

Ag Carbon Credit Contract Checklist

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This information is provided for educational purposes only; it must not be taken as a substitute for legal advice. If you have legal questions regarding entering into a contract to sell carbon credits associated with agricultural or forest production, contact an attorney.

There is considerable interest in selling carbon credits in agricultural circles. Unfortunately, many seem to have an exaggerated notion of how lucrative it may be for farmers or ranchers to sell carbon credits today. This publication provides a checklist of items farmers or ranchers and their attorneys should consider in evaluating a carbon contract with an aggregator (a company contracting with many farmers or ranchers for carbon credits). For more general information regarding the agricultural carbon credit market, see the references at the end of this publication. While this check list cannot identify every possible issue that may arise regarding a carbon contract, it will give you and your attorney something to begin with.

Carbon contracts are very new, and there is no “standard” U.S. carbon contract as of this writing. You must go through the contract you are considering line by line with your attorney in sufficient detail so that you understand the entire contract and could accurately explain it to someone else before you sign it. If you make the mistake of deferring your legal consultation until after you have signed a carbon contract, remember that most attorneys will make more money cleaning up the legal mess of a contract gone bad than the attorney would have charged to analyze the contract before it was signed.

1. How much will you be paid? Some producers have reported receiving offers of \$10-15 an acre or more to sign a carbon credit contract. This probably represents a signing bonus than an indication of what a long-term price for carbon credits might be. One metric ton of carbon sequestered in soil equals one carbon credit, which is the standard carbon credit trading unit. While current carbon credit prices are difficult to nail down (without paying high subscription fees), \$5 a ton would be a representative current price for cropland carbon credits. For a ballpark estimate, it could take as many as 5 to 10 or more acres of cropland to generate one additional ton of sequestered carbon annually. If the carbon credit aggregator took 33% of the gross sale proceeds, the farmer might get \$3.35/ton sold, or between \$0.335 - \$0.67 per acre under the carbon contract. Not exactly big money, and probably not enough to justify implementing the carbon sequestration practices.

If you spend enough time on the internet searching for carbon prices, you can find prognosticators predicting that carbon prices could increase to as much as \$170/ton or more in the next several years. But that slim possibility isn't anything you could take to the bank today. Long story short – some carbon credit aggregators may be willing to pay a substantial bonus to get producers to sign up with their program, creating the mirage of an ag carbon credit bonanza. That is likely to be happening because either (1) they need farmers to populate their carbon credit pilot program and are willing to pay a premium to

sign them up, or (2) they are speculators who expect carbon prices to go through the roof in the future and want to have plenty of relatively inexpensive carbon credits “in the bank” to sell later at these higher prices (should they in fact materialize). But under the most likely scenario, most carbon contract prices will be based on the current market price for ag carbon credits, which today is not very much.

2. What might make U.S. agricultural carbon credits increase in price? One possibility would be if the United States required power plants and industry to reduce their greenhouse gas (GHG) emissions fairly rapidly to bring U.S. GHG emissions to “net zero” by 2050. One policy to accomplish this under consideration by the Biden administration – the Clean Electricity Standard or CES – power plants would have the option to buy and sell “zero-emission electricity credits” in order to comply with the CES each year. If the power plants were able to meet part of their clean energy requirements by purchasing agricultural carbon credits, the demand for ag carbon credits would increase. But the likelihood of Congress’ enacting a CES program this year seems less than 50% as of this writing. In the absence of something like the CES to give large GHG emitters a reason to purchase carbon credits, it is difficult to see anything else that could significantly change carbon credit market conditions, at least in the near term. For more information see Aiken, *The Biden Climate Plan*.

3. When will you get paid? If your payments are based on the sale of carbon credits by the aggregator, there will be a process for quantifying the additional carbon storage each year, selling the carbon credits on the carbon market, deducting the seller’s costs and fees plus any hold-back or insurance coverage for future carbon credit production defaults. After all of that, you will get your share of the carbon credit sale proceeds. This process might take anywhere from several months to over a year. The contract should spell this out and your lawyer should be able to help you understand it.

