

## CFTC Anti-Fraud Blitz Is A Warning To Carbon Credit Sellers

By **Levi McAllister, Stacie Hartman and Pamela Wu** (October 22, 2024, 4:21 PM EDT)

On Oct. 2, the U.S. government announced parallel prosecutions against CQC Impact Investors LLC, a developer of various projects that are certified to generate carbon offsets, alleging that it engaged in a fraudulent scheme designed to inflate the number of offsets awarded to the projects.[1]

The allegations and prosecutorial actions of the Commodity Futures Trading Commission, the U.S. Department of Justice and the U.S. Securities and Exchange Commission reflect the government's continued focus on policing potential fraud within voluntary carbon markets, with an aim toward protecting the integrity of VCMs and the voluntary carbon credits, or VCCs, transacted in those markets.

The cases are Commodity Futures Trading Commission v. Kenneth Newcombe and U.S. v. Kenneth Newcombe, in the U.S. District Court for the Southern District of New York. The prosecutions serve as a warning to market participants actively transacting in VCMs, investing in projects generating VCCs or developing those projects themselves.

The announcement of these actions comes less than two weeks after the CFTC issued final guidance on listing VCC derivative contracts for trading by designated contract markets.[2] With that guidance, and the enforcement actions discussed here, the CFTC is staking out its position as a primary presence in the VCC market, even with limitations on its authority.

### Background

A VCC is a tradeable, intangible instrument issued by a carbon crediting program that represents a real reduction or removal of greenhouse gas emissions from the atmosphere equivalent to one metric ton of carbon dioxide.

The crediting program reviews and certifies mitigation projects or activities that reduce or remove GHG emissions from the atmosphere, and issues VCCs to mitigation projects or activities that satisfy the crediting program's standards, based on the calculated amount of reductions or removals.

VCMs provide a forum for individuals, businesses and nonprofit organizations to purchase and sell VCCs for use to offset their GHG emissions. VCCs can also be traded in derivatives markets, e.g., market



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participants can trade derivatives such as VCC futures.

Futures contracts have been offered on various carbon credits by designated contract markets, which are registered with the CFTC, and VCCs are commodities traded on both the spot and derivatives markets.

The CFTC has exclusive jurisdiction over the derivatives markets, including futures contracts, options on futures contracts, and swap transactions under the Commodity Exchange Act. In addition, it has the authority under the CEA to investigate and charge fraud, manipulation and deception in connection with any swap or contract of sale of any commodity in interstate commerce.

### **Enforcement Actions for Fraud and Deception Against Carbon Credit Project Developer and Individual Executives**

The CFTC's Division of Enforcement investigated CQC, which sold VCCs from projects to replace less efficient cooking methods with more efficient cookstoves in sub-Saharan Africa, Central America and Southeast Asia, and projects to replace less energy-efficient incandescent light bulbs with more efficient LED light bulbs in poor rural areas.

According to the CFTC, CQC was one of the largest cookstove carbon project developers in the world. The developer was responsible for managing on-the-ground project development and implementation, and for arranging project financing.

The investigations resulted in the CFTC's issuing consent orders against CQC and Jason Steele, its former chief operating officer, as well as filing a federal court complaint against Newcombe, the developer's former CEO.

### **Findings**

In the consent orders, the CFTC made several findings, including that CQC and Steele reported false and misleading information about the energy usage and energy savings for its projects to at least one U.S.-based carbon credit registry, and to verification bodies, to inflate the quality of emissions reduction projects.

As a result of this conduct, the CFTC found that CQC was issued millions more VCCs for the projects than was warranted.[3]

These acts formed the basis for violations of Sections 6(c)(1), 6(c)(1)(A), and 9(a)(2) of the CEA, and Section 180.1(a)(1)-(4) of the CFTC's regulations, which prohibit the use or attempted use of any manipulative or deceptive device, untrue or misleading statements or omissions, or deceptive practice, in connection with any swap or contract of sale of any commodity in interstate commerce, or for future delivery.

The CFTC found that CQC and Steele intentionally and recklessly engaged in fraud in connection with contracts of sale of VCCs, by providing falsified or misleading data on the use of, and energy saved by, the projects, in order to misrepresent the quality of the projects and increase the number of VCCs issued to the company. It also found that CQC's reports included false, misleading or knowingly inaccurate information.[4]

CQC is required to pay a \$1 million civil monetary penalty, cease and desist from violating the applicable provisions of the CEA and CFTC regulations, and comply with certain conditions and undertakings, including canceling the VCCs that were issued as a result of the falsified data.[5]

The CFTC's order recognizes the developer's substantial cooperation with the investigation and its representations of remediation, including terminating, replacing or separating from numerous individuals who were responsible for the conduct, appointing new senior executives, implementing improvements to the monitoring, reporting and verification of VCCs, launching new trainings, and amending policies to ensure future compliance.

