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February 16, 2024

VIA ELECTRONIC SUBMISSION

Mr. Christopher Kirkpatrick
Secretary of the Commission
Commodity Futures Trading Commission
Three Lafayette Centre
1155 21st Street, NW
Washington, DC 20581

Re: Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts, RIN 3038–AF40

Dear Mr. Kirkpatrick:

I. INTRODUCTION.

On behalf of The Commercial Energy Working Group (the "**Working Group**"), Eversheds Sutherland (US) LLP submits this letter in response to the request for information from the Commodity Futures Trading Commission (the "**CFTC**" or "**Commission**") addressing the request for comment regarding Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts[1]. The Working Group appreciates the opportunity to provide input and actively participate in the important public policy debate relating to the Proposed VCC Guidance and the Commission's efforts to advance the design of voluntary carbon markets in a manner that promotes transparency and liquidity through the standardization of VCC financial products.

The Working Group is a diverse group of commercial firms in the energy industry whose primary business activity is the physical delivery of one or more energy commodities to others, including industrial, commercial, and residential consumers. Members of the Working Group are producers, processors, merchandisers, and owners of energy commodities. Among the members of the Working Group are some of the largest users of energy derivatives in the United States and globally. The Working Group advocates regarding regulatory, legislative, and market developments with respect to the trading of energy commodities, including derivatives and other contracts that reference energy commodities.

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[1] *See Proposed Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts*, Request for Comment, 88 Fed. Reg. 89,410 (Dec. 27, 2023), available at: https://www.cftc.gov/sites/default/files/2023/12/2023-28532a.pdf (the "**Proposed VCC Guidance**").

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II. COMMENTS OF THE WORKING GROUP.

As active participants on both the supply and demand side of carbon markets, commercial energy firms have a clear interest in the development of open, competitive and well-functioning voluntary carbon markets. The Working Group salutes Commission efforts to inform itself on how to better address climate-related financial concerns beginning with the First Voluntary Carbon Markets Convening in June 2022 and subsequent Request for Information on Climate-Related Financial Risk[2] through the Second Voluntary Carbon Markets Convening held in June 2023 to address: (i) the growing private sector initiatives for ensuring high quality carbon credits, and (ii) current market developmental trends and market participants' perspectives on how the CFTC can promote integrity for high quality carbon credit financial products.

The Working Group appreciates the challenges faced by the Commission with respect to these efforts. The development of voluntary carbon markets is at a nascent stage. At this time, the design and regulatory oversight of such markets is not only decentralized, but also fragmented and lacks uniformity across both domestic and international jurisdictions. Further, trading in voluntary carbon markets involves a broad array of cash-market products which have distinctly different commercial and regulatory purposes – from carbon offsets and credits to renewable energy credits ("**RECs**").[3]

As noted in the Proposed VCC Guidance, VCC futures are relatively new and evolving products listed for trading by designated contract markets ("**DCMs**"). Commercial energy firms have a strong interest in the development of well-functioning and orderly markets for VCC products listed for trading on exchanges operated by DCMs. The Working Group applauds the Commission's efforts to help facilitate the standardization of VCC financial products in a manner that promotes market integrity, liquidity and transparency. These characteristics are critical for ensuring accurate price formation, as well as promoting efficient price discovery and risk management.

As discussed herein, despite concerns with the CFTC's chosen procedural vehicle for adopting this guidance, the Working Group generally supports DCMs performing an appropriately-tailored role in helping to ensure the integrity of actual VCCs used as the underlying commodity for VCC financial products which, in part, includes holding accountable programs that provide accreditation and verification services ("**Crediting Programs**") or

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[2] *See* Commodity Futures Trading Commission, *Request for Information on Climate-Related Financial Risk*, 87 Fed. Reg. 34856 (June 8, 2022)("**Climate Risk RFI**"); *See also* The Commercial Energy Working Group, Comment Letter, *Request for Information on Climate-Related Financial Risk* (Oct. 7, 2022).

