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Release of Draft Carbon Credit Principles Underscores Importance of Integrity to Voluntary Carbon Market Ambitions

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On July 27, the Integrity Council for the Voluntary Carbon Market (ICVCM) released a long-awaited draft of its **Core Carbon Principles** (CCPs). The CCPs aim to provide a "credible, rigorous, and readily accessible" global threshold standard for high-quality — or "high-integrity" — carbon credits that create real, additional and verifiable climate impact, in line with the 1.5°C goal of the Paris Agreement, while avoiding negative environmental and social side effects. The ICVCM also released drafts of an Assessment Framework, which provides guidance on whether carbon credits meet the CCPs' criteria, and an Assessment Procedure, which outlines a process for approving and tagging credits. A two-month comment period ends on September 27.

The draft CCPs follow the June 7 release by the Voluntary Carbon Markets Integrity Initiative (VCMI) of a draft **Claims Code of Practice** (the "Claims Code") for companies making claims about the use of carbon credits toward meeting their emissions reduction goals. The work of the ICVCM and VCMI differs in scope; the CCPs focus on carbon credit *supply* while the Claims Code focuses on claims made by carbon market participants who generate the *demand* for credits.

The ICVCM and VCMI are both supported by a coalition of industry stakeholders, non-governmental organizations and the UK government. Their work represents a concerted push for greater transparency, standardization and improvement in the quality of credits issued in the voluntary carbon market (VCM) — which has faced criticism as it has grown over whether it actually delivers greenhouse gas (GHG) emissions reductions and promised benefits to local communities[1] — in order to accelerate stakeholder engagement with the VCM and, in turn, mobilize investment in climate mitigation projects that will contribute to achieving the Paris Agreement goals.

In this *Alert*, we summarize the VCM,[2] the key features of the draft CCPs and Claims Code, and potential implications for companies and investors who may seek to rely on voluntary carbon credits as part of their climate strategies.

The Voluntary Carbon Market

Many of the world's largest public companies and financial institutions have set targets to reduce emissions to net zero, usually relying in part on the purchase of carbon credits on the VCM. Driven by this demand, the value of the VCM is projected to grow from around $1 billion in 2021[3] to potentially $50 billion by 2030. By purchasing carbon credits in the VCM to "offset" their residual emissions, corporates and investors can provide vital private financing to projects generating emissions reductions or removals that would not otherwise have occurred without carbon finance.

There are different types of VCM credits. Broadly, a carbon credit may be produced by mitigation activities that *avoid* or *reduce* emissions — such as the prevention of deforestation or energy efficiency projects — or that *remove* emissions — such as reforestation or direct air capture.[4] The Science Based Targets initiative (SBTi), an influential standard-setter for net-zero targets, requires that any credits purchased in pursuit of a target be derived from "the permanent removal and storage of carbon from the atmosphere," and be used to neutralize residual GHG emissions only *after* a company has significantly reduced or eliminated emissions within its value chain.

In recent years, particularly with respect to credits based on avoiding or reducing emissions, stakeholders have voiced concerns over technical issues — including accounting, permanence, leakage, vintages, crediting periods and whether certain credits currently on the market truly lower global emissions — as well as over "greenwashing" and the risk that companies will be disincentivized from rigorously reducing their own emissions. These concerns were amplified by the efforts of the Taskforce on Scaling Voluntary Carbon Markets (TSVCM) initiated by Mark Carney in September 2020, which focused on rapidly scaling the VCM.[5] Last year, these concerns led the TSVCM to disband and then reconstitute as the ICVCM, with a focus on assuring the quality of offsets sold. Meanwhile, companies and financial institutions have continued to navigate purchasing decisions without clear guidance in a fragmented and largely unregulated market. The ICVCM and the VCMI's recent publications aim to help address such concerns.

The Core Carbon Principles

The draft CCPs are intended to serve as a robust, independent starting point to create industry-wide guidelines, and to be compatible with (and promote consistency between) existing VCM carbon-crediting programs and standards such as Verra and Gold Standard. The ICVCM outlines the 10 core criteria of a high-quality carbon credit as:

1. **Additionality** — the emissions reductions or removals from the mitigation activity shall be additional, i.e., the activities generating the credit would not have occurred in the absence of the financing provided by the credit's sale;
2. **Mitigation activity information** — the crediting program provides comprehensive, transparent, public information on the credit-generating activities;
3. **No double counting** — the emission reductions or removals the credit represents are counted only once toward achieving climate targets or goals (this addresses double issuance, double claiming and double use);
4. **Permanence** — the emission reductions or removals represented by the credit are permanent or are fully compensated if reversed;
5. **Program governance** — the crediting program has governance structures in place to ensure the effective fulfillment of the other principles;
6. **Registry** — the crediting program operates or makes use of a registry, a system used to record, track, and uniquely identify mitigation activities and carbon credit transactions;
7. **Robust, independent third-party validation and verification** — the crediting program has requirements for rigorous verification of credit-generating activities;
8. **Robust quantification of emission reductions and removals** — the methods used to quantify the GHG reductions or removals represented by the credit are conservative, complete and science-based;
9. **Sustainable development impacts and safeguards** — the crediting program has clear procedures in place to ensure that credit-generating activities prevent negative environmental or social externalities and deliver net-positive sustainable development impacts, including with respect to indigenous peoples and local communities (IPLCs);[6] and
10. **Transition towards net-zero emissions** — the credit-generating activities avoid locking in carbon-intensive practices or technologies that are incompatible with achieving net-zero emissions by 2050.

The CCPs are accompanied by two additional sets of draft guidance:

- The Assessment Framework, a set of granular criteria for each of the 10 CCPs, which must be met for the credit under evaluation to be considered "CCP-eligible";[7] and
- The Assessment Procedure, a process for approving crediting programs (such as Verra or Gold Standard) as "CCP-eligible" and tagging carbon credits, plus an outline for the further development of the VCM.

Assessments of credits and crediting programs would be conducted by the ICVCM's expert panel and approved by its governing board. The Assessment Framework proposes a series of attribute tags for credits, allowing stakeholders to distinguish: (1) credits representing emissions *reductions* from those representing emissions *removals*, which may be further divided into nature-based and technological removals; (2) credits authorized under Article 6 of the Paris Agreement;[8] (3) a quantified contribution to the UN's Sustainable Development Goals (SDGs); and (4) a co-benefit to aid in climate change adaptation. SBTi's Corporate Net Zero Standard, which only permits the use of removal-based credits in setting net-zero goals, could drive demand for credits tagged as representing emission removal activities in particular.

The Claims Code of Practice

While the CCPs outline *what* constitutes a high-quality carbon credit, they do not provide guidance on *how* such credits should be used in pursuit of credible climate targets. For this purpose, the ICVCM references the recent work of the VCMI.

The VCMI's draft Claims Code aims to provide guidance for the credible use of voluntary carbon credits by companies and other non-state actors in pursuit of climate targets. The Claims Code outlines three tiers of certification representing varying levels of reliance on carbon credits to meet Paris-aligned climate goals.

The three tiers of certification are:

- **VCMI Gold:** a company that is on track to achieve its next interim emissions goal through emissions reductions in its value chain and has covered all remaining unabated emissions with high-quality carbon credits;
- **VCMI Silver:** a company that is on track to achieve its next interim emissions goal through emissions reductions in its value chain and has covered at least 20% of remaining unabated emissions with high-quality carbon credits; and
- **VCMI Bronze:** a company that is on track to achieve interim targets for Scope 1 and 2 emissions, has used carbon credits to cover less than half of Scope 3 reduction

targets and has covered at least 20% of remaining unabated emissions with high-quality carbon credits.

Such certifications are available to companies that have (1) made a public, science-aligned commitment to achieve net-zero emissions no later than 2050 across Scopes 1, 2 and 3; (2) detail interim targets and strategies to be utilized in achieving these targets; (3) maintain a public GHG inventory; and (4) commit to aligning corporate advocacy with the goals of the Paris Agreement.

The Claims Code also allows companies that meet the four prerequisites above to claim that a particular product, brand or service is "carbon neutral" if certain additional criteria are met.[9]

Key Implications for Voluntary Carbon Market Participants

The ICVCM and VCMI have garnered significant support for their work to date. For example, both have received funding and development guidance from the UK Treasury, the ICVCM lists a range of influential NGOs on its website and is co-chaired by former SEC Commissioner Annette Nazareth, and the VCMI Claims Code is now being piloted by companies such as Google and Unilever. As a result, the ICVCM's CCPs and the VCMI's Claims Code could become standards by which investors, regulators and other stakeholders assess companies' use of voluntary carbon credits in the absence of regulation,[10] and they could also inform future regulations around such credits.[11] Additionally, credits with the ICVCM's imprimatur, especially those associated with carbon removals, could become more desirable to market participants, thereby generating upward pressure on the price of these VCM credits.

The ICVCM plans to release final versions of the CCPs, Assessment Framework and Assessment Procedure in Q4 of 2022, following the end of the draft's consultation period on September 27, 2022. The VCMI plans to release a final Claims Code in late 2022 or early 2023, and comments are accepted until August 12, 2022.