CQC's cooperation and remediation resulted in a reduced civil monetary penalty by the CFTC — and no penalty by the SEC, as discussed below.

Steele, the former COO, entered into a formal cooperation agreement with the Division of Enforcement that set forth the terms of significant and detailed cooperation with the CFTC and the Division of Enforcement.[6]

### **CFTC Lawsuit**

In addition to the consent orders, the CFTC filed a complaint in federal court against Newcombe, CQC's former CEO and majority shareholder, alleging many of the same facts as the commission found in the consent order.

This includes alleging that Newcombe engaged in a fraudulent scheme and reported false, misleading or inaccurate information on the quality of the company's projects to obtain more VCCs than it was entitled to receive, thereby increasing its revenue by millions of dollars.[7]

The CFTC's complaint alleges that the former CEO "knowingly, intentionally, or recklessly participated in, directed, and set the tone for the fraud in connection with the VCCs." The CFTC further alleges that CQC falsified survey results and prepared false reports for a carbon credit registry with Newcombe's knowledge or at his direction, and that the former CEO certified the accuracy of the impact of the cookstove project.

The CFTC also alleges that once employees became aware of the fraud, the former CEO denied or minimized his involvement and provided pretextual explanations.

In addition to seeking an order finding CEA and CFTC regulation violations, the commission also seeks a permanent injunction order enjoining Newcombe from engaging in the conduct discussed above, or entering in any transactions involving commodity interests, an order directing Newcombe — and any third-party transferee or successor — to disgorge all benefits received from the alleged violative conduct, an order requiring Newcombe to pay a civil monetary penalty, and other relief.

### **SEC and DOJ Actions**

In addition to the CFTC's actions, both the DOJ and the SEC brought actions against CQC and its principals.[8] Through allegations of conspiracy, wire fraud, commodities fraud and securities fraud, the DOJ indicted several principals of CQC, but did not pursue the project developer itself.[9]

Steele pled guilty to the DOJ's indictment,[10] and the charges are proceeding against the other

individuals. For its part, the SEC did issue an order against CQC, and settled securities fraud charges against that entity.[11] As noted above, the SEC refrained from issuing a civil monetary penalty in light of the developer's cooperation and remediation.

## Takeaways

While these enforcement actions are the first CFTC actions for fraud in voluntary carbon markets, other investigations involving VCCs and VCM participation are likely ongoing. More enforcement actions are expected to be announced.

The commission has demonstrated its commitment to combatting fraud and manipulation in VCMs through its actions and initiatives that have ramped up over the last few years. These include:

- The CFTC's voluntary carbon markets convenings,
- The creation of the CFTC's Environmental Fraud Task Force,
- The alert issued by the CFTC's whistleblower program seeking tips of potential CEA violations that are connected to fraud or market manipulation in VCMs; and
- The recent issuance of final guidance on listing VCC derivative contracts for trading by designated contract markets.[12]

A variety of potential misconduct may be the subject of CFTC investigations. Through its exercise of its anti-fraud and anti-manipulation enforcement authority over VCMs, the CFTC can pursue investigations into potentially manipulative trading in futures contract, the validity and credibility of VCCs that are issued — as in the enforcement actions discussed above — and fraudulent statements on the material terms of a VCC, including the quality, additionality, permanence or environmental benefit of the VCC.

Companies that transact VCCs should bear in mind the potential regulatory and enforcement exposure associated with trading and transacting VCC. They will need to ensure that the VCCs held reflect an actual reduction or removal of GHG emissions and that the reduction or removal is accurate, permanent, additional *and verifiable*.

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[1] CFTC Charges Former CEO of Carbon Credit Project Developer with Fraud Involving Voluntary Carbon

Credits, Release No. 8994-24 (Oct. 2, 2024), <https://www.cftc.gov/PressRoom/PressReleases/8994-24>; U.S. Attorney Announces Criminal Charges in Multi-Year Fraud Scheme In The Market For Carbon Credits, Release No. 24-308 (Oct. 2, 2024), <https://www.justice.gov/usao-sdny/pr/us-attorney-announces-criminal-charges-multi-year-fraud-scheme-market-carbon-credits>; C-Quest Admits to \$250 Million Offering Fraud, SEC File No. 3-22224 (Oct. 2, 2024), <https://www.sec.gov/enforcement-litigation/administrative-proceedings/33-11315-s>.

