KIRKLAND & ELLIS

Kirkland Alert

California Legislature Regulates Voluntary Carbon Market and Climate-Related Claims

05 October 2023

December 7, 2023 Update: *At the end of November, California Assembly Member Jesse Gabriel, the author of the Voluntary Carbon Market Disclosures Act (VCMDA), issued a letter to the Chief Clerk of the California Assembly pointing out that the VCMDA does not specify a date on which the first set of disclosures must be posted to a company's website. He adds that it was his intent that the first annual disclosure deadline be January 1, 2025. He said he intends to submit a formal letter to the Assembly Daily Journal when the Assembly reconvenes on January 3, 2024. Accordingly, although the VCMDA is effective as of January 1, 2024, it is possible this letter could influence the enforcement strategy of the California Attorney General and others with power to enforce the law, and that if a court is presented with an enforcement action in 2024, it could consider this letter in connection with determining the VCMDA's disclosure deadline.*

October 10, 2023 Update*: On October 7, Governor Newsom signed the Voluntary Carbon Market Disclosures Act (VCMDA), but vetoed the Voluntary Carbon Offsets Business Regulation Act (VCOBRA), explaining in a statement that while he supports bringing "greater transparency to the verification, issuance, and sale of voluntary carbon offsets," he had concerns that the bill "could inadvertently capture well-intentioned sellers and verifiers" by "imposing civil liability for even unintentional mistakes about offset quality." It is possible that the California Legislature could seek to address these deficiencies in a future legislative session. Although the vetoed VCOBRA focused on the sell-side, the VCMDA will impose disclosure obligations on businesses that market or sell voluntary carbon offsets as well as on purchasers, as discussed further herein.*

In late September, in addition to the Climate Corporate Data Accountability Act and Climate-Related Financial Risk Act covered in our previous *Alert*, the California Legislature passed two more climate-related bills. The two bills, the Voluntary Carbon Market Disclosures Act (AB-1305, the "VCMDA") and the Voluntary Carbon Offsets Business Regulation Act (SB-390, the "VCOBRA"), have yet to be signed into law by Governor Gavin Newsom.

Although focused on the voluntary carbon market ("VCM") for carbon credits (or "offsets"), the VCMDA entails far-reaching disclosure obligations for companies making climate-related claims. And together, the VCMDA and VCOBRA represent the first binding regulation in the U.S. that explicitly addresses the VCM.[1] Both bills provide amendments to existing state legislation and would be fully effective as of January 1, 2024.

In this *Alert*, we explore the VCMDA's and VCOBRA's requirements for companies making certain climate-related statements and VCM participants, as well as broader implications and potential preparatory measures.

Overview

Together, the VCMDA and VCOBRA contain the following requirements for companies making certain climate-related claims, as well as participants on both the supply and demand sides of the VCM:

Activity	*Key Requirements*	*Scope*	*Bill*
Claims regarding net-zero emissions, carbon neutrality or similar claims, as well as claims of significant reductions in greenhouse gas ("GHG") emissions	Publicly disclose information documenting how the claim was determined to be accurate or accomplished, and the measurement of interim progress	Entities operating and making claims within California	VCMDA (AB-1305)
Purchase of carbon credits in conjunction with certain	Publicly disclose detailed	Entities operating and	VCMDA (AB-1305)

climate-related claims	information related to the credits purchased, the underlying offset projects and any independent verification of the climate-related claims made	purchasing or using voluntary carbon credits within California	
Sale or **marketing** of carbon credits	Carbon credits must be quantifiable, real, additional and durable	Entities "doing business in California" or "advertising to consumers in California"	VCOBRA (SB-390)
	Publicly disclose detailed information related to the characteristics of the credits and their underlying offset projects	Entities marketing or selling voluntary carbon credits within California	VCMDA (AB-1305)
Certification / **Verification** of offset projects underlying carbon credits	Underlying offset projects must be quantifiable, real, additional and durable	Entities "doing business in California" or "advertising to consumers in California"	VCOBRA (SB-390)

Voluntary Carbon Market Disclosures Act: Climate-Related Claims

Broadly, the VCMDA is intended to combat “greenwashing” in connection with particular climate-related claims, including claims in connection with the purchase, use, sale or marketing of carbon credits.