4. What happens if you don’t get paid? You and your attorney will need to analyze what your rights are under the contract if the aggregator can’t pay you for your carbon credits. If that happens the aggregator would likely be liquidated in bankruptcy. Then the aggregator’s unpaid lender likely would get paid before unpaid farmers or ranchers. In any event, there could be a costly bankruptcy fight over who gets what if there were anything to recover. If this happens it just be cheapest to chalk it up as a learning experience and move on.

5. What practices might you need to implement? Possibilities include tillage practices, fertilizer practices and land retirement. Possible tillage practices include converting from conventional tillage to reduced or no-till for corn or soybeans. Possible fertilizer practices include reducing fertilizer applications, or using a nitrogen inhibitor. Possible land retirement practices include retiring marginal lands to permanent grassland. More examples are given in Sellars *et al.* at pages 2-3 and in Massey & Willett at pages 18-20. Sellars *et al.* also provide break-even prices for these practices, most of which are well below what farmers could expect to receive under prevailing carbon market prices. So you need to pay careful attention to what practices you would need to implement in the contract, and whether the expected payments would justify incurring those associated costs. For an online tool to estimate how much additional carbon you might be able to sequester on your farm or ranch with different conservation practices, see *COMET Farm*.

6. How long might the contract be? That remains to be seen. Regular ag carbon contracts might be between 10-20 years. Most non-agricultural carbon contracts are for 40-100 years, so the shorter term ag carbon contracts usually receive somewhat lower prices. Because a carbon contract is fairly likely to be long-term, you need to evaluate all the options carefully to make sure that you want to be in the contract that long. However, in a recent farm publication interview – *The Carbon Contract Conundrum* – at least one aggregator expressed a willingness to work with tenants on a shorter-term basis.

7. Will I be able to get out of the contract? That is something your attorney will need to advise you on. As of this writing, there is nothing remotely close to being a standard agricultural carbon contract, so the contracts from different companies are likely to vary considerably. You won't be able to understand the fine print on your own unless you are an attorney. So you should spend some time with your attorney to make sure you understand all the terms of the contract, which is likely to be fairly complex.

8. Does the aggregator have the right to file against my land under the carbon contract? Your lawyer needs to analyze this for you. It is possible that a carbon contract could include the right to file a lien on the land covered by the contract as security for your contract performance, and to secure payment of any penalties for contract nonperformance. In addition, look for contract clauses restricting the sale or rental of the land before the end of the carbon credit contract is up.

9. What about data privacy? Any data needed by the buyer to evaluate each season's additional carbon storage will likely be kept by the aggregator in order to have the necessary records to participate in the relevant carbon market. You and your attorney will need to carefully analyze the contract to determine how much of your farming data will not remain private under the contract, whether the data may be sold, etc.

10. How will carbon sequestration be verified? That is a very important and complicated question. Conventional soil analysis is expensive, although companies are experimenting with using GIS and ag production data to estimate carbon storage in farm fields. Some contracts may require the farmer to pay for the soil analysis, while other contracts may cover those costs from the sale of the carbon credits. You want to make sure you understand what these costs are and how they will affect your payment.

11. Can tenants sell carbon credits? This is a complicated issue that is nowhere near being resolved. The tenant would likely, as a minimum, need a 10-20 year written contract to match the term of the carbon credit contract. The aggregator may need the landlord to be part of the contract as well. There are too many legal issues regarding contract continuity that make purchasing carbon credits from non-landowners risky for most aggregators except perhaps for short-term contracts. Regarding carbon contracting on rented land, see Griffith, *The Carbon Contract Conundrum*.

Will there be more clarity about carbon markets for farmers and ranchers any time soon? Maybe – the proposed "Growing Climate Solutions Act of 2021" would make it easier for farmers and ranchers to participate in carbon markets, and would make those markets a bit more transparent. The proposal, cosponsored by Nebraska U.S. Senator Deb Fischer, would create a USDA standard for certifying carbon sequestration in farmland, ranch land and forests. Under the act the USDA would maintain an online platform where farmers and ranchers could obtain information regarding agricultural carbon markets. The proposal has bipartisan support, and its enactment would go a long way towards making carbon markets more farmer and rancher-friendly.

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