[2] Pamela T. Wu, Levi McAllister, Stacie Hartman, Michael M. Philipp, CFTC Issues Final Guidance on Listing Voluntary Carbon Credit Derivative Contracts, Morgan Lewis (Sept. 27, 2024), <https://www.morganlewis.com/pubs/2024/09/cftc-issues-final-guidance-on-listing-voluntary-carbon-credit-derivative-contracts>.

[3] In re CQC Impact Investors LLC, CFTC No. 24-37 (Sept. 30, 2024), <https://www.cftc.gov/media/11386/enfcqcimpactinvestorsllcorder093024/download>; In re Jason Steele, CFTC No. 24-36 (Sept. 30, 2024), <https://www.cftc.gov/media/11381/enfjasonsteeleorder093024/download>.

[4] Id.

[5] In re CQC Impact Investors LLC, *supra* note 3.

[6] In re Jason Steele, *supra* note 3.

[7] Complaint, CFTC v. Newcombe, Case No. 24-cv-7477 (S.D.N.Y. Oct. 2, 2024), ECF No. 1.

[8] In re CQC Impact Investors LLC, Securities Act Release No. 11315, Exchange Act Release No. 101232 (Oct. 2, 2024), <https://www.sec.gov/files/litigation/admin/2024/33-11315.pdf>; US Attorney Announces Criminal Charges in Multi-Year Fraud Scheme in the Market for Carbon Credits, Release No. 24-308 (Oct. 2, 2024), <https://www.justice.gov/usao-sdny/pr/us-attorney-announces-criminal-charges-multi-year-fraud-scheme-market-carbon-credits>; Information, U.S. v. Steele, Case No. 1:24-cr-00572-MMG (S.D.N.Y. Oct. 2, 2024), ECF No. 1; Indictment, U.S. v. Newcombe, Case No. 1:24-cr-00567-JSR-1 (S.D.N.Y. Oct. 1, 2024), ECF No. 1; Indictment, U.S. v. Goswami, Case No. 24-cr-00567-JSR-2 (S.D.N.Y. Oct. 1, 2024), ECF No. 1.

[9] U.S. Attorney Announces Criminal Charges in Multi-Year Fraud Scheme in the Market for Carbon Credits, Release No. 24-308 (Oct. 2, 2024), <https://www.justice.gov/usao-sdny/pr/us-attorney-announces-criminal-charges-multi-year-fraud-scheme-market-carbon-credits>; Information, U.S. v. Steele, Case No. 1:24-cr-00572-MMG (S.D.N.Y. Oct. 2, 2024), ECF No. 1; Indictment, U.S. v. Newcombe, Case No. 1:24-cr-00567-JSR-1 (S.D.N.Y. Oct. 1, 2024), ECF No. 1; Indictment, U.S. v. Goswami, Case No. 24-cr-00567-JSR-2 (S.D.N.Y. Oct. 1, 2024), ECF No. 1.

[10] Minute Entry, U.S. v. Steele, Case No. 24-cr-00572-MMG-1 (S.D.N.Y. Oct. 3, 2024).

[11] In re CQC Impact Investors LLC, Securities Act Release No. 11315, Exchange Act Release No. 101232 (Oct. 2, 2024), <https://www.sec.gov/files/litigation/admin/2024/33-11315.pdf>.

[12] CFTC Announces Agenda for the June 2, 2022, Voluntary Carbon Markets Convening, Release No. 8539-22 (June 1, 2022), <https://www.cftc.gov/PressRoom/PressReleases/8539-22>; CFTC Announces Second Voluntary Carbon Markets Convening on July 19, Release No. 8731-23 (June 27,

2023), <https://www.cftc.gov/PressRoom/PressReleases/8731-23>; CFTC Division of Enforcement Creates Two New Task Forces, Release No. 8736-23 (June 29, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8736-23>; CFTC Whistleblower Alert: Blow the Whistle on Fraud or Market Manipulation in the Carbon Markets, CFTC, [https://www.whistleblower.gov/whistleblower-alerts/Carbon\\_Markets\\_WBO\\_Alert\\_June\\_20\\_2023.htm](https://www.whistleblower.gov/whistleblower-alerts/Carbon_Markets_WBO_Alert_June_20_2023.htm) (last viewed Oct. 16, 2024); CFTC Approves Final Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts, Release No. 8969-24 (Sept. 20, 2024), <https://www.cftc.gov/PressRoom/PressReleases/8969-24>.