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Christopher Kirkpatrick

Secretary of the Commission

Commodity Futures Trading Commission

Three Lafayette Centre

1155 21st St. NW

Washington, DC 20581

**October 7, 2022**

**Re:** **Climate-Related Financial Risk RFI [87 FR 34856]**

Dear Secretary Kirkpatrick,

We appreciate the opportunity to comment on the above-referenced request for information (“RFI”) by the Commodity Futures Trading Commission (“CFTC”). We write to address the risks and integrity issues associated with carbon offsets, carbon credits, and related derivative products. As explained in greater detail below, we do not believe the problems with carbon offsets and their derivatives can be remedied by better governance, including CFTC oversight. Rather we believe the CFTC needs to disallow or ban carbon offset derivatives due to the following factors, all of which make assuring the integrity of the underlying product, carbon offsets, unachievable:

1. **Inherently Unverifiable**: Carbon offsets are inherently unverifiable because they rely on counter-factual assumptions:
2. **Lack of Permanence and Demand Shifting/Leakage**: In the case of forest offset projects, reductions in emissions cannot be proven to be permanent and are subject to demand shifting to other locations,
3. **Perverse Incentives to Keep Activities “Beyond what is Legally Required”**: Carbon offsets, including the voluntary markets, create a strong perverse incentive to keep harmful activities legal and prevent beneficial activities and standards from becoming legally required, and
4. **Oversight by Private/Non-Government Actors**: Governance by carbon registries and offset verifiers, whose livelihood is tied to the existence of carbon markets, creates huge incentives to ignore the underlying and unfixable flaws of this mechanism.

**Carbon Offsets are Inherently Unverifiable**

As the CFTC is aware, for carbon offsets to be an acceptable commodity they would have to represent real, **additional**, permanent reductions in carbon emissions that are **beyond** what is legally required and what **would otherwise occur** ***but for*** the payment of the carbon offset price. If the activity is already occurring or would occur without the carbon price, then the activity is not “additional.” As a result, the claim that a future offset project is “additional” is a counterfactual assertion that is not subject to verification. The question of whether something would occur without payment of the carbon price requires proof of what would occur in a situation that does not exist. While recent efforts to prop up carbon markets point to investments in facilities designed to remove carbon from the air as an example of something that would not occur but for voluntary carbon markets, even this example is flawed, in that there are other potential future financial benefits for a product that can be patented and that governments or others might purchase or require to be purchased and maintained by private facilities, such as those in high-greenhouse-gas emitting industries.

Dan Welch is credited with recognizing this situation in 2007, when he wrote that carbon offsets are “**an imaginary commodity created by deducting what you hope happens from what you guess would have happened**,’ quoted in The Guardian, June 16, 2007, citing Mr. Welch as a Manchester journalist who investigated offsetters for Ethical Consumer magazine. The CFTC should not proceed with allowing trading of derivatives in this imaginary inherently-flawed commodity. The negative consequences of allowing this trading could dwarf those that resulted from the sub-prime mortgage crisis, as it would damage not just the economy but the climate.

While offset providers have shifted away from mere individual project storytelling to a so-called “standards-based” approach, this approach has not solved the underlying flaw of being unable to solve the imaginary baseline problem. The California compliance offset program is generally acknowledged to be an effort to improve on the prior efforts of the United Nations Clean Development Mechanism (CDM). However, California has based its protocols, not on a finding that the activities would not otherwise occur, but on a finding that they are “significantly better than average” for the particular sector, such as forest management. Both California and the voluntary market allow many activities that are already occurring for reasons other than the offset price to be counted as real, additional, permanent reductions. This in turn allows these activities to be the basis for greenwashing claims of net-zero emissions and the basis for the continued or even increased burning of fossil fuels.

Efforts so far to ensure the additionality of carbon offsets have failed. This has led to new efforts to shore up the concept, such as the “Integrity Council for the Voluntary Carbon Market” and “ScienceBasedTargets.org.” However, these well-funded efforts to promote offsets to serve private sector claims of net-zero emissions have not solved the underlying problems with the original concept.

**Forestry Offsets Lack Permanence and Suffer from Demand Shifting/Leakage**

Forestry offsets have been, by far, the most popular type of offsets in the voluntary carbon markets. In the forestry sector, assumptions about what would have happened without the offset price, as well as what will happen in the future with payment of the offset price have been flawed. The threats from wildfire and tree death as a result of escalating climate warming are not sufficiently predictable to be reliably incorporated into assumptions about permanence. Similarly, the fact that demand for wood shifts elsewhere in a world market has not been successfully addressed.