[3] As discussed in Section II.B.3., credits traded in voluntary carbon markets are generated by a wide variety of projects that range from small community based activities to large commercial and industrial projects (*e.g.,* high-volume hydroelectric plants, commercial reforestation and forms of industrial carbon capture and sequestration technology) to the development of renewable and clean energy resources (*e.g.,* wind and solar generation, battery storage). While certain credits transacted in these markets, such as carbon offsets and credits are intended to substantiate the removal, avoidance or reduction of a fixed volume of carbon dioxide or an equivalent greenhouse gas ("GHG") from the atmosphere, others, such as RECs, substantiate the generation or production of a fixed volume of renewable or clean energy.

outsource such services to independent third-parties, as well as registries, that participate in this process.

However, the Working Group urges the Commission to avoid adopting interpretive guidance that would impose unduly onerous requirements on DCMs which are outside of DCMs' core competencies, expertise and operational remit. The imposition of such burdens on DCMs could have the unintended consequence of creating insurmountable hurdles to the development of liquid and well-functioning markets for VCC financial products which, in turn, would harm the development of underlying, voluntary cash-markets for VCCs which also presently only have limited open interest and liquidity.

A. The Commission Should Either Clarify that the Proposed VCC Guidance is Subject to Periodic Updates as Voluntary Carbon Markets and VCC Financial Products Evolve or Institute Formal Rulemaking Proceedings to Address Substantive Issues Raised by Such Guidance.

As promulgated, the Proposed VCC Guidance is "not intended to modify or supersede existing statutory or regulatory requirements, or existing CFTC guidance that addresses the listing of derivative products by CFTC-regulated exchanges."[4] Rather, the Proposed VCC Guidance takes into account certain unique attributes of VCC derivatives and voluntary carbon markets and outlines specific issues a DCM should consider when listing a VCC contract for trading, including Appendix C to Part 38 of the CFTC Regulations ("**Appendix C Guidance**").[5]

Notwithstanding the characterization of the Proposed VCC Guidance as non-binding in nature, the Working Group is concerned that, once finalized, this issuance will act as the CFTC's definitive interpretation of how it will exercise its statutory authority under the Commodity Exchange Act ("**CEA**") with respect to the listing of VCC financial products on DCMs.[6] As discussed herein, the Proposed VCC Guidance raises substantive jurisdictional, definitional and functional DCM compliance issues that could have a potentially significant impact on the development of markets for VCC financial products, as well as underlying voluntary carbon markets.

In light of these issues, and in recognition of the fact that VCC financial products "are a comparatively new and ***evolving*** class of products,"[7] the Working Group believes that the Commission should expressly clarify that any final interpretive guidance adopted in this proceeding is subject to periodic review (including public notice and comment).[8] Specifically, such clarification would ensure that the Commission reserves both the substantive and procedural flexibility to revise, modify and update such interpretive guidance for purposes of ensuring that it evolves with, and continues to accurately reflect, the development of voluntary carbon markets and VCC financial products developed for such markets.

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[4] Proposed VCC Guidance at 89,415 and fn. 20.

[5] Proposed VCC Guidance at 89,415; 17 C.F.R. Part 38, Appendix C.

[6] *See, generally,* CEA Section 5(d).

[7] Proposed VCC Guidance at 89,415.

[8] Such review could be trigger by the Commission when acting sua sponte or at the written request of DCMs or market participants.

Without the requested clarification, any final interpretative guidance issued in this proceeding will have the practical force and effect of a final rule. Specifically, it will constitute the Commission's binding – and static – view with respect to the unique issues DCMs must consider when addressing their compliance obligations under Part 38 of the CFTC Regulations and the Appendix C Guidance when listing a VCC financial product for trading.

