; or 3) the rental or holding for rental of any premises by any insured person." If the farmer has this policy and the direct marketing business earns more than $2000 per year, the venture will not be covered by the policy.

Will the comprehensive farm policy cover damages caused by activities undertaken for the producer association?

Another provision in most comprehensive farm policies applies directly to some joint producer initiatives and excludes coverage for any injury caused by the farmer if he is acting on behalf of a corporation or other type of organization. This would generally include most producer associations.

The insurance policy used as an example above excludes from coverage any injuries that arise out of "custom farming." "Custom farming" is defined as "any activity arising out of or connected with: a) the use, lease, rental, maintenance, or transportation of any farm tractor, farm machine, farm implement, or animal for agricultural purposes; or b) care or raising of livestock or poultry by any insured person for any other person or organization in accordance with a written or oral agreement." To be safe, the best advice is to make sure you and the organization are both named as a covered person in a liability policy.

Depending on the size of the business, your group may want to consider visiting with an insurance agent or attorney to help you assess the types of risks involved with the business and the types of insurance you should obtain. This consultation may be especially helpful in determining how both you and the producer association are open to liability claims.

Members of association not covered, unnless it is a nonprofit

Although farmers are generally not covered in a comprehensive farm liability policy for injuries caused when the farmer is acting on behalf of another organization, some policies will cover the activity if the farmer is working for a nonprofit organization. For example, one policy states:

> We do not cover bodily injury or property damage arising out of any act or omission of any insured person as an officer, director, trustee, member or agent of any corporation or other organization, not listed as an insured person on the declarations, unless:
>
> a. the corporation or organization is a not-for-profit entity which is not subject to either state or federal taxation;
> b. the insured person serves without compensation from the corporation or organization;
> c. the act or omission of the insured person was within the scope of the insured person's responsibilities as an officer, director, trustee, member or agent of the corporation or organization; and
> d. the act or omission of the insured person does not constitute intentional, willful, wanton, or reckless conduct.

What is directors' and officers' insurance?

Producers who are directors or officers of an organization should also be concerned with possible liability for acts they commit in relation to the organization. In general, if the organization has limited liability status, officers of the organization will not be held liable for injuries caused when acting in the scope of their organizational responsibilities. But this is not always the case. For example, if an officer is deemed to make decisions breaching the officer's duty of care to the organization, the officer could be personally liable for injuries caused by that decision. This type of claim could arise in everything from a wrongful termination claim to a violation of a federal environmental law. In practice, this means that the officer will be sued separately from the organization for damages allegedly caused by the officer's wrongful conduct. To protect officers from personal liability, many insurance companies offer "directors' and officers'" or "D and O" insurance. Often the organizations will purchase this insurance for its directors and officers.

Products liability, negligence, and strict liability

Much of the information in this section is taken from an article on the National Agricultural Law Center website by Michael Roberts and Doug O'Brien, *Animal Identification: Liability Exposure and Risk Management*, lmic.info/memberspublic/animalID/fs06.pdf.

What is products liability?

Tort law generally covers the liability exposure of farmers and processors whose products injure someone else. Generally, tort law deals with cases where a plaintiff has suffered a loss and is trying to shift the responsibility for the loss to one or more defendants. The plaintiff must first prove a defendant's conduct was of a type entitling the plaintiff to compensation. The two most common forms of conduct that may justify such shifting of loss are negligence and strict liability.

In the food and agriculture business, the plaintiff could be anyone harmed by someone else's conduct. The plaintiff could be a consumer harmed by food poisoning or a producer association harmed by something the farmer did. To prove the case, a plaintiff will need to know who caused the injury. In other words, the product causing the harm will need to be traceable back to the person responsible. Depending on what type of marketing and processing system the food went through, the food might not be traceable.

What is the negligence standard under strict liability?

Negligence is the failure to exercise reasonable care. Reasonable care is what a reasonably prudent person would do in the same circumstances. Therefore, in a negligence action, a defendant must show that he or she exercised the kind of care in the management of a farm or business a reasonable person would have exercised under similar circumstances. This is a fact-specific question usually determined by juries on a case-by-case basis. If the defendant fails to exercise reasonable care, the plaintiff must show the defendant's action was a proximate cause of the plaintiff's injury and the plaintiff suffered legally compensable damages.