In its narrowest provisions, focused specifically on the marketing and sale of voluntary carbon credits, the VCMDA imposes the following requirements **on companies that market or sell voluntary carbon credits within California**:

- Publicly disclose information about the credits sold or marketed, including but not limited to (1) the location and timeline of the offset project generating the credits, (2) the types of offsets being sold (including the extent to which the credits from the offset project are derived from a carbon removal versus avoided emissions), (3) whether the credits have been verified by third-party auditors or standard-setters, (4) any accountability protocols for the offset projects, (5) all data and calculation methods relevant to the credits’ production, and (6) the durability period for any offset project that the seller knows or should know will reduce or remove GHGs for less than the atmospheric lifetime of carbon dioxide.

The remainder of the VCMDA’s requirements apply if subject entities make claims (1) regarding the achievement of net zero emissions, (2) that the entity, related entity or a product is “carbon neutral” (or other claims implying the entity, related entity or a product does not add net carbon dioxide or GHGs to the climate), or (3) that the entity has made significant reductions to its GHG emissions (collectively, “Climate-Related Claims”).

For companies making Climate-Related Claims, the VCMDA imposes two tiers of disclosure obligation:

1. **For (A) companies that operate within California and (B) make Climate-Related Claims within California**: publicly disclose how — or whether — the company has determined the Climate-Related Claims’ accuracy and measured its progress against them. Additionally, disclose whether or not there has been independent, third-party verification of the Climate-Related Claims and/or any company data disclosed in support of them. While the VCMDA’s introductory text focuses specifically on disclosures related to the marketing, sale and purchase of voluntary carbon credits, the text of this section of the bill does not limit the disclosure obligations to Climate-Related Claims involving offsets.
2. **For companies that (A) purchase or use voluntary carbon credits sold within California and (B) operate within California**: publicly disclose all of the information in #1 above *and* publicly disclose detailed information related to the

carbon credits purchased and the underlying offset projects — including (1) the name of the seller and registry, (2) the carbon offset project name and identification number and (3) the carbon offset project type and measurement protocol.

Notably, the scope of claims triggering these disclosure requirements differs from the SEC's proposed climate disclosure rule, which requires certain disclosures if a company has set a climate-related target or goal for the future.[2] Distinctly, the VCMDA could potentially apply to claims about a company's past climate achievements as well as claims about future goals.

The VCMDA does not define what it means to "operate" or "make claims" within California, nor does it clarify the scope of communications that would qualify as a subject "claim." The bill would amend Division 26 of the California Health and Safety Code, and disclosures mandated by the VCMDA would need to be made available on the company's website and updated no less than annually. The VCMDA's requirements would apply from its effective date on January 1, 2024, with each violation of the law subject to civil penalties of up to $2,500 per day (not to exceed a total of $500,000 per violation).

Voluntary Carbon Offsets Business Regulation Act (SB-390): Sell-Side Standards

The VCOBRA regulates claims concerning carbon credits transacted in the VCM. The VCOBRA bans the sale, marketing and verification of voluntary carbon credits and projects that fall outside of a specific definition of quality. The VCOBRA amends Division 7 of the California Business and Professions Code (CBPC) to make it unlawful to (1) verify or certify, (2) issue, (3) maintain on a registry, (4) market or (5) sell a carbon credit that the person "knows or should know" is unlikely to be quantifiable, real or additional. Further, the bill outlaws the marketing and sale of carbon credits that a person "knows or should know" do not meet a specific standard of durability relative to the atmospheric lifetime of carbon dioxide.[3]

The requirements above apply to any person "doing business in California"[4] or "advertising to consumers in California."[5] Further, the requirements apply to carbon credits and projects representing both GHG reductions *and* removals.[6]

It is unclear what evidence would be sufficient to show a person "should have known" certain information about a project or carbon credit under the CBPC as amended by

the VCOBRA. We note, however, that Division 7, Article 1, Section 17500 of the CBPC states that false advertising entails making statements that the advertiser "by the exercise of reasonable care" should know to be untrue or misleading. Further, Section 17502 notably exempts any publication that "broadcasts or publishes, including over the Internet, an advertisement in good faith, without knowledge of its false, deceptive or misleading character."

Violations of the VCOBRA after the January 1, 2024 effective date would not constitute crimes, but the bill authorizes "all available civil remedies that are applicable to a violation," which can include a fine of up to $2,500 for each violation. Further, private plaintiffs could attempt to use violations of the VCOBRA's provisions as the basis for consumer or competitor claims in California courts.

