Carbon Contracts: Common and Uncommon Provisions

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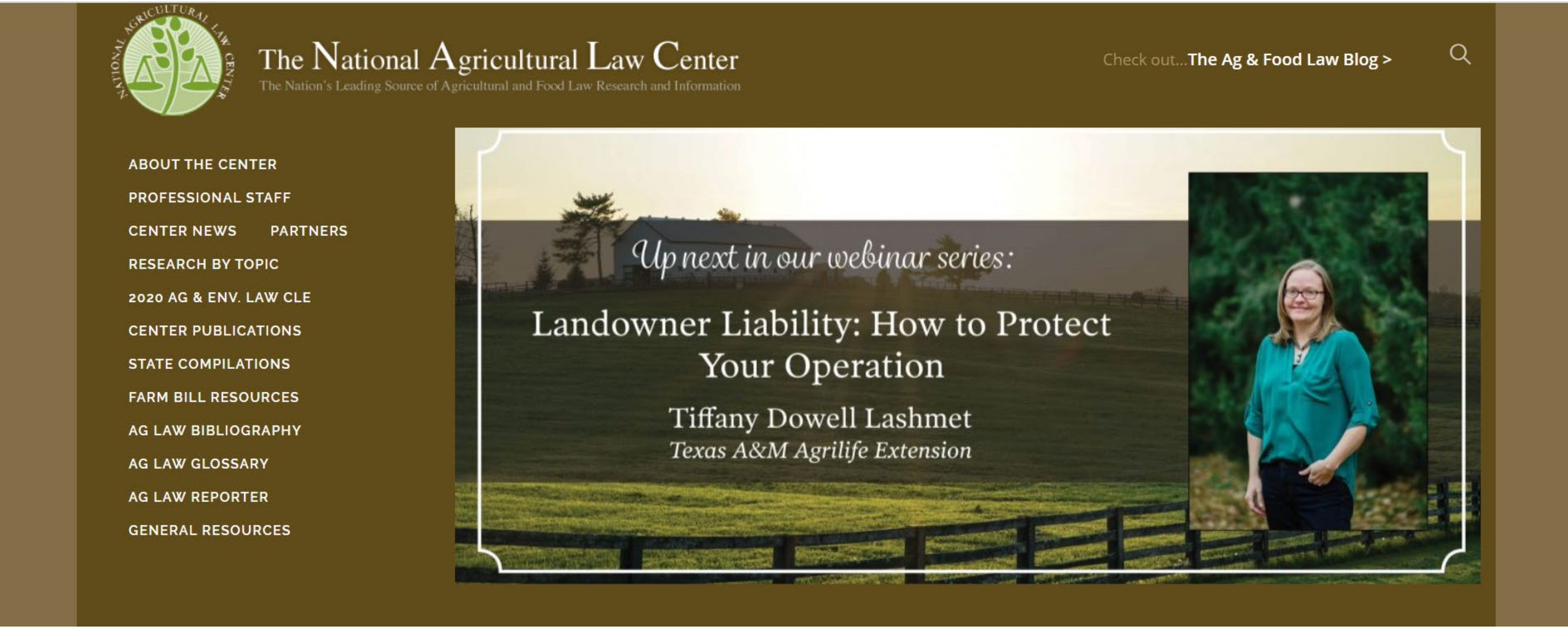
- The National Agricultural Law Center is the nation's leading source for agricultural and food law research and information.
  - Created in 1987, the NALC is a unit of the University of Arkansas System Division of Agriculture
  - The Center also works in close partnership with the USDA Agricultural Research Service, National Agricultural Library

- We provide objective, non-partisan research and information regarding laws and regulations affecting agriculture



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Carbon Resources

- Reading Rooms on Climate Change, Environmental Law, Conservation Programs

- Our "Considering Carbon" series of blog posts about recent developments in the carbon arena

- Our "Every Third Wednesday" series of webinars
  - We have several recorded webinars on the topic

- Looking forward to developing more resources on contracts, data security, land use and other factors for this new industry

Overview

- Background on Carbon
- Carbon Sequestration Agreements

Highlights of the Carbon Industry

- These are voluntary, incentive-based markets designed to sell offsets to companies that emit pollution (in this case carbon, but other markets exist on a more limited basis)
  - Not cap and trade…unless you are in CA

- 3rd parties are needed to quantify and verify these practices as well as the carbon that is sequestered in order to entice companies to buy the credits

Highlights of the Carbon Industry

- Payments are typically based on the amount of carbon sequestered so different practices can earn more or less money…this also can vary from company to company
  - Different soils can also have different carbon carrying capacities. There's a big potential difference between Illinois and Kansas.

