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New Laws, Regs Mean More Scrutiny Of Airline Carbon Claims

By **Franco Corrado, Levi McAllister and Pamela Wu** (June 24, 2024, 4:22 PM EDT)


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The International Air Transport Association and its more than 300 airline members have committed to achieving net-zero carbon emissions by 2050 — a goal largely driven by the industry's use and investment in sustainable aviation fuel, or SAF.

But with that public commitment to reducing emissions has come more scrutiny over greenwashing, and new disclosure requirements under evolving regulatory rules.

On April 30, the European Commission and European consumer authorities announced they had sent letters to 20 airlines, alleging the airlines had made potentially misleading green claims and asking them to conform to EU consumer law within 30 days.[1]

Scrutiny over green marketing claims and business practices within the aviation sector will likely intensify in the U.S. as well, through oversight by U.S. regulatory agencies and litigation challenging net-zero claims and disclosures.

Despite a strong increase in the use of SAF in 2023, it only accounts for 3% of all global renewable fuel production. With most of the airline industry still relying on liquid fuels, the time for investment in, and adoption of, clean technologies has arrived.

Sustainable Aviation Fuels

SAF is a nonconventional aviation fuel that is derived from alternative feedstocks rather than crude oil, and that can be blended with conventional jet fuel. Demand for this kind of fuel is on the rise, driven by increasing policy initiatives and investments in production infrastructure.

The Carbon Offsetting and Reduction Scheme for International Aviation, a global market-based measure designed to offset international aviation carbon dioxide emissions, further encourages the use of SAF. But this fuel is not without its limitations.

Currently, it is not a one-to-one replacement for conventional jet fuel, and it is not as energy-dense as conventional jet fuel. Limited production capacity translates to higher costs as compared to those of traditional fuels.

In 2024, there is a wide gap between existing SAF production and projected demand. Investments

totaling up to $1.45 trillion will be needed between now and 2050 for the infrastructure to deliver the needed quantities of SAF. Potential investment structures include the following:

- Blended financing through combining private and public funds, and leveraging government subsidies alongside private investments;
- Direct investments in feedstock production, in the research and development of innovative feedstocks, and in the development of SAF production facilities; and
- Offtake agreements between airlines and producers, established through long-term contracts that can span 20 to 30 years.

Hydrogen's Role in Decarbonization

The aviation industry is also exploring several potential uses of hydrogen to reduce carbon emissions.

These include hydrogen combustion in gas turbines, using fuel cells to convert hydrogen into electricity to power propeller engines, and creating e-fuels through renewable energy sources. Each of these methods offer a unique approach to leveraging hydrogen's potential as a clean energy source.

In addition to technological advancements, federal funding opportunities provided by the Bipartisan Infrastructure Law and the Inflation Reduction Act will further support the adoption of hydrogen as a viable alternative fuel for the aviation industry.

These financial incentives will be crucial for encouraging investment by aviation companies in hydrogen-based solutions as they seek to reduce their carbon footprints.

Carbon Offsets

Given the gap between available SAF and other technologies, many aviation companies are turning to carbon offsets to help meet their net-zero or emissions reduction goals. A carbon offset is a credit that represents the reduction or removal of one ton of carbon dioxide emissions from the atmosphere.

Emissions-reducing projects can generate a carbon offset by capturing and destroying a greenhouse gas that would otherwise be emitted, or by producing energy with a clean, renewable resource.

A carbon offset can be purchased or sold to allow the holder of the carbon offset to mitigate or negate the impact of the greenhouse gas emissions from its own activities to achieve its climate commitments and emissions reduction goals.

Aviation companies purchasing carbon offsets are taking into account many factors as they transact carbon offsets, including the different standards and protocols that are applied to carbon offset projects, the permanence of the emissions reductions represented by the offsets transacted, retirement of the carbon offsets, and additionality.

Over the last two years, the U.S. Commodity Futures Trading Commission has taken measures to pursue potential fraud or manipulation in the carbon markets. These measures include the following:

- Establishing an environmental fraud task force to investigate potential fraud in connection with the environmental benefits represented by carbon offsets, as well as any material misrepresentations on environmental, social and governance products or strategies;

- Establishing a whistleblower office that is actively soliciting tips from the public on potential fraud and manipulation in the carbon market;

- Hosting voluntary carbon market convenings that feature in-depth discussions with market participants regarding the state of the market and the types of issues market participants face; and

- Issuing proposed guidance that identifies criteria that should be addressed clearly in the design of a voluntary carbon offset derivative contract.