Key Implications

Assuming they are enacted as law, the VCMDA and VCOBRA represent landmark regulation of climate-related claims — which have become increasingly common within the private sector — and the VCM, and have important implications for businesses:

- **Growing regulatory scrutiny of climate claims, particularly with respect to voluntary carbon credits**: The VCMDA is part of a broader trend of regulators considering prohibitions on unsubstantiated climate-related statements — often called "greenwashing." For example, rules currently under development in the European Union will regulate the use of explicit environmental claims, including that an entity or product is "carbon neutral," "climate friendly" or "green"; such claims will have to be supported by rigorous evidence. Further, the United Kingdom's advertising regulator recently issued guidance governing corporate environmental claims, which contains calls for evidence — similar to those in the VCMDA — on carbon credit use and claims such as "carbon neutral." Finally, in addition to California, other regulators are also considering sell-side regulation of the VCM. Notably, on September 19, 2023, the Chairman of the U.S. Commodities and Futures Trading Commission (CTFC) remarked that the CFTC intends to release a consultation on regulation of voluntary carbon credit trading.
- **Potential for expanded litigation**: The VCMDA and VCOBRA may provide further legal support for the growing wave of litigation related to claims of corporate "greenwashing." These challenges — based on allegations of unsubstantiated, misleading and/or selective claims about a company's environmental performance — are often grounded in consumer protection and advertising laws such as those that

the VCMDA and VCOBRA will amend.[7] Once they are in effect, the California bills may expand both the volume of greenwashing claims against private entities and the scope of practices captured within those claims.

- **Interplay with third-party VCM standards**: The VCMDA and the VCOBRA create de facto, overarching standards for sellers, buyers and certifiers of voluntary carbon credits. However, they do so without explicitly referencing any of the numerous technical standards that — in recent years — have attempted to establish commonly accepted practices within the VCM, including the buy-side Voluntary Carbon Market Integrity Initiative's Claims Code of Practice and the sell-side Integrity Council for the Voluntary Carbon Market's Core Carbon Principles (discussed here), as well as international rules being developed under Article 6 of the Paris Agreement. It remains to be seen the extent to which these third-party standards and international agreements will inform future state or federal lawmaking, or inform the enforcement of the VCMDA or VCOBRA.

Next Steps for Businesses

As with California's other two climate-related disclosure bills from this legislative session, legal challenges to the VCMDA and VCOBRA are possible. Such challenges may focus on the vagueness of the proposed bills, including with respect to the knowledge requirement of the VCOBRA, as well as the complexities and burdens associated with complying with the proposed bills. There is also the possibility of a challenge in the form of seeking a ballot referendum that would allow Californians to vote directly on the issues. The outcome and timing of any such challenges is uncertain. Businesses that are likely in scope of either the VCMDA or the VCOBRA may wish to take steps now to help facilitate compliance by January 1, 2024.

- **Businesses Making Climate-Related Claims**. Businesses making Climate-Related Claims that may fall within the scope of the VCMDA may wish to consider the following to support the development of required disclosures and mitigate risk:
  - *Inventory Existing Climate-Related Claims*. Businesses can create an inventory of their existing Climate-Related Claims that includes details of documents/information substantiating those claims, any KPIs and targets associated with those claims, and any third-party verification of the claims.
  - *Address Any Potentially Unsubstantiated or Misleading Climate-Related Claims, or Regulatory Gaps*. Based on the inventory, businesses can consider whether any of their existing disclosures lack adequate substantiation or could potentially be misleading, and put in place a plan to address the identified deficiencies. Businesses may wish to work with counsel to manage any legal or reputational

risks involved in modifying or adding to existing disclosures, and to ensure all disclosures comply with applicable regulatory requirements across jurisdictions.

