INTERNATIONAL ENERGY CREDIT ASSOCIATION

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Re: Comments of the IECA on: **Commission Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts; Request for Comment**, 88 Fed. Reg. 89410 (published December 27, 2023) RIN 3038-AF40

Dear Mr. Kirkpatrick:

The International Energy Credit Association ("IECA") appreciates the opportunity to submit these comments to the Commodity Futures Trading Commission ("CFTC" or "Commission").

Background about the IECA

The IECA is an association of over 1,400 credit, risk management, legal and finance professionals that is dedicated to promoting the education and understanding of credit and other risk management-related issues in the energy industry. For the last 100 years, IECA members have actively promoted the development of best practices that reflect the unique needs and concerns of the energy industry.

The IECA seeks to protect the rights and advance the interests of a broad range of domestic and foreign energy market participants, representatives of which make up the IECA's membership. These entities finance, produce, sell, and/or purchase for resale substantial quantities of various physical energy commodities, including electricity, natural gas, oil, refined products, hydrogen, ammonia, renewable energy credits, voluntary carbon credits, and numerous other energy-related physical commodities (both tangible and intangible) necessary for the healthy functioning of the energy markets and the "real economy."

I. Comments on Proposed Guidance.

Comments on Section I.B.1

The description of Protocol development at voluntary Carbon registries fails to acknowledge the rigors that reputable registries apply to their development. See, for example, the detailed material concerning

development reviews of each of California's compliance offset protocols available at https://ww2.arb.ca.gov/our-work/programs/compliance-offset-program/compliance-offset-protocols. See Verra's detailed description of how methodologies are developed, available at https://verra.org/documents/methodology-development-and-review-process/. See the Gold Standard methodology development process described at https://www.goldstandard.org/our-work/innovations-consultations/methodology-development-procedure.

The statement on p. 11 of the Proposed Guidance preprint that there is a "current absence of a standardized methodology or protocol to quantify emissions reduction or removal levels" is necessarily false. There are hundreds of robustly developed protocols active with many reputable registries, that have been developed in open and transparent public processes, including those accepted by the State of California, and other State and foreign governments, that are each a standardized methodology or protocol to quantify emissions reduction or removal levels. If the CFTC's statement was true, there would be no protocols and, because there would be no way to measure emissions reduction attainments, there would be no offsets.

Comments on Section I.B.2

There are not only recent "private sector and multilateral initiatives" that promote transparency in Carbon offset markets, Carbon offset registries have engaged in exhaustive transparency in protocol development and quality assessments for decades. See for example The World Bank's 86 page technical note on the development of Carbon Offset programs, from 2015, available at https://documents.worldbank.org/curated/en/891711468309365201/pdf/939450WP0201500ers0385391B00PUBLIC0.pdf. Compliance offsets, noted in footnote 48 of the pre-print as a basis for existing futures contracts, have long been used for voluntary attainments. See for example The World Bank's 109 page technical note on the use of options for international programs available at https://documents1.worldbank.org/curated/en/291491467999129585/pdf/99183-NWP-Box393189B-PUBLIC-add-series-name.pdf. The CFTC does not have the jurisdiction to establish standards for compliance offset protocols, as these are within the purview of the duly authorized State or foreign governments.

Comments on Section II.A.

The CFTC suggests on p. 23 of the pre-print that "a DCM should consider the VCC commodity characteristics when addressing the following criteria in the design of a VCC derivative contract: … Delivery points and facilities … ." The climate crisis was formerly generally known as "global" warming, and "global" remains an appropriate descriptor for emissions of Carbon Dioxide, as opposed to, for example, particulate pollutants. To the extent voluntary Carbon credit projects have a point at which they physically deliver reductions or removals from the atmosphere, such a point would be commercially irrelevant under most conceivable protocols. If the CFTC is asking DCMs to determine where the carbon credit is delivered and that is intended to refer to the delivery from a seller's account at the applicable registry to the buyer's account at such registry, then please make that clear.

Comments on Section II.A.2.c

The CFTC is making assumptions about "permanence" as a necessary characteristic for voluntary carbon credits that are outside of its regulatory purview. The CFTC is not an environmental regulator. Nature-based protocols necessarily work with living organisms, which do not store carbon on geological timelines. Some object to forestry offsets on the ground that the carbon sequestration is not on a geological time scale. That is a factor that the market can apply to the offset, perhaps discounting its value. It is not the role of the CFTC to exclude from the market all non-geologic and nature based offsets.

