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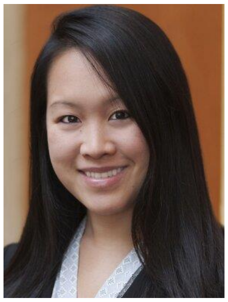
Phone: +1 646 783 7100 | Fax: +1 646 783 7161 | customerservice@law360.com

Adopting 7 Principles May Improve Voluntary Carbon Markets

By **Levi McAllister, Pamela Wu and Patrick Pennella** (June 10, 2024, 5:25 PM EDT)


Levi McAllister


Pamela Wu


Patrick Pennella

The Biden administration released a statement on May 28 that outlines principles for adoption, aimed to build high-integrity voluntary carbon markets. This VCM policy statement signals a commitment to addressing existing VCM challenges, and provides guidance on responsible VCM participation.

It will be critically important that companies seeking to or currently participating in VCMs be able to ensure that the carbon credits transacted reflect actual and permanent emissions reductions, as we anticipate these markets, the carbon credits transacted and the companies using carbon credits to offset their emissions will remain under intense scrutiny by government agencies, the public and investors.

Companies will want to carefully review their emissions and quantify the emissions that cannot be reduced through operational changes to ensure appropriate use of carbon credits, as well as accurate representations and disclosures of such use.

We discuss these points in more detail below.

Background on VCMs

VCMs offer a voluntary mechanism for individuals, businesses and nonprofit organizations to offset carbon dioxide emissions.

Through the VCMs, entities that engage in activities that remove or reduce carbon emissions from the atmosphere may generate carbon credits that can be sold, and entities that emit carbon dioxide can purchase carbon credits to offset their emissions.

These carbon credits often fund efforts to remove or reduce carbon dioxide emissions or preserve natural carbon sinks — e.g., forests — that might otherwise have been removed.

Carbon Credits

The purchase, sale and use of carbon credits has faced heavy scrutiny.

A carbon credit should represent one metric ton of carbon dioxide, or its equivalent, reduced or removed from the atmosphere beyond what would have otherwise occurred.

A carbon credit should be permanent, quantifiable, verifiable, additional and otherwise unclaimed.

Joint Policy Statement

As discussed below, the joint policy statement identifies principles to promote the function and integrity of VCMs and responsible participation in the VCMs.

It was co-signed 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.

The policy statement recognizes that high-integrity and high-functioning VCMs can present economic opportunities for sellers of carbon credits to transfer high-quality carbon credits to buyers seeking to achieve their decarbonization goals.

7 Principles for Responsible VCM Participation

As the joint policy statement notes, VCMs have the potential to support meaningful decarbonization efforts, but there is a need to address challenges and concerns regarding the transparency and integrity of VCMs, and to promote robust standards, improve market functioning, ensure fair and equitable treatment of participants, and instill confidence in the markets.

The joint policy statement sees widespread confidence in the integrity of credited emissions reductions or removals as necessary for VCMs to reach their full potential.

Because credit buyers cannot directly examine the impact of their purchase as they could with the purchase of a physical commodity, there is a need for accurate measurements and appropriate methodologies to ensure the integrity of carbon credits transacted.

Because of concerns that have been raised, including findings that some crediting methodologies and activities generating carbon credits have not accurately reflected the stated reduction outcome, there is a need to enhance market transparency, integrity and certainty.

In addition, concerns have been raised that some purchasers may purchase and use lower quality, and less expensive, credits with less integrity to offset their emissions, and may use carbon credits to offset emissions that could be abated by the holder of the carbon credits.

The joint policy statement encourages participation in VCMs that is consistent with the following seven principles.

1. Carbon credits and the activities that generate them should meet credible atmospheric integrity standards and represent real decarbonization.

Key elements include that the credits are:

- Additional to what would have otherwise happened;

- Unique, real and quantifiable;
- Validated and verifiable;
- Permanent reductions; and
- Based on a robust baseline.

Crediting certification bodies should foster transparency, accountability, responsiveness and verifiability; have procedures to address double-counting and double-selling risks; ensure procedures are in place to address conflicts of interest; and facilitate equitable participation, including with projects in developing countries.

2. Credit-generating activities should avoid environmental and social harm and should, where applicable, support co-benefits and transparent and inclusive benefits-sharing.

Projects should avoid negative externalities in the local communities, be designed and implemented in partnership with stakeholders, and be based upon respect and informed consent.

3. Corporate buyers that use credits should prioritize measurable emissions reductions within their value chains.

VCMs should complement measurable within-value-chain emissions reductions as part of an overall net-zero strategy.

4. Credit users should publicly disclose the nature of purchased and retired credits.

Disclosure of purchased, canceled or retired credits should be made at least annually, and include details that enable outside observers and stakeholders to assess whether credits are of high integrity, and avoid negative environmental and social impacts.

5. 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. Credited emissions reductions or removals that have been reversed, revealed as inflated, or exposed as failing environmental or social safeguards should not be used as the basis for any claims.

6. Market participants should contribute to efforts that improve market integrity.

VCM stakeholders should create incentives to promote credit integrity and transparency; promote fair treatment of credit suppliers; mitigate conflicts of interest; prevent fraud and manipulation; facilitate appropriate accounting and legal treatment of credits; support robust market participation; and collaborate with the private sector, civil society and the government.

7. Policymakers and market participants should facilitate efficient market participation and seek to

lower transaction costs.

VCMs should expand market opportunities and reduce high transaction costs, and policymakers should enhance certainty for credit providers that make long-term and significant decarbonization investments.

Takeaways

The joint policy statement identifies many of the same issues and concerns that the market has been grappling with for years, but puts front and center the opportunities in the VCMs that can be pursued as companies work toward achieving their decarbonization goals and emissions reductions commitments.

These issues and concerns include but are not limited to the additionality, permanence, quantification, verification, accuracy and double counting of carbon credits, as well as the transparency and variability within the VCMs.

The joint policy statement also highlights the initiatives that various federal agencies, including the U.S. Securities and Exchange Commission and the Commodity Futures Trading Commission, have undertaken and the regulatory frameworks that have been put in place to oversee the purchase, sale and use of carbon credits, of which companies transacting in the VCMs should be mindful.

For companies that are seeking to transact, or that currently transact, in the VCMs or use carbon credits, the joint policy statement reiterates how important it is that buyers and sellers of carbon credits ensure that the carbon credits transacted reflect an actual and permanent reduction or removal of carbon emissions that otherwise would not have happened but for the issuance of the carbon credit.

The use of carbon credits to achieve net-zero goals and decarbonization will continue to be heavily scrutinized, not only by the federal agencies that are overseeing the purchase, sale and use of carbon credits, but also by the public and investors.

Concerns have been — and will continue to be — raised about the quality of the carbon credits that have been used to offset emissions, as well as the use of carbon credits to offset emissions that could be mitigated or reduced by companies without having to turn to carbon credits. Companies should therefore carefully review their Scope 1, 2 and 3 emissions, and assess and quantify the emissions that they can and cannot reduce on their own initiative.

Levi McAllister is a partner at Morgan Lewis & Bockius LLP. He is head of the firm's electric vehicles working group, energy decarbonization working group, and energy commodity trading and compliance working group.

Pamela Wu is a partner at the firm.

Patrick Pennella is an associate at the firm.