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Cleantech and Derivatives Update June 17, 2024

U.S. Department of Treasury Releases Joint Policy Statement and Principles on Voluntary Carbon Markets

The Policy Statement asserts that "the U.S. Government is playing an increasingly important role in carbon credit markets" and serves to "codify the U.S. Government's approach to advance high-integrity voluntary carbon markets."

On May 28, 2024, the Biden-Harris Administration ("Administration") released a Joint Statement of Policy and new Principles for Responsible Participation in Voluntary Carbon Markets (the "Joint Statement") announcing the U.S. government's approach to further developing high-integrity voluntary carbon markets ("VCMs").[1] The principles and statement are cosigned by Treasury Secretary Janet Yellen, Agriculture Secretary Tom Vilsack, Energy Secretary Jennifer Granholm, Senior Advisor for International Climate Policy John Podesta, National Economic Advisor Lael Brainard and National Climate Advisor Ali Zaidi.

Background:

High-integrity VCMs complement mandatory carbon markets as well as other clean energy products such as Renewable Energy Certificates ("RECs") in a sustainability portfolio and are considered crucial to promoting sustainability goals and carbon reduction and removal efforts by providing a market for the purchase and sale of carbon offsets. While federal regulators such as the Commodity Futures Trading Commission (the "CFTC"), the Securities and Exchange Commission (the "SEC") and the Environmental Protection Agency ("EPA") are interested in

VCMs, there is currently no primary federal regulatory regime for VCMs nor is there a clear legislative framework on the horizon.

The CFTC and the SEC have said that carbon credits are “environmental commodities,” which means that the carbon credits themselves are not derivatives and they are not securities. As a result, neither the CFTC nor the SEC has issued rules regulating the trading of carbon credits in VCMs. The CFTC has enforcement authority over fraud and manipulation in VCMs but no rulemaking authority. However, derivatives on carbon credits would be regulated by the CFTC and subject to the CFTC’s rules. The SEC has authority over public filers and others under its jurisdiction that participate in the VCMs, including disclosure requirements. There have been SEC enforcement actions related to greenwashing and funds’ environmental, social and governance (“ESG”)-related internal controls, as well as comment letters pressing public companies on perceived inconsistencies between sustainability report disclosures and their SEC filing obligations. Although trading in the VCMs is largely unregulated, there may be certain state regulation for brokers and other participants in VCMs. Accordingly, certain industry groups have been working to come up with consistent standards, practices, and codes of conduct across VCMs.

Absent a clear regulatory framework, there are some concerns that VCMs are sufficient to produce additional decarbonization activity and provide certainty that a carbon credit actually represents the removal or reduction of one tonne of carbon dioxide, or is equivalent, from the atmosphere as a result of a particular project.

VCMs are still developing in the United States. While pressure to participate in these markets mounts, many would-be participants are wary. Among other reasons, companies are cautious due to activist and regulatory scrutiny of greenwashing, consumer fraud, securities laws violations (e.g., greenwashing or disclosures), verification issues and associated reputational concerns.

As a counterweight, and to demonstrate its commitment to VCMs, the Joint Statement outlines how the U.S. Government seeks to shape VCMs in line with the principles for responsible participation detailed below. The publication of the Joint Statement indicates that the U.S. government thinks that current private sector initiatives have room for improvement. The principles enunciated in the Joint Statement are one component of the U.S. Government’s efforts in this area, and the Administration has called upon the “U.S. private sector and other stakeholders in the carbon credit value chain to responsibly participate in VCMs, consistent with the principles” of the Joint Statement.

Principles for Responsible Participation:

The Joint Statement announces seven principles, which are not exhaustive, that seek to codify and strengthen concepts and practices already developed market participants, governments and international bodies. The primary aim of these principles is to inform and support the continuing development of VCMs. The principles are as follows:

__Principle 1__: **Carbon credits and the activities that generate them should meet credible atmospheric integrity standards and represent real decarbonization**, including these elements:

- **Additional**. The activity would not have occurred in the absence of the incentives of the crediting mechanism and is not required by law or regulation.
- **Unique**. One credit corresponds to only one tonne of carbon dioxide (or its equivalent) reduced or removed from the atmosphere and is not double-issued.
- **Real and Quantifiable**. Claimed emissions reductions or removals represent genuine atmospheric impact that is determined in a transparent and replicable manner using robust, credible methodologies. Relevant activities are designed to prevent emissions from occurring, being shifted, or intensifying beyond their boundaries as a result of the activity ("leakage").
- **Validation and verification**. Activity design is validated, and results are verified, by a qualified, accredited, independent third party.
- **Permanence of greenhouse gas benefits**. The emissions removed or reduced will be kept out of the atmosphere for a specified period of time during which any credited results that are released back into the atmosphere are fully remediated.
- **Robust baselines**. Baselines for emissions reduction and removal activities are based on rigorous methodologies that avoid over-crediting, prioritizing the use of performance benchmarks where applicable, and that evolve over time to reflect advancements in national climate policy, emissions pathways and decarbonization practices, and technology.