Accordingly, if the Commission is unwilling to include such clarification in the final guidance, the Working Group respectfully requests that the Commission commence a formal rulemaking proceeding subject to the requirements of the Administrative Procedures Act ("**APA**") to address the substantive issues raised by the Proposed VCC Guidance.[9] This will provide a clear procedural path forward, facilitate additional regulatory transparency and the development of a full and complete record, as well as afford all interested parties with the protections of judicial review under the APA.[10]

B. Relevant Legal, Regulatory and Policy Considerations Implicated by the Proposed VCC Guidance.

1. Jurisdictional Considerations Under the CEA.

The principles-based statutory framework, embodied in 23 "Core Principles," applicable to DCMs under CEA Section 5(d) is well established. This framework sets forth the general standards and requirements for DCMs to conduct their business and reflects the important role DCMs play in promoting confidence in, and the integrity of, CFTC-regulated derivative markets.[11] The Core Principles require DCMs to, among other things: (i) establish and enforce rules for trading on the DCM, (ii) provide a competitive, open and efficient market for trading, (iii) monitor trading activity, and (iv) ensure that contracts listed for trading are not susceptible to manipulation.[12]

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[9] 5 U.S.C. §§ 551 *et seq.*

[10] The Working Group would support the convening of a Technical Conference comprised of the diverse market, DCM, regulatory and NGO interests in voluntary carbon markets for purposes of further assessing and addressing the complex technical and policy matters that must be considered and synthesized to facilitate the standardization of VCC derivatives and development of workable, liquid and transparent markets for such products. The participants in the Technical Conference would make specific on the record recommendations to the Commission in furtherance of these objectives, which would be subject to public notice and comment under the APA.

[11] *See, generally,* CEA Section 5(d), 7 U.S.C. 7(d). There are 23 Core Principles for DCMs set forth in the CEA.

[12] Proposed VCC Guidance at 89,411. For example, DCM Core Principle 3 provides that DCMs may only list derivative contracts that are not readily susceptible to manipulation. Core Principle 4 requires a DCM to have the capacity and responsibility to prevent manipulation, price distortion, and disruptions of the delivery or cash settlement process, through market surveillance, compliance, and enforcement practices and procedures. Core Principle 5 requires a DCM to adopt for each contract that it lists for trading, as is necessary and appropriate, position limitations or position accountability for speculators, in order to reduce the potential threat of market manipulation or congestion, especially during trading in the delivery month. DCM Core Principle 12 requires a DCM to establish and enforce rules to protect markets and market participants from abusive practices, and to promote fair and equitable trading on the DCM.

In addition, the CFTC has jurisdiction over the sale of a commodity in interstate commerce under CEA Section 1(9).[13] VCCs that are transacted and physically-delivered in cash markets are subject to CFTC jurisdiction under Section 1(9). However, the Commission's oversight authority is generally limited to policing market behavior (*i.e.,* trading activity) for fraud and manipulation under CEA Sections 9(a) and 6(c)(1), and CFTC Regulation 180.1. The CEA does not provide the CFTC with statutory authority to directly impose standards in voluntary carbon markets.

If appropriately tailored, the Working Group believes that the Proposed VCC Guidance has the potential to meet the Commission's policy objectives of advancing the standardization of VCC financial products in a manner that promotes transparency and liquidity. However, as promulgated, the Working Group is concerned that the Proposed VCC Guidance could be construed as an attempt to use the Core Principles process to not only bring standardization to VCC markets, but also indirectly impose standards on underlying cash markets for VCCs.

Accordingly, the Proposed VCC Guidance could be viewed as a misapplication of the CFTC's Core Principles authority set forth in CEA Section 5(d) and in Part 38 of the CFTC Regulations and impose obligations on DCMs that require greater due diligence than required for other products. The Commission should further articulate and clarify whether and how the due diligence obligations imposed by the Proposed VCC Guidance on DCMs that effectively impose standards on cash markets for VCCs do not exceed its statutory authority or the authority granted to DCMs under CEA Section 5(d).