- There is a give and take for farmers. Farmers earn money by selling credits through a 3rd party in return for adopting sustainable practices <u>AND</u> agreeing to some form of monitoring and assessment.

3rd Parties in Carbon Markets

- There WILL need to be 3rd parties to aggregate acreages, quantify the amount of carbon sequestered and to verify that the contracted practices are maintained for the life of the agreement.

- There's a lot of people pushing and pulling on things that they may not understand…

Who are the Players

- Mix of Public and Private Companies as the 3rd party facilitators:
  - Established agricultural companies like Corteva, Bayer and Nutrien
  - Coalitions such as the Food and Agriculture Climate Alliance
    - AFBF, NFU, NASDA, Environmental Defense Fund, Nature Conservancy, etc…
  - Private groups such as Nori and Indigo
  - There's also a potential for USDA to get involved through the CCC at least as a pilot program

- This list is representative, not expansive, and seems to evolve frequently!

Where are we in the Process?

- We are still in the early days.
- Lots of ongoing work quantifying practices and their effects.
- Likely to be variation in the amount of carbon that particular types of soil can capture
  - This could mean substantial differences in the ability of farmers to capture payments in some parts of the country…
- There seems to be substantial (voluntary) demand at present

Overview

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Some Questions to Ask Your Client Right off the Bat

- Do they know how to farm using the new practices that they'll have to adopt?
- Can they make/not lose money under this agreement?
- Are they okay with people coming onto their property for years to come to take soil samples?
- Do they know how the carbon company will calculate the pay?
- Are you able to get a copy of the agreement?

Start with the Money - Payments are based off of Carbon Sequestered

- Different companies may use different methodologies…
  - \$15-\$20 per ton is what we are seeing presently
    - 1 contract offered \$3 per acre for no/minimum till and \$6 per acre for a cover crop…
  - Nori is using their own cryptocurrency as well where they take 15% off of the top for their share
  - In one of them the landowner bids out what they'd like to be paid
  - About half of them don't tell you how the carbon sequestered is calculated…

- EX. Your client has 100 acres that she wants to enroll for a cover crop at \$6 per acre so she'll be paid **\$600**.
- Her estimated costs:
  - Red Clover seed - \$2.50 per pound at 5 pounds per acre for 100 acres is **\$1,250**.
  - Diesel?
  - Time?
  - Wear and tear on equipment?

Payments, continued

- Some money may be paid up front, but it typically takes a couple of years to see how much carbon is sequestered.
  - Some contracts actually cover all environmental benefits (such as water quality credits) but may not say how your client will be compensated for them…**Read them carefully.**

- What about earlier adopters?
  - Real problem about how to treat early adopters. Should they be paid and, if so, how much?
    - Most do not pay early adopters…

- There are also practical difficulties to consider:
  - What happens if a fire destroys a cover crop?
  - What if not as much carbon is sequestered as expected?
  - What about a change of ownership?
  - No insurance for these types of occurrences are available yet.

Sample Payment Language

Contract #1

- "Carbon Company" will provide the farmer with a credit towards the cost of the services provided to the farmer under the Services Agreement equal to 70% of the sale proceeds received by "Carbon Company" for the Credits less any expenses incurred by "Carbon Company" of approximately $0.40 per tonne processed to create the credits

Contract #2

- Farmer is entitled to payment for 60% of eligible carbon credits.
- 15% are kept by the company
- Up to 20 to 28% are withheld in a buffer pool to ensure that buyers are getting what they purchased
  - This gets doled out 5% and 10% at a time over the next 4 years.

How much Carbon **<u>IS</u>** being Sequestered?

- Contracts deal with this differently, but this is of critical importance
- How they (and their 3rd party verifiers) calculate carbon sequestered directly impacts how much your client will be paid!
  - Some contracts are completely silent on the topic
  - Here's sample language from one contract:
    - Carbon Company (CC) has the exclusive right, in its sole discretion, to select the methods, practices and manner (including without limitation, timing and frequency) in which it determines your eligibility and how it quantifies and verifies carbon credits that may be generated. You will not be entitled to review or have access to any confidential information or proprietary methods or models.