For example, in a case where a consumer becomes ill from E. coli poisoning, the consumer may initially sue the retailer and packer for negligent handling of the meat. If the packer has a traceability system in its plant, the packer may bring in as another defendant the feeder who fed the steer. For the producer to be liable, the packer will have to show the feeder failed to exercise reasonable care in raising and feeding the steer and this failure caused the meat to carry E. coli. Although it is impossible to predict what a court might find as "reasonable care," it might mean the usual level of cleanliness of other feeders.

Is strict liability any different than negligence?

Strict liability is imposed when one has introduced a defective product that is unreasonably dangerous into the stream of commerce. Unlike negligence, strict liability pays no attention to whether someone employed a duty of care. If strict liability applies, the farmer or organization could be liable even if they used the best management practices in good faith.

The critical issue for strict liability is whether the plaintiff can prove the defendant caused the harm. Under strict liability, a farmer can be liable only if the plaintiff can trace a defect to the producer's operation. If a third party altered the product in the time between when the producer had control of the animal and the plaintiff consumed the product, then the producer may not be liable. For example, if an E. coli

Can an animal be an unreasonably dangerous product?

Although the law is not well developed on whether animals can be defined as "unreasonably dangerous products" for purposes of strict liability, it is probable at least in some cases where an injury is caused by a characteristic of an animal. For example, if a plaintiff alleges harm from beef from consuming an animal with BSE (also commonly referred to as Mad-Cow Disease), it is possible the cattle feeder could be held liable under strict liability. This could happen if the court determined the cow was unreasonably dangerous when it entered the stream of commerce. Under a negligence analysis, however, the feeder would not be liable if the feeder used best management practices and raised the cattle as any reasonable person would have. In this case the feeder had no reason to suspect the feed had a chance of causing BSE.

Animals used as pets have sometimes been found to be "products" for strict liability purposes. The court in *Beyer v. Aquarium Supply Co.*, 404 NYS2d 778 (1977) defined diseased hamsters as products. Some courts have refused to define farm animals as products. For example, in *Anderson v. Farmers Hybrid Cos.*, 408 N.E.2d 1194 (Ill. App. Ct. 1980), the court refused to define hogs as products, even though the hogs spread the contagious and infectious disease "bloody dysentery" to other hogs. See Christopher H. Hall, Annotation, *Live Animal as "Product" for Purposes of Strict Products Liability*, 63 A.L.R.4th 127 (1988-2004).

contamination occurs during or after slaughter, the producer should not be held liable. In contrast, if drug residues in meat are caused by improper withdrawal periods and harm results, a producer may be found liable. Just as with negligence, it is sometimes difficult to predict exactly when an action "causes" injury. Ultimately, these are questions of fact left to the jury.

A court will likely focus on the condition of the product at the time of the purchase rather than concentrating on the ability of the product to become defective after the transaction. For example, for liability to attach to a livestock producer, the diseased animal must have been infected at the time it was sold. If meat is contaminated with E. coli during the grinding process, even if the meat can be traced back to the ranch, the producer will not be liable if the animal was sold without E. coli in the meat.

What does all of this mean for my relationship with a producer association?

In most products liability cases, the injured party will include everyone who could possibly be responsible for the product causing the harm. What typically occurs is the various defendants point fingers at other defendants in an effort to avoid liability. This can lead to the situation where the producer association selling or processing your products will try to blame you for problems caused by the food that you produced. Because the organization's executives have a duty to protect the interests of the entire organization (and not just one member), they may have no choice but to single you out for liability if you are the possible cause.

Crop insurance

Crop insurance can help producers deal with production risks, and some types of policies may help producers deal with the marketing risk of low prices. In 2000, Congress passed the Agricultural Risk Protection Act to encourage the Federal Crop Insurance Corporation (FCIC) to contract with private companies to develop more insurance products so more farmers utilize federal crop insurance. Since then a number of new products have come on to the market. Typically, a new product is tested as a pilot program in a limited geographic area, such as a number of counties or states. The pilot program also limits which crop or animal species are covered.