The Joint Statement also emphasized that verifiers and issuers of carbon credits play a pivotal role in VCMs, and that they should:

- Effectively govern their standards to ensure transparency, accountability, responsiveness (e.g., to evolving best practice, science, and policy landscapes), and, when applicable, the longevity necessary to responsibly certify removal activities;
- Operate or make use of a registry to transparently track the attributes, issuance, ownership, and retirement and/or cancellation of credits, coordinating where appropriate to ensure that activities are not registered with more than one registry;
- Ensure robust measurement, monitoring, reporting, and verification ("MMRV") of emissions reductions and removals;
- Have procedures in place to effectively address double-counting risks, including to prevent double-registration and -issuance, to prohibit double-selling and -use, and to transparently reinforce multi-stakeholder efforts to avoid double-claiming as applicable;
- Require publicly available and accessible, comprehensive, and transparent information on crediting activities;
- Ensure verification of reported emissions reductions and removals, and validation of the relevant project or program, is undertaken by independent, accredited third parties;

- Ensure their governance procedures address real or perceived conflicts of interest in relation to the standards body's own governance, as well as in registry administration and in validation and verification activities; and
- Support a robust enabling environment for equitable participation, including by projects and programs in developing countries.

<u>Principle 2</u>: Credit-generating activities should avoid environmental and social harm and should, where applicable, support co-benefits and transparent and inclusive benefits-sharing.

The Joint Statement here emphasizes protecting local communities, considering impacts on land, use, food security, and biodiversity and encourages stakeholder to respect Free, Prior and Informed Consent where applicable.

<u>Principle 3</u>: Corporate buyers that use credits should prioritize measurable emissions reductions within their own value chains.

Principle 3 relates to taking inventory of Scope 1, 2, and 3 emissions and regularly reporting them, and setting clear emissions targets across multiple time horizons, and collaborating with suppliers.

<u>Principle 4</u>: Credit users should publicly disclose the nature of purchased and retired credits.

Disclosure of purchased, cancelled, or retired credits should be issued at least annually and include reasonable detail sufficient for an outside observe to assess the integrity of credits. The format should be consistent and considerate of evolving market practices, including the consideration of aggregate public reporting.

<u>Principle 5</u>: Public claims by credit users should accurately reflect the climate impact of retired credits and should only rely on credits that meet high integrity standards.

Claims should rely only on the impact of credits that meet current high integrity standards at the time the claim is made and that avoid adverse impacts (see Principles 1 and 2 above). These claims should be in the context of a corporate climate strategy that prioritizes within-value-chain emissions reductions (see Principle 3 above). Unless remediation has occurred (e.g., through buffer pools), credits that have been reversed or otherwise negated should not be used as the basis for any claims.

<u>Principle 6</u>: Market participants should contribute to efforts that improve market integrity.

Consistent with past statements of the U.S. Government and regulatory agencies, the Joint Statement recognizes the need for private sector initiatives to develop high quality VCMs but is agnostic with respect to the particular market structure.

<u>Principle 7</u>: Policymakers and market participants should facilitate efficient market participation and seek to lower transaction costs.

Lowering transaction costs could facilitate greater market participation, and the Joint Statement encourages collaboration among all stakeholders to achieve these aims. The use of well-calibrated models may reduce MMRV costs and improve credit integrity.