2. Other Legal, Regulatory and Policy Interests in Voluntary Carbon Markets.

The Proposed VCC Guidance adopts an expanded and onerous set of due diligence obligations that DCMs must satisfy in order to comply with applicable Core Principles set forth in Part 38 of the CFTC Regulations (including the Appendix C Guidance) when listing VCC financial products for trading. However, DCMs' compliance with such due diligence obligations cannot be limited to exclusively considering the regulatory interests of the CFTC.

Specifically, in addition to the CFTC's regulatory interest in voluntary carbon markets, these markets are subject to a decentralized and fragmented patchwork of state, federal and

[13] As noted in the Proposed VCC Guidance, VCCs are a type of environmental commodity which if physically settled are exempt from swap regulation under the CEA. Proposed VCC Guidance at 89,412 fn. 33. *See also Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*; Final Rule, 77 FR 48208 (Aug. 13, 2012).

international legal, regulatory and policy initiatives,[14] some of which are more broadly focused on the mitigation of climate risk through mandating climate disclosures.[15] In order to comply with the due diligence obligations imposed by the Proposed VCC Guidance, it would appear that DCMs will need to: (i) identify any relevant state, federal or international regulatory initiatives, and (ii) consider how such initiatives should be treated and synthesized with its obligations under the CEA as part of the Core Principle compliance process when listing VCC financial products for trading.

The Working Group is concerned that the obligation of DCMs to consider this complex array of regulatory interests in voluntary carbon markets may create disincentives to DCMs listing VCC financial products for trading. Accordingly, the Working Group requests that the Commission clarify the extent to which DCMs must consider related (or potentially competing) state, federal or international initiatives that could have impacts on voluntary carbon markets when performing their expanded due diligence obligations set forth in the Proposed VCC Guidance.[16]

3. The Commission Should Clarify the Universe of Environmental Commodities that are Subject to the Proposed VCC Guidance.

Rather than adopting a formal regulatory definition of VCC, the Proposed VCC Guidance points to the definition of "carbon credit," as set forth in Section 5 (Definitions) of the Integrity

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[14] For example, in October 2023, the California state legislature enacted AB 1305, the Voluntary Carbon Market Disclosures Act ("**VCMD**"). The VCMD requires participants in the California voluntary carbon market to, among other things, include disclosures on their website of detailed information regarding the relevant voluntary carbon offset projects by (1) entities marketing or selling "voluntary carbon offsets" within California and (2) entities operating in California that purchase or use "voluntary carbon offsets" sold within California and make certain claims within the state regarding carbon neutrality, reaching net zero emissions or making significant reductions to greenhouse gas emissions. Further, immediately prior to the issuance of the Proposed VCC Guidance by the Commission, the International Organization of Securities Commissions ("**IOSCO**") published a consultation report outlining a set of "Good Practices to promote the integrity and orderly functioning of the Voluntary Carbon Markets." See International Organization of Securities Commissions, Voluntary Markets Consultation Report (Dec. 2023), found at: https://www.iosco.org/library/pubdocs/pdf/IOSCOPD749.pdf.

[15] In addition to AB 1305, California recently adopted two statutes that impose new and sweeping climate-related reporting obligations on public and private companies. *See Climate Corporate Data and Accountability Act*, SB 253, 2023 Leg. § 1(l) (Cal.2023); *Climate Related Financial Risk Act*, SB 261, 2023 Leg. § 1(j) (Cal.2023). The U.S Securities and Exchange Commission ("**SEC**") has proposed expansive climate disclosure rules for public companies and foreign private issuers, which are expected to become final in the spring of 2024. *See*, U.S. Securities and Exchange Commission, *The Enhancement and Standardization of Climate-Related Disclosures for Investors*, Release Nos. 33-11042 (Mar. 21, 2022), available at https://www.sec.gov/files/rules/proposed/2022/33- 11042.pdf ("**SEC Climate Disclosure Proposals**"). Under the SEC Climate Disclosure Proposals, if, as part of its net emissions reduction strategy, a company uses carbon offsets or RECs, the company would be required to disclose the role that such credits play in the company's climate-related business strategy. Enhanced climate disclosures may accelerate the growth and standardization of VCC cash and derivative markets as companies seek to demonstrate and quantify their GHG emission reduction efforts.

