

# CARBON MARKET CONTRACT BASICS

*Key aspects corn farmers need to know*



Minnesota**Corn**  
GROWERS ASSOCIATION

Carbon markets (either voluntarily or mandatory through government regulation) have emerged in recent years as a practical means to use free-market economic principles to reduce greenhouse gas emissions and mitigate global climate change. In carbon markets, businesses or individuals who reduce greenhouse gas emissions or sequester carbon in the soil can sell "credits" to other businesses or individuals who generate carbon emissions to offset those emissions.

For example, a utility that burns coal to generate electricity can calculate the amount of greenhouse gases it emits and purchase credits representing the same amount of carbon dioxide equivalent to offset its emissions to satisfy regulatory requirements, consumer demands, or voluntary sustainability initiatives.

As part of the natural carbon cycle, growing plants absorb carbon dioxide from the atmosphere and store the carbon in their roots and plant matter. When the plants die, the carbon is deposited in the soil or released back into the atmosphere as the plant matter decays. By implementing certain conservation practices (e.g., planting cover crops, reducing tillage, or managing nitrogen fertilizer applications), farmers can reduce the amount of greenhouse gases they emit and increase the amount of carbon they sequester in the soil.

Carbon markets provide farmers an opportunity to receive additional compensation for implementing these practices.

But as with most things in life, this money does not come without obligations.

To monetize carbon offsets, the emission reductions or carbon sequestration on which a carbon credit is based must be:

- **Quantifiable** - the amount of carbon mitigation is reliably calculated;
- **Verifiable** - sufficient data is collected to confirm the amount of carbon mitigation; and
- **Enforceable** - future obligations to implement mitigation practices are legally binding.

The organizations that administer carbon marketplaces where carbon credits are bought and sold impose specific requirements to create and verify the carbon mitigation.

# Most farmers do not market carbon credits directly.

Farmers who wish to participate in carbon markets generally enter into contracts with third-party developers to implement conservation practices on their farms.

Third-party developers take the necessary steps to document and verify carbon mitigation to create the carbon credits and then sell those credits in carbon marketplaces.



# Key terms to know before entering a carbon contract

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- **Producer Requirements** - The first, and most basic, contract terms a farmer should understand is the specific obligations that the contract imposes on the farmer. These requirements may fall within several categories.
  - **Carbon Mitigation** - Some carbon contracts identify specific production practices (e.g., planting cover crops or using specific tillage practices) that a farmer must implement on particular fields. In other words, these contracts specify the particular means a farmer must use to achieve carbon mitigation. Other contracts merely require a farmer to sequester a specific quantity of carbon or reduce greenhouse gas emissions by a specific amount over a period of time and allow the farmer to choose from a menu of practices to achieve these reductions. Each structure has its advantages and disadvantages that should be considered with the other contract terms. In either case, a farmer should understand the specific requirements that the contract imposes.

■ **New or Existing Practices** - Many carbon contracts will require a farmer to implement new conservation practices and will not count any existing practices that a farmer already uses toward the carbon mitigation requirements. In some cases, carbon contracts will allow farmers to count existing practices that a farmer has previously implemented as long as those practices are voluntary (i.e., are not already required by existing laws, regulations, permits, or contracts). Before entering into a contract, farmers should make sure they understand whether or not any existing practices are included in the contract.

■ **Restrictions on Enrolling in Other Programs**- In some cases, the conservation practices required under a carbon contract may also qualify for other programs. For example, a carbon contract may provide payments for removing land from row crop production and converting the land to grassland, which may also qualify for the Conservation Reserve Program. In addition to excluding land that was already converted and enrolled in these programs (as described above), a contract may also prohibit a farmer from enrolling covered land in other programs after the contract requirements are implemented. Make sure they understand whether or not any existing practices are included in the contract.



- **Land Use Restrictions** - Most carbon contracts will require farmers to implement conservation practices on farmland for a specified period of time. And in many cases, the contract will identify the specific land on which these practices must be implemented. If a farmer leases crop ground, a farmer should confirm that the contract allows leased ground to be included in the contract and make sure that the lease extends for the duration of the contract (i.e., that the farmer will have the right to farm the ground for the duration of the contract). A farmer should also understand whether the contract imposes or requires a restrictive covenant, easement, or lien that attaches to the land and may restrict the farmer's ability to sell or use the land in the future.
- **Verification** - Most carbon contracts will include some verification requirements. These contract terms may require farmers to create and maintain certain records related to their farming practices, collect certain measurements, or make their property and records available for inspection. Farmers should understand both the requirements they are required to perform and the rights they are granting to third parties with respect to verification and inspection.



# Key terms to know before entering a carbon contract

**Payment Terms** - Farmers should also understand the payment terms of a carbon contract. This begins with the manner in which payments are calculated. In this regard, some contracts calculate payments based on the number of acres on which the required conservation practices will be implemented, while other contracts calculate payments based on the amount of carbon sequestered (or amount of carbon emissions reduced) or on the market price of the carbon credits generated from the conservation practices. Farmers should also understand whether the payments are guaranteed or instead are contingent on some future event (such as the sale of the carbon credits generated) and whether there are penalties imposed if required future practices cannot be implemented or the amount of carbon actually sequestered is less than anticipated. Finally, farmers should understand how the payments are structured (i.e., how many payments will be made and when will they be made during the term of the contract).



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- **Contract Duration** - Another basic term a farmer should understand before entering into a carbon contract is how long the contract lasts. In other words, a farmer should understand how long they will be required to implement the specified conservation practices and whether the contract allows either party to terminate the agreement early (and if so, under what conditions or at what cost).
  - **Control of Data** - As noted above, most carbon contracts impose verification requirements to document and measure the amount of carbon emissions that are mitigated or the amount of carbon that is sequestered in the soil. These verification requirements will generate significant data about the land and farming practices. Farmers should understand who owns this data, who will have access to this data, and how this data may be used in the future.
  - **Who are you dealing with?** - Finally, farmers should understand who they are dealing with before entering into a carbon contract. Because many of these contracts impose obligations and payment rights that may extend for many years in the future, farmers should understand whether the other party is an established company that has a long track record or is a start-up who may not have the resources to make payments in the future. A farmer should also know any third parties who will be involved in collecting measurements or data relating to their farm.

# THE EMERGING ECOSYSTEM SERVICES MARKETS

Carbon contracts may provide many farmers with supplement compensation to implement production practices that are good for the environment and their farming operation. But these contracts may also impose obligations that extend for a long time in the future and restrict future opportunities. Farmers should therefore make sure to fully understand the terms of a contract, and carefully weigh the benefits and costs, before entering into these contracts.



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