- Finding out ***how*** they arrive at the number they say your client sequestered may not be something that you <u>ever</u> find.

Length of a contract

- Most contracts for carbon sequestration in working lands take place over a substantial period of time –
  - There is variation though…One lease that I've seen is for 1 year and involves foregoing harvesting of mature timber during that time period.
  - Some appear to be year to year so long as both parties want to continue
  - Cargill is 3 years in the contract that I've seen
  - One is 10 years
  - Some are as long as 15 years

- Things to consider:
  - Does the farmer own the land <u>OR</u> have a lease agreement that covers a long period of time
  - If it is a lease agreement – do you expect the tenant to keep leasing the land?
  - Are there other potential tenants in the area that can (successfully) farm <u>and</u> abide by the carbon contract?
  - The land has a carrying capacity for carbon so there will be diminishing returns at some point…

Sample Length of Contract Language - Uncommon

- “The crediting period for fields enrolled in “Carbon Company is 10 years and renewable up to two times (at the sole discretion of Carbon Company) for a potential of 30 years.”
  - The farmer is also bound by a “Permanence Period”

- What is the permanence period?
  - “You understand that the issuance of Carbon Credits and payments for Carbon Credits requires that greenhouse gas reductions are stored on your Fields for at least **100 years** following the issuance of a Carbon Credit.

What Practices are Covered?

- Different companies use (and value) different practices.

- Common ones include:
  - **Cover Crops**
  - **No-till or minimal till**
  - Buffer strips along streams (think EQIP)
  - Crop rotational practices
  - Rotational grazing practices
  - Digesters at CAFOS
  - Planting of trees/foregoing logging operations

People on the Property

- There will be people on the property
  - They need to take soil samples to measure carbon

    And
  - They need to make sure that you are following those practices that your client agreed to perform.
    - This could also extend to auditing your client's records

- Does your client know and understand this?

Other Clauses – Modification Clauses

- We reserve the right to modify, make updates, amendments, additions, and deletions so long as we send written notice that you have 10 days to object.
  - If you don't object within 10 days then this counts as acceptance and you are bound thereby in all respects.
  - If you do object then we can terminate your participation without any liability to you including the forfeiture of any unvested credits.

- Some of these clauses can be difficult to find and some contracts include other websites with clauses that are incorporated by reference to the one that may be in front of you.

Other Clauses

- No “Double Dipping” clauses…i.e. you can’t sell the same benefits twice!
  - Make **<u>SURE</u>** that USDA programs don’t count…especially the new funding from the Inflation Reduction Act and FY23 appropriations bill.
  - The 3rd parties are scientists that have no idea about USDA and farmers
- Confidentiality Clauses…lots of them!
- Access to the property clauses
- Several refer to a website that is incorporated by reference in the contract AND can be amended by the 3rd party at any time.
- Who owns the data?

“Legalese”

- Assignment clauses
  - Typically very favorable to the company, but researching the company is still a great idea.
- Termination clause
  - Adequate notice and a cancellation fee if possible
- ADR
  - If you can take it to court locally things may go better for you…
- Limitations of Liability
- Venue and Choice of Law
  - Keep it local if at all possible

Contract Takeaways…

- Some of the contracts are remarkably short
  - At least 4 contracts that I've seen are under 4 pages in length
- There are a <u>LOT</u> of confidentiality clauses and watermarks
- Many of the shorter contracts don't discuss a formula to determine payment.
- The language for a breach of contract (such as not maintaining a cover crop) is usually pretty benign, but not always!
  - Damages are usually limited to the total payment available under the contract
  - One contract says that they 3rd party may choose not to work with you for several years if you breach it…
- Many contracts allow the farmer to select the acreage they want to enroll and one requires that they register everything they own.
- Watch to see what is covered in the contract…read the definitions!

Things to Consider for Farmers

- Contracts remain elusive

- Many private companies talk broadly about the agreement, but the websites are often short on detail

- Carbon companies may know a lot about science, but there is differences in what they know and understand about agriculture

Things to Consider for Farmers

- How much access will 3rd parties have to their property
- Many companies out there and not all will make it for the life of the agreement…
- What is to be done about the early adopters?
- Technical support for the new practices – Who teaches farmers how to transition to no-till, cover crops, etc…
- What data is going to be need to quantify the results and who will have access to it during the life of the contract and after it has run its course?

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