[16] For instance, whether DCMs be required to include any state, federal or international regulatory or legal initiatives that are applicable to a VCC as part of its obligation to meet transparency requirements set forth in Part 38, Appendix C, Paragraph (b)(2)(i)(A) of the CFTC Regulations.

Council for the Voluntary Carbon Market ("**ICVCM**"), Carbon Core Principles.[17] In relevant part, the ICVCM definition of carbon credit is defined as:

> a tradeable intangible instrument that is issued by a carbon crediting program. The general industry standard is for a VCC to represent a [greenhouse gas] (GHG) emissions reduction to, or removal from, the atmosphere equivalent to one metric ton of carbon dioxide.

The Proposed VCC Guidance goes on to note that "[t]ypes of carbon mitigation projects or activities for which VCCs are issued include *renewable energy*, industrial gas capture, energy efficiency, forestry initiatives (avoiding deforestation), regenerative agriculture, wind power, and biogas." (Emphasis added). Without further clarification, this statement could create confusion and regulatory uncertainty with respect to the scope and applicability of the Proposed VCC Guidance to renewable and clean energy projects.

Renewable and clean energy projects perform an indirect emissions reduction function and can meet the emission reduction requirements to support the issuance of VCCs as characterized in the Proposed Guidance. The Working Group does not take any issue with the application of the Proposed VCC Guidance to financial products that utilize VCCs as the underlying commodity that are generated by renewable and clean energy resources. These financial products would be within the scope of the Proposed VCC Guidance.

The Working Group notes, however, that the predominant environmental commodity generated by renewable and clean energy facilities and transacted in voluntary markets are RECs. RECs are operationally and legally distinct from carbon off-sets and carbon credits. First, RECs are inextricably tied to the generation or production and qualifying use of an identifiable and measurable unit of renewable, sustainable or clean energy (*i.e.,* one megawatt hour of renewable power).[18] Second, RECs are the accepted legal instrument through which renewable energy generation and use claims are substantiated and are supported by several different levels of government, regional electricity transmission authorities, nongovernmental organizations, and trade associations, as well as in state and federal case law.[19]

Based on the foregoing, the Working Group respectfully requests that the Commission clarify that financial products where the underlying commodity is a REC or another environmental commodity whose terms and conditions (and issuance) are not functionally or

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[17] Proposed VCC Guidance at 89,412 fn. 35. The Proposed VCC Guidance further note that the general industry standard is for a VCC to represent a GHG emissions reduction to, or removal from, the atmosphere equivalent to one metric ton of carbon dioxide. *Id.* at 89,412, fn 36.

[18] While the development and use of renewable electric generation resources are considered emission reduction activity, RECs that are created by the production of electricity from such resources are identified as "Generation Attributes" and there are several systems that track them as such. For example, there is the PJM Generation Attribute Tracking System or GATS that tracks and records electricity production associated with renewable resources operating in the PJM system. *See* description of the PJM GATS. Available at: https://www.pjm-eis.com/getting-started/about-GATS.aspx.

[19] *See* Environmental Protection Agency, *Green Markets, Renewable Energy Credits*, available at: https://www.epa.gov/green-power-markets/renewable-energy-certificates-recs#:~:text=RECs%20and%20Offsets%3F-,What%20is%20a%20REC%3F,attributes%20of%20renewable%20electricity%20generation.

operationally based on the reduction or removal of an identified quantity of carbon emissions from the atmosphere is not subject to the Proposed VCC Guidance.