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1. *See, e.g.*, Laura Martin, "Avoiding 'Carbon Colonialism': Developing Nations Can't Pay the Price for Pollution," *The Hill* (April 26, 2021); Frances Schwartzkopff, "'Crazy' Carbon Offsets Market Prompts Calls for Regulation," *Bloomberg* (January 6, 2022). ↩

2. Carbon markets consist of *compliance markets*, which exist under mandatory regulatory regimes (such as the EU Emissions Trading System and California's Cap-and-Trade Program), and *voluntary markets*, which are currently

largely unregulated and involve voluntary transactions administered on private registries by verification and certification standards (such as Verra and Gold Standard). This *Alert* focuses on the latter. ↩

3. Voluntary carbon credit issuances grew over 400% year-over-year in 2021, topping $1 billion in traded value. ↩

4. The Final Report of the Taskforce on Scaling Voluntary Carbon Markets, the precursor body to the ICVCM, distinguishes between *avoidance/reduction* activities — which "reduce emissions from current sources, such as by funding the implementation of lower-carbon technologies such as renewable energy, and avoiding practices that cause emissions such as by reducing deforestation" — and *removal/sequestration* activities — which "take out and use/store CO2 from the atmosphere, including through nature-based sequestration such as reforestation, peatland restoration, and technology-based removal such as bio-energy with carbon capture and storage (BECCS) and direct air capture with carbon capture and storage (DACCS)." In "Climate Change 2022: Mitigation of Climate Change," the Intergovernmental Panel on Climate Change asserts that limiting global warming to 1.5°C will likely require both the biological and industrial capture and storage of carbon dioxide, stating that "the deployment of carbon dioxide removal (CDR) to counterbalance hard-to-abate residual emissions is unavoidable if net zero CO2 or GHG emissions are to be achieved." ↩

5. We discussed the TSVCM's Blueprint in a March 2021 *Alert.* ↩

6. The Assessment Framework criteria require that programs "have guidance and procedures on respect for the human rights, dignity, aspirations, culture and livelihoods of IPLCs," including but not limited to the implementation of the Free, Prior and Informed Consent (FPIC) principle, a concept designed for use by project developers in protecting the rights of indigenous people to self-determination and self-governance. ↩

7. The ICVCM outlines two thresholds for credits to be considered "CCP-eligible," with the intention for the first threshold to apply to *current* crediting programs "with consistent atmospheric, environmental and social integrity in line with current good practice," and for currently CCP-eligible programs to commit to meeting the more stringent requirements of the second threshold over time. ↩

8. Recent negotiations at COP26 resulted in the adoption of rules implementing Article 6 of the Paris Agreement, establishing an accounting mechanism ("corresponding adjustment") under which VCM credits purchased abroad by private entities can be counted toward a country's progress on its national emissions reductions commitment. ICVCM has asked for public feedback on whether the voluntary use of carbon credits should require host country authorization to ensure association with "corresponding adjustments" under Article 6, either as a general matter or in particular circumstances. ↩

9. To certify a specific brand, product or service as "VCMI Carbon Neutral," a company must also maintain a public GHG inventory for that entity's lifecycle emissions, demonstrate ongoing reductions in those emissions, avoid "greenwashing" in the entity's marketing, use "high-quality" carbon credits to cover its unabated emissions and verify disclosures with respect to each of the above with a third-party audit. ↩

10. Use of carbon credits of uncertain quality can raise greenwashing risks. For example, in July 2022, KLM was sued over its offsetting claims. And as discussed in our March 2022 *Alert*, the SEC's proposed climate rule would require disclosure of details of offsets to the extent used to meet climate goals or targets. ↩

11. The UK established a VCM Forum in 2021, and the European Commission is investigating whether to create a common minimum standard for carbon removal VCM credits. In the U.S., the CFTC and the FTC (which publishes the Green Guides) are considering how the VCM should be regulated. ↩

Authors

Paul Barker

Partner / Bay Area – San Francisco

James Dolphin, III

Partner / Houston

Jennie Morawetz

Partner / Washington, D.C.

Kyle Neema Guest

Associate / Washington, D.C.

Tony Moller

Advisor, ESG & Impact / Bay Area – San Francisco

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Suggested Reading

- 06 June 2024 - 07 June 2024 Speaking Engagement 63rd Annual Corporate Counsel Institute
- 05 June 2024 Kirkland Seminar ESG in Exits Webinar: Capturing Value & Mitigating Risks
- 04 June 2024 - 07 June 2024 Sponsored Event SuperReturn International 2024