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Aligning ESG strategies: a guide to the evolving voluntary carbon marketplace

By Levi McAllister, Esq., Morgan Lewis

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Companies are increasingly turning to voluntary carbon markets (VCMs) to buy and sell carbon credits to achieve their decarbonization goals as part of their overall environmental, social, and governance (ESG) strategies. While VCMs can help individuals, businesses, and nonprofits to offset their carbon emissions, their nascency and lack of an established regulatory framework have led to a disordered marketplace with questionable credits.

As a result, there is an increase in scrutiny of these markets and greenwashing litigation, as well-meaning businesses face challenges regarding environmental claims that rely on unverifiable and potentially worthless carbon credits.

However, a recent policy statement from the White House signals a commitment to address existing VCM challenges and seeks to provide guidance on responsible VCM participation. This article provides a brief primer on VCMs and carbon credits, reviews the seven principles set forth in the White House's statement, and offers key takeaways for organizations looking to participate in VCMs safely and responsibly in pursuit of their decarbonization and ESG objectives.

How VCMs and carbon credits work

Through VCMs, entities that perform activities to remove or reduce carbon emissions from the atmosphere can generate carbon credits to sell, while entities emitting carbon dioxide can purchase these credits to offset their emissions. These credits often support initiatives aimed at reducing or removing carbon dioxide emissions or preserving natural carbon sinks, such as forests, that might otherwise be destroyed.

In practice, 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. Furthermore, it must be permanent, quantifiable, verifiable, additional, and unclaimed by any other entity.

The White House's seven principles

In May 2024, the White House unveiled the "Voluntary Carbon Markets Joint Policy Statement and Principles," outlining guidelines to enhance the functionality and integrity of VCMs and encourage responsible participation. The statement acknowledges that high-integrity and high-functioning VCMs can offer economic opportunities, enabling sellers to provide high-quality carbon credits to buyers aiming to meet their decarbonization targets.

It also highlights that while VCMs hold significant potential for supporting meaningful decarbonization efforts, challenges regarding transparency and integrity must be addressed. This includes promoting robust standards, improving market functioning, ensuring fair and equitable treatment of participants, and instilling confidence in the markets. Achieving widespread trust in the integrity of credited emissions reductions or removals is essential for VCMs to realize their full potential.

A recent policy statement from the White House signals a commitment to address existing voluntary carbon markets challenges and seeks to provide guidance on responsible voluntary carbon markets participation.

Since credit buyers cannot directly verify the impact of their purchases as they would with physical commodities, accurate measurements and appropriate methodologies are crucial to ensure the integrity of transacted carbon credits. Concerns have been raised about the accuracy of some crediting methodologies and carbon-credit-generating activities, which sometimes fail to reflect the stated reduction outcomes, so enhancing market transparency, integrity, and certainty is key.

Additionally, there are concerns that some purchasers may seek lower quality (and less expensive) credits with less integrity to offset their emissions or use carbon credits to offset emissions that could be abated by the credit holders themselves.

The joint policy statement encourages participation in VCMs aligned with the following seven principles:

(1) **Carbon credits and the activities that generate them should meet credible atmospheric integrity standards and represent real decarbonization**. To do so, credits must

be 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 encourage transparency, accountability, responsiveness, and verifiability; have measures in place to address double-counting and double-selling risks; ensure procedures exist 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 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**. In other words, VCMs should complement measurable within-value-chain emissions reductions as part of an overall decarbonization strategy.

(4) **Credit users should publicly disclose the nature of purchased and retired credits**. The joint policy statement notes that disclosure of purchased, cancelled, or retired credits should be made *at least annually*. Such disclosures should include details that enable outside observers and stakeholders to assess whether credits are of high integrity and avoid the 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, as they could expose a credit user to legal liability.

(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 increase market opportunities and lower high transaction costs. Policymakers should work to enhance certainty for credit providers that make long-term and significant decarbonization investments.

Key takeaways for responsible VCM participation

The joint policy statement identifies many of the same issues and concerns that the voluntary carbon marketplace has been grappling with for years but also highlights the opportunities in VCMs that can be pursued as companies work toward achieving their ESG and decarbonization goals.

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

For companies that are seeking to, or that currently, transact in VCMs or use carbon credits, the joint policy statement reiterates that buyers and sellers of carbon credits must ensure carbon credits purchased or sold 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 a company's decarbonization and ESG goals will continue to be heavily scrutinized by not only the government bodies overseeing the purchase, sale, and use of carbon credits, such as the U.S. Securities and Exchange Commission and the Commodity Futures Trading Commission, but also by the public and investors.

Furthermore, concerns will continue to be raised regarding the practice of companies offsetting emissions with carbon credits, particularly when those emissions could be mitigated or reduced through internal initiatives. Companies should therefore carefully review their Scope 1, 2, and 3 emissions, thoroughly assessing and quantifying the emissions they can and cannot reduce on their own.

About the author

Levi McAllister, a partner at **Morgan Lewis**, is head of its electric vehicles (EV) working group, energy decarbonization working group, and energy commodity trading and compliance working group, and helps energy companies navigate the regulatory and investment environment for both conventional and emerging energy technologies. He guides clients seeking to reduce their carbon footprints and take advantage of new and evolving energy storage and infrastructure assets, while also advising on energy commodity trading and the deployment of EVs and EV infrastructure in U.S. markets. He is resident in the Washington, D.C., office and can be reached at levi.mcallister@morganlewis.com.

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