Accordingly, without the requested clarification, the proposed revisions to the DCM Core Principles set forth in Part 38 of the CFTC Regulations, including the Appendix C Guidance, to REC derivatives products listed for trading would be misplaced and would have a detrimental and chilling impact on cash markets for RECs, REC derivatives and the renewable and clean energy sector as a whole.[20]

C. DCMs Should Be Permitted to Rely on Industry Best Practices and Accepted Crediting Programs.

For purposes of complying with their expanded due diligence obligations under the proposed revisions to Part 38 of the CFTC Regulations and the Appendix C Guidance, DCMs should be able to rely on good faith representations made by Crediting Programs that utilize best practices in accordance with accepted industry standards. The Working Group believes that Crediting Programs and registries in voluntary carbon markets remain best positioned to establish and enforce the independent, foundational measures designed to ensure the integrity of financial products for VCCs.

Such an approach is conceptually consistent with Commission policy underlying the operational resilience framework set forth in the pending proposed rulemaking addressing "Operational Resilience Framework for Futures Commission Merchants, Swap Dealers, and Major Swap Participants."[21] In relevant part, this framework is reasonably designed to identify, monitor, manage, and assess risks relating to third-party relationships, as well as emergencies or other significant disruptions to normal business operations.[22]

Permitting DCMs to recognize Crediting Program best practices would also help to mitigate burdens imposed on DCMs by allowing them to: (i) identify uniform standards for VCC financial products, and (ii) rely on binding representations from Crediting Programs that such standards are satisfied, in lieu of spending considerable additional time and resources to confirm conformance therewith. For example, Crediting Program best practices that DCMs could recognize and rely upon might include, but are not limited to:

- Robust requirements around third-party verification, including protocols designed to check double counting between third-party verifiers.

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[20] REC derivative products that are listed for trading by DCMs are already subject to the Core Principle process. Further, as noted above, RECS are generated for purposes of substantiating the generation or production of renewable or clean energy, not for substantiating the removal or reduction of carbon emissions from the atmosphere.

[21] *See Operational Resilience Framework for Futures Commission Merchants, Swap Dealers, and Major Swap Participant*s, Notice of Proposed Rulemaking, 89 Fed. Reg. 4,706 (Jan. 24, 2024)("**Operational Resilience Proposed Rule**").

[22] In relevant part, the Operational Resilience Proposed Rule utilizes a principles-based approach to help identify and assess the risks associated with third-party relationships and that allows entities subject to this proposed rule to adapt their risk management practices consistent with those risks, their risk appetite and risk tolerance limits, and the nature, size, scope, complexity, and risk profile of their business activities, following generally accepted standards and best practices. *See* 89 Fed. Reg. at 4720.

- Protocols that require the prompt review of identified problems with methodologies that have led or may lead to, for example, over-crediting and over-issuance of carbon credits.

- Establishment of timelines to review all their existing/legacy methodologies, starting with the highest priority methodologies.

- Protocols designed to identify whether there is a risk of over-issuance under the current or previous versions of the methodologies, and if so, apply corrective measures such as requiring projects to reassess their baselines, transparently put issuance of additional VCCs on hold until projects have been investigated, and limit the number of credits issued by a particular project.

- Protocols that ensure that crediting programs have unique serialization of each individual VCC.

- Publicly available operating procedures for the issuance and retirement of VCCs that explain how these processes work and terms of use that govern participation in the crediting program.

In sum, the Working Group respectfully submits that such an approach can provide a practical and meaningful degree of comfort from a legal, regulatory, and commercial perspective with respect to the integrity of markets for financial VCC derivatives.

D. Crediting Programs Should Be Accountable to the Commission for Any Intentional or Reckless Acts or Omissions that Result in Harm to the Integrity of VCC Financial Markets.