USDA Risk Management Agency (RMA) administers many different kinds of crop insurance programs and operates the FCIC. The premiums for crop insurance are subsidized by the federal government so the premiums producers pay are less expensive than if private companies offered them. In some situations, such as catastrophic insurance discussed later, the government will pick up the entire premium and require the farmer to pay only an administration fee. While RMA approves various crop insurance programs, policies are actually administered by private insurance companies.

When should I consider obtaining crop insurance?

If you rely on yield or income from a crop and you bear the risk of loss, you should consider acquiring crop insurance. Crop insurance will shift some of the risk to the insurance company and help you project stable levels of income.

What does crop insurance actually insure?

You are insuring either the crop yield or revenue you expect to receive from the crop. Obviously the amount of revenue you receive for a crop is closely related to the yield, but these different insurance approaches can lead to different results. Crop insurance policies based only on yield will pay out if the yield falls below a certain level, no matter what happens to the price of the commodity; while revenue-based policies consider both yield and price.

Will all crop insurance policies cost the same no matter the agent?

Not necessarily. Until a few years ago, FCIC set the price of the policies and private agents were not allowed to offer different prices. In recent years, some insurance companies have begun to offer discounted policies that may save you money. As a result, it may pay to shop around.

What is the connection between crop insurance and federal disaster assistance?

Both programs are designed to help farmers deal with natural disasters. Generally, if a crop is eligible for crop insurance, a farmer must purchase a minimum level of that insurance before being eligible for disaster assistance. In recent years, Congress has become more active in requiring farmers to utilize crop insurance as a condition of receiving disaster assistance.

What happens if I am not sure what a term in my policy means?

If people disagree on the meaning of language in a crop insurance policy, they can seek clarification from RMA. This process is known as "Subpart X Final Agency Determination" and it provides a relatively quick way to answer questions about the meaning of federal crop insurance statutes and regulations. The determination controls the policies because the meaning of words in the statute and regulations determines the meaning of the same words in the policy. Any participant in the crop insurance program may seek a determination. Participants include anyone who has applied for or has obtained an insurance policy, insurance companies, loss adjustors, or contractors. In this review process, RMA only considers questions of general applicability, meaning it will only look at questions that affect everybody, not just a particular farmer.
A participant must first submit a request for determination by citing the language in question and providing their own interpretation. Then RMA has 90 days to either agree or disagree with the interpretation. If RMA does not provide a final agency determination within 90 days, the requestor may assume the suggested interpretation is correct for the applicable crop year.

For legal purposes, this is the final agency determination, meaning only a federal court can overturn it. This varies from most other agency determinations that may be overturned by appealing within the USDA to the National Appeals Division.

Basic obligations

The USDA-RMA website (www.rma.usda.gov/policies/) provides the following information about important expectations and deadlines related to crop insurance.

Producers must:

- Report acreage accurately,
- Meet policy deadlines,
- Pay premiums when due, and
- Report losses immediately.

Failure to do any of these things means the producer will probably not be covered under the insurance policy. One of the most common problems producers experience is when the number of acres reported to the insurance company does not match the number of acres reported to the Farm Service Agency for commodity program purposes. If these two numbers vary by more than five percent, the farmer may lose crop insurance coverage.

Important Deadlines

- Sales closing date--last day to apply for coverage.
- Final planting date--last day to plant unless insured for late planting.
- Acreage reporting date--last day to report the acreage planted. If not reported, insurance will not be in effect.
- Date to file notice of crop damage--after damage, the date the producer decides to discontinue caring for the crop; prior to the beginning of harvest, immediately, if farmer determines the crop is damaged after harvest begins, or the end of the insurance period, whichever is earlier.
- End of insurance period--latest date of insurance coverage.
- Payment due date--last day to pay the premium without being charged interest.
- Cancellation date--last day to request cancellation of policy for the next year.
- Production reporting date--last day to report production for APH.
- Debt termination date--date company will terminate policy for nonpayment.

Example: Assume a participant requested RMA to determine whether the term "measurement" in the context of revising acreage reports includes only on-farm measuring of acres or if it also includes digitized measurement. The requestor interpreted the term "measurement" as not including digitized measurements. In its final agency determination, RMA disagreed and ruled that digitized measurements could be used.

For more information on Subpart X, as well as the actual Final Agency Determinations, go to www.rma.usda.gov/regs/533/section533.html.

Can my producer association obtain insurance?

