



WHAT QUESTIONS SHOULD YOU ASK BEFORE SIGNING A CARBON CONTRACT?

Featuring Dr. Chad Hart

Professor of Agricultural Economics, Iowa State University

DJ May:

Welcome to the Decode 6 Podcast, where we take your questions about carbon and ecosystem services and match them to the experts with the answers. I'm your host, DJ May, and today we're talking about carbon contracts.

Specifically, what are the questions you should ask before signing a carbon contract? Joining me today to answer that question is Dr. Chad Hart, a professor of economics at Iowa State University. Chad's research has examined the interaction between agricultural commitments within the World Trade Organization. He's also studied policies and programs of World Trade Organization members, crop insurance, international trade, federal agricultural policy, and crop marketing. He knows a thing or two about contracts. Chad, welcome to the show.

Chad Hart:

It's my pleasure to be with you.

DJ May:

Excellent. Well, let's jump right in. So, when we talk about carbon contracts, what are we talking about?

Chad Hart:

Well, the carbon contract, and I'd say that's one of the hardest parts to define here. What we're talking about is looking at the ability to either reduce the amount of carbon we're releasing into the atmosphere or the ability to capture carbon and sequester it either in the soils or plants that we might grow. So, for farmers, mainly what we're talking about here is that second part. How do we use our agricultural production to help lock more carbon into our soil, such that it is held there for a long period of time, therefore not adding to the greenhouse effect that we're seeing with climate change.

DJ May:

Perfect. Well, if I am interested in the carbon program and I'm sitting down, I have a contract in front of me, what are the questions I should ask myself? What's the first thing to look for?

Chad Hart:

One of the big things to look for is, let's call it the flow of funds. How, for the most part, when we think of carbon markets, I think a lot of folks are thinking, okay, there's a payment for coming from a carbon market to a farmer to sequester this carbon, but that's not the only flow of funds. When you think about these carbon markets, we have to look at, there are basically verification costs and marketing costs and all sorts of different costs to help the market function well. Who's covering those costs? And depending upon what entities we look at here, because for example, when, as I sit here in Iowa, we have about 15 or 16 companies that are offering carbon trading opportunities, and they all handle those costs a little bit differently. Some of those companies absorb those costs themselves. Others of them, if you will, share them with the farmers so that the farmer's partially on the hook to create the marketplaces were looking out there.

Probably the biggest one that I've noticed farmers worried about are the verification cost. How do you verify and who pays for the verification of sequestering that carbon in the soil? Whether it be through just checking on the practices that are on the farm or whether we're talking about soil testing and literally, yeah, well, having laboratory tests on that soil to verify that carbon. Because when you think about that soil testing, that can get rather expensive, and so you need to know when you're going into these types of contracts, who is paying those additional costs? How are they shared?

DJ May:

Excellent. Well, I imagine too, when you have something like verification or even when you sign up, you're generating a lot of data that you're handing over. So, what should you consider? What happens with that data you submit?

Chad Hart:

You're definitely on task there when it comes to the data as well. Because when you think about these soil tests that we might do, yes, you're generating a tremendous amount of data, and I'm going to argue this data issue existed before the carbon markets have come about, but the carbon markets sort of magnifies it. When you think about all the precision agricultural technology that we see within ag today, we're generating a tremendous amount of data about what is happening on the farm, how we produce the crops, what are the side benefits and costs of producing those crops? There's been a big question within precision agriculture, who owns that data? Is it the company that created the box that captured the data? Is it the farmer, who's if you will, farming practices are creating the data? Is it some combination of the two? We're seeing that same thing as we look here with the carbon markets.

So, again, this is something that a farmer's going to have to do some homework on, in looking at that carbon contract that they might have. Do they own the data or is it owned by the company that I'm selling it to? If it's owned by somebody else, how can they share that with others, or to turn it around another way, as I, as a farmer, can I share my data with others? So, this issue about not just the flow of funds, but the flow of data and who controls that flow does matter here, especially as we're looking at times now where, let's face it, data is being utilized to create additional government programs that might impact agriculture. So, farmers probably want to know and understand how their data can and might be used.

DJ May:

Yeah, yeah. Well, I'm thinking, whenever I have terms and conditions pop up on my phone, is there any specific language you should look out for around data sharing or what's the tip-off?

Chad Hart:

Well, I think the tip off is usually one in that terms and conditions. It sort of tells you who owns the data, who literally has control over whether that data is shared or not. That's one of the big things to look at, and then let's say it is sort of jointly owned, what are the conditions that restrict or allow that flow? Say, for a farmer, for example, let's say it's jointly-shared data with the company they're working with. What do they have to do in order to share that data with their agronomist or their crop insurance agents, so that they might qualify for certain discounts or something like that? Those are, I would say, the transactional costs you want to look at here in terms of is it just me signing a piece of paper saying I want to share this, or is there a fee to that? How can I set that up?