To incentivize appropriate long-term behaviour designed to protect the integrity of markets for VCC derivative products, Crediting Programs should be held accountable in situations where the integrity of such markets is harmed as a direct and proximate result of their acts or omissions.[23] The Working Group believes that the extension of the Commission's anti-fraud authority under CEA Sections 9(a) or 6(c)(1), or CFTC Regulation 180.1 to Crediting Programs is reasonable and legally supportable under such circumstances.

Critically, the process for assessing and certifying projects is entirely outside of the control of market participants, DCMs and regulators. As users, operators and overseers of

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[23] The Working Group notes that this request is consistent with the creation and mission of the Commission's Environmental Fraud Task Force in June 2023. The Environmental Fraud Task Force will address fraud and other misconduct not only in regulated derivatives markets, but also in relevant spot markets (such as voluntary carbon credit markets), relating to purported efforts to address climate change and other environmental risks. The task force will examine, among other things, fraud with respect to the purported environmental benefits of purchased carbon credits, as well as registrants' material misrepresentations regarding ESG products or strategies. *See CFTC Press Release Number 8723-2*, available at: https://www.cftc.gov/PressRoom/PressReleases/8723-23; *see also CFTC Whistleblower Alert: Blow the Whistle on Fraud or Market Manipulation in the Carbon Markets*, available at: https://www.whistleblower.gov/sites/whistleblower/files/2023-06/06.20.23%20Carbon%20Markets%20WBO%20Alert.pdf

financial markets for VCCs, these entities are, at the most fundamental level possible, entirely reliant upon Crediting Programs to properly certify projects and to help ensure the integrity of VCCs issued by such projects. In this respect, Crediting Programs should share some reasonable degree of exposure to potential enforcement risk for any identified intentional or reckless acts and omissions in the performance of their duties or issuance of any representations relied upon by market participants, DCMs or regulators with respect to the integrity of (i) projects certified, and (ii) as applicable, credits issued by such projects that directly result in, or materially contribute to, undermining the integrity of VCC derivative markets.[24]

The application of the Commission's enforcement under the CEA and CFTC Regulations in this context also has the benefit of reducing burdens and costs imposed by the Proposed VCC Guidance on DCMs. Specifically, it would mitigate potentially insurmountable operational and compliance hurdles that could result from requiring DCMs to act as *de facto* arbiters of the integrity of voluntary carbon markets (and, more narrowly, VCCs used as the underlying for financial VCC derivative products). The Working Group is concerned that such insurmountable hurdles will translate into DCM reluctance to list VCC derivative products for trading. Such action would harm already thin liquidity in (i) financial VCC markets, and (ii) underlying voluntary carbon markets.

Lastly, the extension of the CFTC enforcement authority to Crediting Programs can also further the Commission's policy objective of advancing the standardization of VCC derivatives. Specifically, it would drive the creation of a market and regulatory environment where Crediting Programs that possess the independence, internal and financial wherewithal, as well as technical support and expertise, must be able to uniformly and reliably meet (and represent they meet) standards (including industry-accepted best practices) recognized by DCMs which are applicable to financial VCC derivative products listed for trading.

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[24] Relevant circumstances where a Crediting Program could be exposed to potential CFTC enforcement risk could include, but would not be limited to, the failure of an accredited VCC to contribute to additionality, lack of permanence or post-issuance reversal due to the lack of integrity during the crediting process. As noted above, DCMs, market participants and regulators rely on the good faith, accuracy and integrity of Crediting Programs. Crediting Programs failing to meet such standards – whether intentionally or recklessly – and certifying VCCs of low quality and compromised integrity fundamentally undercut the confidence in voluntary carbon markets and the value of VCC derivatives. A failure at this point in the chain of custody can result in market participants and DCMs acting in good faith and exercising reasonable due diligence being exposed to potential enforcement and civil litigation risk.

III. Working Group Response to Specific Questions in the Proposed VCC Guidance.

A. General.

In addition to the VCC commodity characteristics identified in this proposed guidance, are there other characteristics informing the integrity of carbon credits that are relevant to the listing of VCC derivative contracts? Are there VCC commodity characteristics identified in this proposed guidance that are not relevant to the listing of VCC derivative contracts, and if so, why not?