A producer association may obtain insurance in a crop, but only if the association has an interest in the crop. (See box). If the organization does have an interest in the crop, it can not also be covered by the producer's insurance policy. The Common Crop Policy provides that for a crop insurance policy to extend to any other person, such as a partner or a landlord, the other person shuld be specifically included on the accepted insurance application. 7 CFR section 457.8.

The next section looks at some of the developments related to crop insurance designed for specialty crops and considers how the basic crop insurance policies may or may not apply to them.

Insuring specialty crops.

In the Agricultural Risk Protection Act of 2002, Congress directed RMA and private crop insurers to place a special emphasis on developing products for specialty crops. The crop insurance policy providing the best opportunity for specialty crop producers who live in eligible states is a program called Adjusted Gross Revenue-Lite. As a result producers now have a broader range of insurance products to consider.

Who has the right to obtain crop insurance?

The Common Crop Insurance regulations (7 CFR section 457.8) provide:

Application for insurance on a form prescribed by the Corporation, or approved by the Corporation, must be made by any person who wishes to participate in the program, to cover such person's share in the insured crop as landlord, owner-operator, crop ownership interest, or tenant. No other person's interest in the crop may be insured under an application unless that person's interest is clearly shown on the application and unless that other person's interest is insured in accordance with the procedures of the Corporation.

Adjusted Gross Revenue-Lite (AGR-Lite). The idea for AGR-Lite is to insure the revenue of the entire farm rather than the individual crops. It is designed with small to mid-sized diversified operations in mind and is available in states where traditional types of crop insurance did not work well with the types of crops that were raised. Eligible areas in 2005 include most counties in Alaska, Connecticut, Delaware, Idaho, Massachusetts, Maine, Maryland, North Carolina, New Hampshire, New Jersey, New York, Oregon, Pennsylvania, Rhode Island, Vermont, Washington, and West Virgina.

AGR-Lite can be used alone or with other crop insurance policies. Recordkeeping beyond that already done for tax purposes is minimal because the program is based on the five-year average of revenue reported to the IRS on Schedule F. Eligible revenues include income from almost all crops, livestock, and animal products such as milk. The policy excludes income from processing, post packaging, and sorting. Typical of almost all insurance policies, the policy covers only unavoidable losses and not those due to negligence, mismanagement, or wrongdoing. The policy modifies a standard definition of negligence for use in this context, providing: "The failure to use such care as a reasonable prudent and careful person experienced in the production of agricultural commodities would use under similar circumstances."

The following types of agricultural products are eligible for coverage under AGR-Lite: Grain and non-grain crops, vegetables, fruits, nuts, nursery plants, floriculture, Christmas trees, maple tree sap, animals, products from animals such as milk and eggs, and any other agricultural production, excluding timber, forest, and forest products.

To be eligible for AGR-Lite:

- You must have filed a Schedule F in the five years prior to applying for a policy using essentially the same tax entity;
- Your average annual adjusted gross revenue must be less than $512,821; and
- Not more than 50% of your allowable income comes from agricultural commodities purchased for resale.

If you suffer a loss of revenue, the amount of payment depends upon two variables that you choose – the coverage level, which is the amount of your AGR you want to cover, and the payment level, which is the percentage of the covered loss.

AGR-Lite is based on its big brother AGR. The main differences between the two programs is that AGR-Lite will provide coverage only to farms with less than about $513,000 gross income, while AGR has no income limitation but the liability limit is $6.5 million. Another difference is that AGR will not insure farms that derive more than 35 percent of their income from livestock; AGR-Lite has no such limitation.

Around 60 specialty crops are specifically covered by federal crop insurance in at least some parts of the country. But the geographic areas vary widely. For example in 2003, almonds were covered in 16 counties in one state, cabbage in 27 counties in 15 states, mint in 9 counties in 4 states, and potatoes in 325 counties in 39 states. One of the primary factors determining whether a particular region is eligible for coverage will be whether data exists for insurers to determine the amount of risk involved in growing a crop in that particular region. The following discussion covers some of the other basic approaches to crop insurance under the federal system.