Companies transacting carbon offsets — either physically or through futures contracts that reference carbon offsets — will want to ensure that their agreements address key issues and risks, including those discussed above; that they stay apprised on regulatory developments and oversight over carbon offsets; and that they have the necessary documentation to support their climate and net-zero related representations and disclosures.

Climate-Related Disclosures

Staying ahead of regulatory changes will be crucial for the aviation industry's efforts to decarbonize while remaining compliant with new federal and state regulations mandating carbon emissions disclosures.

For example, on March 6, the U.S. Securities and Exchange Commission adopted final rules requiring climate-related information disclosure from public companies. The rules were immediately challenged in court, and are on pause while the case, State of Iowa v. SEC, is reviewed by the U.S. Court of Appeals for the Eighth Circuit.

The new rules mandate extensive climate-related risk disclosures in annual reports and registration statements. Disclosure of expenditures and impacts from actions taken to achieve publicly set climate-related targets or goals is required. Larger companies must disclose Scope 1 and Scope 2 greenhouse gas emissions, if material, and obtain third-party attestations.

Litigation will likely affect the SEC's proposed timeline for implementing the new climate-related information disclosure rules. The Eighth Circuit proceedings could extend for 18 months or more, and review by the U.S. Supreme Court, if granted, could increase the delay significantly.

Companies should continue to proactively plan for eventual compliance, and be mindful of the SEC's prior guidance — such as its 2010 interpretive release on how existing rules may require climate-related disclosures, and the Division of Corporation Finance's **2021 sample letter on climate-related disclosures** that public companies should consider, which remain in place.

In addition, there is a trio of related disclosure laws passed in California. Effective Jan. 1, the Voluntary Carbon Market Disclosures Act imposed new disclosure obligations for any business that purchases, sells or markets voluntary carbon offsets in California, as well as any business that makes net-zero or carbon-neutral claims.

If broadly interpreted, the law could apply to any business that transacts or does business in California, or makes net-zero or carbon-neutral claims through marketing, advertisement or sales of products involving such claims in California.

Two other California climate laws — the Climate Corporate Data Accountability Act and the Climate-Related Financial Risk Act — will require any company in virtually any industry that meets certain revenue thresholds to make climate-related disclosures starting in 2026, regardless of their emissions levels and regardless of whether they predominantly do business outside of California.

On Jan. 30, the first legal challenge to the latter two laws, Chamber of Commerce of the U.S.A. v. California Air Resources Board, was filed in the U.S. District Court for the Central District of California by a coalition of business groups, on First Amendment grounds.

Greenwashing Litigation

In the U.S., greenwashing claims are often brought as class actions, where an individual plaintiff or small group of plaintiffs seek to represent the larger group of persons who bought the defendant's goods or services. As aviation companies make net-zero claims and disclosures, there has been a rise in litigation challenging them, including class actions.

Plaintiffs have filed suit against airlines, challenging the validity of carbon offsets and otherwise claiming misleading advertising concerning the true environmental impact of air travel. These claims typically focus on consumer protection laws and breach of warranty.

Action in Europe, on the other hand, relies more on government enforcement actions and nongovernmental organizations, such as consumer groups, rather than the class action mechanism prevalent in the U.S. Indeed, on April 30, the European Commission and other European consumer authorities announced they had sent letters to 20 airlines, alleging potentially misleading green claims.

European authorities suggest these airlines' representations could be misleading actions or omissions, prohibited under the EU's Unfair Commercial Practices Directive. If the airlines do not take necessary compliance steps, European authorities may initiate further enforcement actions.

Greenwashing litigation poses significant risks for companies. Such litigation can be costly to defend, can create distractions for employees, and can cause reputational damage from negative publicity.

Companies engaging in green marketing should carefully evaluate environmental claims to identify potential legal issues before publication and mitigate risk.

Looking Ahead

The road to sustainable aviation requires a multifaceted approach. While SAF presents a powerful solution, ongoing research and development are crucial for cost reduction, production scaling and potential energy density improvements.

SAF, hydrogen and carbon offsets form a comprehensive strategy for decarbonizing the aviation industry. With the regulatory landscape evolving rapidly, companies operating in this space should closely monitor these developments, ensure compliance with relevant regulations and be conscious of greenwashing.

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[1] https://ec.europa.eu/commission/presscorner/detail/en/ip_24_2322.