Actions to Develop VCMs:

In its Fact Sheet[2] accompanying the announcement of the Joint Statement, the Administration also emphasized related efforts by the U.S. Government:

- **Creating New Climate Opportunities for America's Farmers and Forest Landowners:** The Department of Agriculture's Agricultural Marketing Service published a Request for Information in the Federal Register asking for public input relating to the protocols used in VCMs.
- **Conducting First-of-its-kind Credit Purchases:** The Department of Energy ("DOE") announced the semifinalists for its $35 million Carbon Dioxide Removal Purchase Pilot Prize whereby DOE will purchase carbon removal credits directly from sellers on a competitive basis.
- **Advancing Innovation in Carbon Dioxide Removal (CDR) Technology:** The U.S. is making comprehensive investments in programs to accelerate the development and deployment of critical CDR technologies that are designed to enable more supply of high-quality carbon credits.
- **Leading International Standards Setting:** Global collaboration and bilateral partnerships to promote best practices.
- **Supporting International Market Development:** The U.S. government is engaged in a number of efforts to support the development of high-integrity VCMs in international markets, including in developing countries, and to provide technical and financial assistance to credit-generating projects and programs in those countries.
- **Providing Clear Guidance to Financial Institutions Supporting the Transition to Net Zero:** In September 2023, the Department of the Treasury released its Principles for Net-Zero Financing and Investment[3] to support the development and execution of robust net-zero commitments and transition plans. Later this year, Treasury will host a dialogue on accelerating the deployment of transition finance and a forum on further improving market integrity in VCMs.
- **Enhancing MMRV:** Federal departments and agencies such as DOE, USDA, the Department of the Interior, the Department of Commerce, and the National Aeronautics and Space Administration are engaging in collaborative efforts to develop, test, and deploy technologies and other capabilities to measure, monitor, and better understand GHG emissions. (See also Principle 7 above.)
- **Advancing Market Integrity and Protecting Against Fraud and Abuse:**S. Regulators, such as the CFTC, have been involved in promoting VCMs, such as:
    - In December 2023, proposing guidance regarding factors that derivatives exchanges may consider when listing voluntary carbon credit derivative contracts

to promote the integrity, transparency, and liquidity of these developing markets.[4]

  - Earlier in 2023, issuing a whistleblower alert[5] to inform the American public of how to identify and report potential Commodity Exchange Act violations connected to fraud and manipulation in voluntary carbon credit spot markets and the related derivative markets.
  - Creating the Environmental Fraud Task Force[6] to address fraudulent activity and bad actors in these carbon markets.
  - Participating in international working groups and Co-Chairing the Carbon Markets Workstream of the International Organization of Securities Commission's Sustainable Finance Task Force, which published a consultation on 21 good practices for regulatory authorities to consider in structuring sound, well-functioning VCMs in December 2023.[7]

- **Taking a Whole-of-Government Approach to Coordinate Action**: The White House created an interagency Task Force on Voluntary Carbon Markets.

Takeaways and Considerations:

Although the Policy Statement does not call for legislation, it asserts that "the U.S. Government is playing an increasingly important role in carbon credit markets" and serves to "codify the U.S. Government's approach to advance high-integrity VCMs." In that regard, the Policy Statement may be best understood as a roadmap for developing and refining industry standards, as well as for future legislative and regulatory actions. Additionally, the Policy Statement may serve as a bridge to a state of play where participation and conduct in VCMs are not entirely voluntary for companies to meet their sustainability goals. In the meantime, VCMs will lack a formal regulatory regime.

Accordingly, companies should consider the following when determining whether and how to participate in VCMs:

- Sustainability reports and public disclosures may justify or even necessitate VCM transactions.
- Are your actions consistent with publicly stated sustainability goals?
- Consider cost, accounting and risk profiles of VCMs and other sustainability-related products such as RECs or Inflation Reduction Act tax credits.
- Develop a plan to purchase or sell products (timing and types of credits based on sustainability goals).
- Assess federal, state, and international regulatory implications.
- Identify transaction options (direct transactions, in a secondary market, through a broker, or in a principal market).
- Understand documentation choices and assess market standards.
- Review and evaluate your announced sustainability goals and targets.

- Engage stakeholders regarding carbon reduction in supply chain.
- Be mindful of inconsistencies in GHG emissions reporting (e.g., Inflation Reduction Act tax credit reporting).

[1]*See* Voluntary Carbon Markets Joint Policy Statement and Principles (May 2024), available at: https://www.whitehouse.gov/wp-content/uploads/2024/05/VCM-Joint-Policy-Statement-and-Principles.pdf

[2] https://www.whitehouse.gov/briefing-room/statements-releases/2024/05/28/fact-sheet-biden-harris-administration-announces-new-principles-for-high-integrity-voluntary-carbon-markets/

[3] https://home.treasury.gov/system/files/136/NetZeroPrinciples.pdf

[4] For more detail on this CFTC proposal, please refer to Gibson Dunn's earlier client alert, available here.

[5] https://www.cftc.gov/PressRoom/PressReleases/8723-23

[6] https://www.cftc.gov/PressRoom/PressReleases/8736-23

[7] https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf

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