DJ May:

Perfect. Well, what else should you consider?

Chad Hart:

Well, I think when we're looking here as well, we've got to think about, let's call it the future developments as we're looking at these carbon markets. Like I say, we're at the beginning stages here now, and I think we're going to see interest not only from private companies trying to set up carbon transactions, but we're also going to see some government programs that are directed this way as well, especially sort the continuation of the Paris Climate Accords and things such as that. We have seen an interest under President Biden's administration to set up some sort of carbon market or carbon systems within USDA. So, I think farmers also have to be cognizant of thinking, how does this opportunity affect my potential to participate in future opportunities down the line?

If I sell my carbon today, and it's sort of locked up for the next 10 years, does that preclude me from joining in possibly new government programs during that time? Or do I have the flexibility built within this contract that says we can sort of stack, if you want to think of it this way, that I can participate in what I'm doing now, but then also participate in new and upcoming programs that might come down the line over the next few years.

DJ May:

Yeah. I know I've heard people talk about just sort of this divide between maybe public and private programs, and what happens if you sign up for a private program now, and maybe then it turns into a government program later.

Chad Hart:

Yeah, there's a lot of concern, I say, especially for farmers. They're worried that if I sell it voluntarily now and then there's a possibility of maybe there's some mandatory programs that come down the line. Well, if I've already sold it voluntarily beforehand, does that mean I have to create additional carbon credits to meet the mandatory program or does, do my voluntary efforts count towards that mandatory program? So, there is a lot of concern here about that, especially when we're talking about the potential for a government program here. I would say, for the most part though, what we've seen is when the government does tend to get involved, they do try to make sure that farmers aren't being held to a, let's call it a double standard, meaning that, okay, if you've voluntarily made these moves in the past, we're not going to require something additional from you because you've already been ahead of the curve.

You've already made a move that we were looking for anyway, and so I understand the concern. At the same time too, I think I'm less worried about it one from a government standpoint, and two in that most of the contracts that I have seen do sort of lend themselves to saying, hey, if there is a government program here, our credits will play well within any future government program.

DJ May:

Oh, excellent. Good news.

Chad Hart:

Yep. It's always nice when these things can work together, and I think that's the deal, creating that flexibility where we can allow these markets to evolve to better fit what, if you will, what actually works in the real world right now. I'd say that's the biggest challenge right now is figuring out how to build this carbon market where it can be fully functioning out in real time, real life agriculture.

DJ May:

Excellent. Well, I know a lot of these programs are practice-based, but what happens if something goes wrong, and you can't do a practice after you've signed a contract?

Chad Hart:

Well, that is a challenge for some of these contracts because it's not completely well written in that point yet. So, with some of these contracts, it would be, that what they'll say is that, okay, if you can't do that practice this year, then what we'll do is we'll delay for a year, but that extends the contract for a year. Others have what I'll call a clawback provision, meaning that, nope, you didn't do that practice for a year, so you don't get paid for that year. What I mean by a clawback there is if they've already paid you that they could pull some money back if you're not able to do the practice. This also comes back to the point of trying to figure out, okay, how long of the contract should I sign?

If we're just talking about an annual contract, well then it's fairly easy to catch back up again. But if it's a 10-year contract, yeah, lot of the ramifications if I get into year three, and I've been planting cover crops, but in year three I can't get there. The weather conditions just won't allow it. That's where you have to get into the nitty-gritty legalese of what does the contract allow in terms of potential changes out there, and how does that impact the flow of funds, the flow of data, and the flexibility within the contract.

DJ May:

Excellent. Well, do you have any final thoughts, Chad, before we wrap up?

Chad Hart:

Well, I think as we're looking here, like I say, one of the biggest things is for farmers that they're going to need to do their homework as they're looking at these opportunities here. It's not just like marketing corn or soybeans or wheat, where we're jumping into a market. We know the price and we know what we're delivering. Here it's more amorphous, if you will, in that you're signing a legal document to do some things that are creating practice changes on your farm, and that can have some long-term ramifications. So, I need to make sure that I understand what those are, and that I'm comfortable in making those guarantees not only for this year, but for potentially years to come.

DJ May:

Excellent. Well, just to summarize, make sure you consider the flow of funds. Take a look at what happens with any data that you submit. Make sure you know what the penalties are or if there are any changes on your farm, and finally think about how the carbon opportunities you're taking today will impact your choices down the line. Tell me if I missed anything.

Chad Hart:

Nope. I think we're good there.

DJ May:

Excellent. Well, thank you so much, Chad. I really appreciate it.

Chad Hart:

Ah, it's been my pleasure.

DJ May:

If you want more information about carbon contracts and economics, check out the show notes, and if you're curious about carbon and ecosystem services, come visit us at decode6.org to learn more.