**Perverse Incentives to Maintain the Legal Status Quo**

Since the activities that become offsets must be beyond what is legally required, the development of both compliance and voluntary carbon markets creates a huge private sector investment in the legal status quo. A CFTC finding that the voluntary carbon markets can be successfully overseen and have integrity would further cement this incentive to fight new regulations that improve climate outcomes across entire sectors. The result would be a well-funded lobby that would fight de-carbonizing regulation of the activities in sectors for which offsets are allowed. For instance, new regulations requiring dairies with a certain number of cows to have anerobic digesters would require that the use of such digesters at these dairies could no longer be claimed as “reductions” (as compared to other methods of manure management as carbon offsets). Similarly, if destruction of ozone depleting substances (ODS) is required, their destruction could no longer be used to create offsets. This also applies to coal mine methane and rice cultivation, which are the subject of offset protocols in California. Even when the perverse incentive to keep emissions of refrigerant by-products (a powerful ODS) legal in China was recognized by the United Nations CDM, it took many years to disallow such offsets. In the meantime, there was a huge financial incentive for China to keep emissions of ODS legal.

**Oversight of Carbon Offset Creation by Registries and Offset Verifiers**

The voluntary carbon markets rely on offset registries and verifiers for oversight. These private bodies are not truly independent and available to support the public interest, because they only exist if the carbon offsets are allowed to be traded. Recognition of the flaws of carbon offsets cited above by either registries or verifiers would do away with their role and employment. Further, for verifiers, their only function is to verify that the approved protocol, however flawed, was properly implemented.

**Damages to all Climate Tools and the Alternative to Carbon Offsets**

While the CFTC may consider the broader impacts of carbon offset derivatives on climate policy to be beyond its scope, it is an important element of recognizing the public interest in the CFTCs decision making. A key point that needs to be acknowledged is that there is a viable path forward without the use of compliance or voluntary offset markets, one that would provide a high level of transparency and integrity. Specifically, there are four categories of tools available to governments to address the climate crisis:

1. Market mechanisms
2. Regulation
3. Public Investment
4. International Agreement

Why all climate tools are undermined by allowing/supporting carbon offsets: Within each category, there will be a need for smart choices. If properly designed, these categories of tools are complementary. However, if carbon offsets are selected as a government-supported market mechanism, they will weaken all other available tools. For example, carbon offsets undermine the use of regulation as noted above. They create strong pressure to keep polluting activities legal and to not require activities that promote decarbonization. Carbon offsets also are used to keep the price of polluting with fossil fuels low. This is contrary to the goal of increasing the incentive to shift away from fossil fuels and to increase energy efficiency and conservation. The result of this low carbon price is to undermine public investment because it increases the cost to government to support and/or incentivize reductions in fossil fuel use. Government is forced to shoulder more of the heavy lifting. Supporting carbon markets in general, including by the sale of derivatives, also undermines the United States’ ability to use of international agreements to achieve global adoption of effective climate policies with greater integrity to support more rapid decarbonization.

**The Alternative: Complementary Use of Climate Tools with Integrity**

In contrast, as shown in the chart below, a market mechanism with integrity that would complement the other climate tools available would be the imposition of a gradually rising carbon fee at the point where fossil fuels enter the economy and a per-person rebate approach to keeping energy affordable for everyone during a transition away from fossil fuels. As the CFTC may be aware, this approach has been endorsed by thousands of economists (https://www.econstatement.org/).

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| Climate Tools | Policy Result of Carbon Offsets | Policy Result without Carbon Offsets |
| Market Mechanisms | Favors Cap-and-Trade and Offsets and “Net-Zero” claims | Favors Carbon Fees with Per-Person Rebates |
| Regulation | Weakened in order to keep carbon offset activities “beyond” what is legally required | Would complement new regulation that would require cessation of polluting activities and performing activities that reduce emissions |
| Public Investment | Requires additional spending to achieve climate goals because it weakens regulatory tools and the incentives for energy efficiency and conservation by keeping the price of energy low. | Reduces the public spending needed to achieve climate goals, because a combination of carbon fees and regulation will do more of the heavy lifting. |
| International Agreements | Adopting a carbon offsets approach sets that as the international standard for U.S. agreements. | Rejecting carbon offsets in the U.S. and pursuing transparent carbon pricing to incentivize the shift away from fossil fuels supports international agreements that rely on border adjustments and similar regulation in other countries. |

**The CFTC’s Mission** **Requires that It Disallow Carbon Offset Derivatives**

The CFTC should investigate the integrity of carbon offset derivatives and their underlying carbon offsets. We believe a full and careful investigation will demonstrate carbon offsets do not permanently or reliably reduce greenhouse gas emissions beyond what is legally required and would otherwise occur. Rather, carbon offsets undermine other climate tools and create a volatile market in an imaginary commodity. CFTC rejection of carbon offset derivatives would send a powerful message and improve the chances that the United States will become a global leader in greenhouse gas reductions, while supporting our climate, environmental and economic health.

Sincerely,

Laurie Williams and Allan Zabel

For additional information on our background and expertise, please see:

Open Letter to Congress, May 2008: <http://www.precaution.org/lib/epa_lawyers_oppose_cap_trade.080513.pdf>

Video – The Huge Mistake – 2009 <https://www.youtube.com/watch?v=BA-QufQzuWU>

Washington Post Op-ed October 2009 <https://www.washingtonpost.com/wp-dyn/content/article/2009/10/30/AR2009103002988.html>

P.S. We would welcome the opportunity to submit additional evidence for the points in this letter and hope the CFTC will allow an additional public comment period on its draft decision following consideration of all comments submitted by October 7, 2022.