USDA-RMA report on specialty crop insurance

RMA has prepared a number of specialty crop insurance reports in the past years. The latest 71-page report is available at www.rma.usda.gov/pubs/2004/specialtycrop.pdf. It features research and development on the latest risk management products. RMA generally refers to specialty crops as any agricultural crop, except wheat, feed grains, oilseeds, cotton, rice, peanuts, and tobacco. The report includes a number of tables providing information on underserved states (states Congress identifies as having unmet insurance needs), crops insurable under crop insurance programs, and other USDA initiatives.

Good farming practices

The AGR-Lite policy will not cover losses due to the "failure to follow good farming and management practices." The policy also provides that "[f]or conventional or sustainable farming practices, these practices are those generally recognized by agricultural experts for the area; or for organic farming practices, these practices are those generally recognized by the organic agricultural industry for the area." The policy states that insurers or producers can contact the Federal Crop Insurance Corporation to determine whether or not a practice would be considered a "good farming practice."

For an example of what this might mean, consider a case about a tobacco farmer in Kentucky. The farmer bought a crop insurance policy that did not cover losses due to a "failure to follow recognized good farming and harvesting practices." The farmer had committed to raising twice as much tobacco as he had ever raised before and had trouble getting the crop planted in a timely manner. After making a claim just three weeks after planting, insurance adjusters found that over 90 percent of the crop was already dead. The farmer blamed an untimely rain and then a drought, for the crop's failure. The insurer, however, argued the farmer failed to plow the ground at the right time and he planted the tobacco so shallow it was unable to withstand the lack of water. The court agreed with the insurance company and found the farmer failed to follow good farming practices so the farmer was unable to collect from the insurance company. *Royalty v. Federal Crop Insurance Co.*, 618 F. Supp. 650 (W.D. Ky. 1985).

When trying to prove you exercised good farming practices, one of the most important things you can do is to document what you did to the crop and when. Good records could make the difference between being paid for a loss or not if the insurance company believes the crop failed because of your bad practice.

Yield-based insurance coverage

Common crop policy or actual production history (APH). The basic crop insurance policy is known as the "common crop policy." It is also known as APH because this policy utilizes a producer's actual production history. This policy insures the producer against yield losses due to natural causes such as drought, too much rain, wind, frost, insects, and disease. It does not provide any type of insurance against low prices. In determining the insurance level, the producer needs to make two choices – the amount of average yield to insure (from 50 to 75 percent) and the percent of an RMA-predicted price to insure (between 55 and 100 percent). For example, assume the average yield for a particular farm is 150 bushels of corn per acre and the RMA predicted price is $2.00. A farmer could choose to insure 65 percent of the yield (130 bushels) at 75 percent of the predicted price ($1.50). There would be no pay out unless the actual yield was 130 bushels or below. If the crop only yielded 100 bushels, the policy would pay the farmer for 30 bushels times the insured price of $1.50, or $45 per acre.

Group risk plan. A variation on the common crop policy is known as the common group risk plan or GRP. GRP utilizes county yield information, as opposed to the actual individual yields, to determine losses. These policies involve less recordkeeping and paperwork, but they do not address situations where your farm might be the only one in the country that experiences losses.

CAT coverage – the basic yield policy

Catastrophic or CAT insurance is the most basic APH-type policy and provides a minimum level of protection from low yields at 50 percent of the APH yield and 55 percent of the expected price. This means CAT does not pay out until you have lost at least 50 percent of your crop. Although producers need to pay an administration fee on a CAT policy, the actual premium is subsidized by the federal government. The Administrator may waive the fee for limited resource farmers (farmers who had less than $20,000 income from all sources in the previous two years).

Revenue-based insurance coverage

The other basic approach to crop insurance addresses the risk of low revenues from the crop. Adjusted Gross Revenue plans dealing with revenue from the entire farm have already been discussed. The following types of policies are revenue-based, but focus on only one type of crop or livestock. One of the main components of all of the policies in this section is the price of a futures contract traded on a commodity exchange such as the Chicago Mercantile Exchange. Because of this, specialty crops are not generally eligible for these types of insurance.

Crop Revenue Coverage (CRC). CRC insures against both low yields and low prices and is specific to a particular crop. This type of policy pays out when the gross revenue from the crop falls below an insured level. The main variables in CRC are the actual production history and the base price, which is determined by looking at a future's contract price for the end of the season. For example, for corn the base price is determined by looking at December's future's contract prices during February. To determine the actual revenue guarantee, the policy looks to the higher of the base price or the actual price at harvest time, meaning CRC also provides some upside potential if the price moves upward during the growing season.