The Working Group does not support vintage year cut-offs for VCC financial products. The Commission has not made clear its overall intent with respect to the treatment of vintage years. This lack of regulatory clarity could lead to unintended consequences for the overall performance of the voluntary carbon markets. The Working Group recognizes that older vintage VCC financial products often trade at a discount. However, the ability to transact older vintages allows market participants to utilize these products to meet carbon reduction goals under circumstances where they may be subject to internal resources or budgetary constraints, or the market is experiencing supply chain issues.[25]

Are there standards for VCCs recognized by private sector or multilateral initiatives that a DCM should incorporate into the terms and conditions of a VCC derivative contract, to ensure the underlying VCCs meet or exceed certain attributes expected for a high-integrity carbon credit?

The Working Group believes that VCC financial products should be designed to align with benchmarks for carbon credit quality, such those developed by ICVCM.

B. Transparency.

Is there particular information that DCMs should take into account when considering, and/or addressing in a VCC derivative contract's terms and conditions, whether a crediting program is providing sufficient access to information about the projects or activities that it credits? Are there particular criteria or factors that a DCM should take into account when considering, and/or addressing in a contract's terms and conditions, whether there is sufficient transparency about credited projects or activities?

If the current terms and conditions of a VCC underlying a derivatives contract are no longer considered appropriate and require material change or revision, DCMs should require the establishment of a new VCC financial product, rather than changes to the current contract. Such changes to the terms and conditions of the underlying VCC should be transparently reflected in any VCC financial product listed for trading on a DCM.

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[25] The Working Group notes that, just because vintage VCC financial products may be cheaper, it does not mean that more expensive newer VCC financial products are necessarily better quality. In the exercise of their compliance obligations under Part 38 and the Appendix C Guidance, DCMs can review if vintage VCC financial products align with current best practices and standards.

C. Inspection Provisions.

Should the delivery procedures for a physically-settled VCC derivative contract describe the responsibilities of registries, crediting programs, or any other third-parties required to carry out the delivery process?

DCMs should ensure that the terms and conditions of a VCC financial product highlight potential delivery risk if a Crediting Program and/or registry is unable to deliver underlying VCCs into that derivative contract due to a project or basket of credits no longer being recognized as "high integrity" by an accepted industry organization, regulatory entity or SRO in voluntary carbon markets, such as ICVCM. The DCMs should consider whether it is appropriate under such circumstances to require that Crediting Programs block transfers of VCCs used as the underlying commodity to a VCC financial product and pause issuance of such credits while any investigation or regulatory scrutiny is ongoing related to the integrity of the underlying VCC.

D. Sustainable Development Benefits and Safeguards

Certain private sector and multilateral initiatives recognize the implementation by a crediting program of measures to help ensure that credited mitigation projects or activities would avoid locking in levels of GHG emissions, technologies or carbon intensive practices that are incompatible with the objective of achieving net zero GHG emissions by 2050, as a characteristic that helps to inform the integrity of VCCs issued by the crediting program. When designing a VCC derivative contract, should a DCM consider whether a crediting program has implemented such measures?

When undertaking their due diligence obligations as part of the process for listing a VCC derivative for trading, DCMs should apply ICVCM guidance under its Carbon Core Principles.

III. CONCLUSION

The Working Group appreciates this opportunity to comment in this proceeding and looks forward to working with the Commission as it considers new policy initiatives or regulatory proposals resulting from the Proposed VCC Guidance that are focused on voluntary carbon markets and mitigation of climate change risk. The Working Group reserves the right to further supplement its comments filed herein.

If you have any questions, please contact the undersigned.

Respectfully submitted,
/s/ R. Michael Sweeney, Jr.

R. Michael Sweeney, Jr.
David T. McIndoe
Angelica Li

Counsel to
The Commercial Energy Working Group