  - *Consider Third-Party Verification*. Particularly for quantitative Climate-Related Claims, businesses may wish to consider obtaining third-party verification, if they have not already.
  - *Developing Disclosure Controls and Procedures for Future Climate-Related Claims*. Businesses may wish to consider enhancing their governance processes for Climate-Related Claims going forward, including standards and approvals required for such claims.
- **Businesses Transacting in the VCM**. Businesses transacting in the VCM that may fall within the scope of the VCMDA and/or VCOBRA may wish to consider the following to support the development of required disclosures and mitigate risk:
  - *Enhanced Due Diligence*. Businesses may wish to consider working with counsel to develop and implement enhanced diligence procedures related to the rigor and integrity of carbon credits bought, certified, issued, listed on a registry, marketed or sold, as applicable, in order to mitigate potential reputational or legal risks — including misleading advertising claims — stemming from carbon credits that do not meet evolving market or regulatory expectations.
  - *Developing and Maintaining Robust Records*. Businesses can begin compiling rigorous documentation of all information related to transacted credits' measurement, verification, safeguards and underlying offset project details, and developing recordkeeping procedures for transacted credits going forward.

The VCMDA and VCOBRA, if signed into law, would impose sweeping disclosure obligations on companies making Climate-Related Claims and also represent an important milestone in the domestic regulation of the VCM. By taking steps now to prepare, businesses can put themselves in position to develop disclosures that comply with the bills' requirements in advance of the January 1, 2024 effective date. By developing this capacity now, businesses may also position themselves to comply with future voluntary or other regulatory standards governing climate-related statements and the VCM.

---

1. The VCM does not capture carbon credits purchased to comply with the caps imposed under a regulated carbon market, such as California's Cap and Trade Program or the European Union Emissions Trading System. ↩

2. *See* "Targets and Goals Disclosure" (Proposed Rule: The Enhancement and Standardization of Climate-Related Disclosures for Investors, pg. 266). ↩

3. The VCOBRA defines "durability" as "the duration of time over which an offset project operator commits to maintain its GHG reductions and GHG removal enhancements, as applicable, exclusive of any aspirational outcomes that exceed or extend beyond the mandatory outcomes required of the offset project pursuant to its offset protocol," and makes it unlawful to market or sell credits for which the durability of the underlying project and/or the atmospheric lifetime of the GHG(s) associated with the offset are less than the atmospheric lifetime of carbon dioxide. This prohibition applies unless the credits are explicitly marketed as not having the equivalent climate impact as credits that do *not* have these specified deficiencies in durability. ↩

4. The VCOBRA does not define what "doing business in California" or what "advertising to consumers in California" means. However, we note that the California Tax Code defines "doing business" as actively engaging in any transaction for the purpose of financial gain within California, being organized or commercially domiciled in California, or having California sales, property or payroll exceed specified amounts. ↩

5. *See* Division 7, Article 1, Section 17508 of the CBPC. ↩

6. Emissions "reductions" — which are also often called "avoided" emissions — are defined in the VCOBRA as quantified *decreases* in emissions over a specific period of time, relative to an established baseline scenario. Emissions "removals," in contrast, are defined as a calculated total mass of a given greenhouse gas *removed from the atmosphere* over a period of time, with no requirement for a specific baseline scenario. ↩

7. E.g.,*Verbraucherzentrale Baden-Württemberg v. Commerz Real* (2020), *FossielVrij NL v. KLM* (2022). ↩

Authors

Paul Barker

Partner / Bay Area – San Francisco

Robyn E. Bladow

Partner / Los Angeles – Downtown

Rhys Davies

Partner / London

Alexandra N. Farmer, P.C.

Partner / Washington, D.C.

Jennie Morawetz

Partner / Washington, D.C.

Abbey Raish

Partner / Los Angeles – Century City

Tammy A. Tsoumas

Partner / Los Angeles – Century City

Kyle Neema Guest

Associate / Washington, D.C.

Tony Moller

Advisor, ESG & Impact / Bay Area – San Francisco

Related Services

Practices

- ESG & Impact

Suggested Reading

- 06 June 2024 - 07 June 2024 Speaking Engagement 63rd Annual Corporate Counsel Institute
- 04 June 2024 - 07 June 2024 Sponsored Event SuperReturn International 2024
- 07 May 2024 Kirkland Seminar D.C. Women in Climate Investing & Finance Drinks and Discussion

This publication is distributed with the understanding that the author, publisher and distributor of this publication and/or any linked publication are not rendering legal, accounting, or other professional advice or opinions on specific facts or matters and, accordingly, assume no liability whatsoever in connection with its use. Pursuant to applicable rules of professional conduct, portions of this publication may constitute Attorney Advertising.
© 2023 Kirkland & Ellis LLP.