Income protection (IP) and Revenue Assurance (RA). IP also insures against both low yields and low prices. The main difference between CRC and IP is that IP looks only to the early season base price; if the crop price goes up during the season, the policy does not insure the crop at the higher price. You can choose to insure between 50 and 75 percent of the expected revenue. Another product called Revenue Assurance (RA) is similar to IP except with RA you may be able to insure up to 85 percent of the revenue if you include your entire farm under the policy.

Livestock Risk Protection (LRP). The Agricultural Risk Protection Act of 2000 provided for the development of livestock insurance. The main type of policy, known as Livestock Risk Protection (LRP), protects producers from low prices. Only swine, fed cattle, and feeder cattle are eligible for coverage. The policy uses the Chicago Mercantile Exchange (CME) to determine prices so the actual price you receive for your livestock does not determine your coverage. For example, assume you have a group of hogs you plan to sell in 20 weeks but you are concerned the live market for hogs might plummet before you are able to sell. You decide to purchase an LRP policy, which will use the price on the CME for the time you estimate you will sell the hogs, say 50 dollars per hundred weight. You can choose to buy 80 percent coverage, which translates to 40 dollars per hundredweight. When the 20 weeks has passed, if the CME price is 37 dollars the policy will pay you three dollars per hundredweight that you have insured. Notice the price at which you actually sold the hogs is not part of the equation. To be eligible for LRP, you must have ownership in livestock.

Livestock Gross Margin LGM insurance policy

A pilot program created in 2003, LGM takes the Livestock Risk Protection policy a step farther by insuring the gross margin a producer receives. The gross margin is the difference between livestock prices and feed prices. In 2005, the policy is available only for swine and only for most counties in Iowa. LGM builds on LRP's use of the futures markets for the price of swine by using the Chicago Mercantile Exchange prices for corn and soybeans to determine possible coverage levels and payments. The policy does not consider the actual price paid for feed or the actual price received for the sale of hogs.

Non insured Crop Disaster Assistance Program (NAP). If you raise a crop not eligible for a policy from the federal crop insurance program, you may be able to utilize the Noninsured Crop Disaster Assistance Program (NAP). NAP is administered by the USDA Farm Service Agency as opposed to RMA. NAP works much like CAT coverage in that you need to sign up by providing actual production history before the planting season. You will need to pay an administrative fee of $100 per crop per county. You receive a payment under NAP if you lose over 50 percent of your expected production. The actual payment rate is 55 percent of the expected market price determined by the FSA county committee.

Conclusion

Risk is inherent in everything that you or your producer association does. The keys to dealing with risk are recognizing where it exists, determining who bears the risk, and creating a strategy to manage the risk. Risk management strategies may include everything from changing the way you do business to purchasing crop insurance. You may choose to manage risk by entering into contractual arrangements with others, such as a producer association, to limit the risk of accessing a market or price variability. The next chapter considers the basic rules that regulate these contracts.

Additional Internet Resources for Risk Management

Agricultural Risk Management

Farm Risk Management Briefing Room (USDA – ERS)
Introduction to Risk Management (USDA – RMA)
National Ag Risk Education Library (University of Minnestoa)
Risk Management Education Centers (USDA - CREES)
Risk Management Links (Ag Marketing Resource Center)

Business Liability and Insurance

Overview

Insurance and Liability (Findlaw.com)
Insurance Center (Entrepreneur Magazine)
Insurance Links (Ag Marketing Resource Center)
Small Business Insurance and Risk Management Guide (Iowa Business Network)

National Agricultural Law Center (website)

Animal Identification: Liability Exposure and Risk Management
Landowner Liability Reading Room

Crop Insurance

USDA Risk Management Agency (website)

Crop Insurance Policies
Crop Insurance Providers for 2006
Specialty Crop Insurance Report

USDA Farm Service Agency Disaster Assistance (website)

Noninsured Crop Disaster Assistance Program (NAP)

National Agricultural Law Center (website)

Crop Insurance Reading Room

Other Resources

FarmDoc Crop Insurance Guide (University of Illinois)

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