The CFTC has elsewhere seemed to assert that its jurisdiction to investigate manipulation is not limited to transactions in commodities, but also includes claimed personal uses of purchased commodities. For example, one CFTC Commissioner claimed that the CFTC has authority to investigate "fraud with respect to the purported environmental benefits of purchased carbon credits." Kristin N. Johnson, *Keynote Remarks of Commissioner Kristin N. Johnson at Rice University's Baker Institute for Public Policy Annual Energy Summit: Credibility, Integrity, Visibility: The CFTC's Role in the Oversight of Carbon Offset Markets*, https://www.cftc.gov/PressRoom/SpeechesTestimony/opajohnson7 (Oct. 5, 2023). By this logic, the CFTC would have the authority to investigate "fraud with respect to the purported health benefits of purchased vaccines." And why stop with "use" of a commodity or "purported benefits" of a commodity? The CFTC's jurisdiction would thus be virtually unlimited, especially when, according to the CFTC, "commodities" means everything. See Brief for Amicus Curiae U.S. Commodity Futures Trading Commission in Support of Rehearing, *Laydon*, No. 20-3626, Dkt. 383, 2022 WL 17369433 (2d Cir. Nov. 29, 2022) at 5–9; CFTC, *Further Definition of "Swap," "Security-Based Swap," and "Security-Based Swap Agreement"; Mixed Swaps; Security-Based Swap Agreement Recordkeeping*, 77 Fed. Reg. 48208, 48246–47 (Aug. 13, 2012).

Comments on Section II.B

The CFTC suggests at the top of p. 34 of the pre-print, "where there are changes to either the crediting program or the types of projects or activities associated with the underlying VCC, due for example to new standards or certifications, then the DCM should amend the contract's terms and conditions to reflect this update." This should be tempered by reality and market practice. Projects conduct their activities based on the protocol available to them at the time the measuring and verification takes place. That process is a multi-month, possibly full year process. Protocol development continues while the projects are engaging in the application of the protocol to their activities so they can receive the offsets. Projects cannot go back in time to change the monitoring, measurement, and verifications they in fact performed based on later changes to the rulebook. Market participants know they are getting the protocol version they agreed to buy. In terms of a futures contract, a buyer of a contract for delivery in March 2025 should not get a more valuable product because the standards improved in the interim. The buyer should get the standards the buyer agreed to pay for and the seller agreed to deliver based on the characteristics at the time of trading. Mandating an update would also impair deliverable supply. The CFTC should not be mandating that the contract deliverable must meet amended standards. This should be a DCM decision or a decision of the market participants advising DCMs the products they want to see listed in the marketplace.

II. Responses to Specific Questions.

8. In this proposed guidance, the Commission recognizes VCCs as additional where they are credited for projects or activities that would not have been developed and implemented in the absence of the added monetary incentive created by the revenue from carbon credits. Is this the appropriate way to characterize additionality for purposes of this guidance, or would another characterization be more appropriate? For example, should additionality be recognized as the reduction or removal of GHG emissions resulting from projects or activities that are not already required by law, regulation, or any other legally binding mandate applicable in the project's or activity's jurisdiction?

It is inappropriate for the CFTC to define "additionality" for Carbon offset projects. Determination of additionality is made by the applicable offset registry in the development of its protocols. The CFTC is not an environmental regulator. The CFTC has undertaken no public process concerning the appropriate definition of additionality. In stark contrast to the uninformed and cavalier approach of the CFTC to suddenly decide to define additionality, the Federal Trade Commission, in its development of its green guides, undertook an

exhaustive and well-developed process, in 2010. See 75 Fed. Reg. 64594-97. For its part at around the same time, also in 2010, the CFTC speculated on the nature of "additionality" in a rulemaking, without drawing any conclusions. See 75 Fed. Reg. 23689. (See attached Exhibit A.)

The concept of "additionality" is core to both compliance and voluntary Carbon offset markets, and the CFTC has not engaged in any formal rulemaking process to ascertain the appropriate commercial meaning for this term. The CFTC held two "Carbon market convenings," which were informative, but were not formal rulemaking proceedings. Nor were there any opportunities for "public" input. The CFTC selected who spoke and who provided it information. Fundamentally, it was the CFTC soliciting what it wanted to hear. As is clear from the many factual errors concerning the voluntary Carbon market in the Proposed Guidance, the information provided to the CFTC by these self-referential, invitation-only "convenings" was incomplete.

The fact that it is "guidance" is no less substantive to registered entities than a formal rulemaking or regulation. Appendix C to Part 38 – the existing "guidance" for listing new futures contracts has been in effect for years and is the de facto standard by which DCMs list new products as if it were a law. Similarly, by cross reference in Appendix C to Part 37, such Appendix C of Part 38 is also applicable to Swap Execution Facilities (SEFs) seeking to list new Swaps.

III. In the Listing Process, DCMs Should Report Commercially-Reputable Data, As is typical in the requirements of existing Appendix C to Part 38, But the CFTC Should Avoid Requiring DCMs to validate and verify data. That is the job of applicable not-for-profit VCC Registries.

In essence, the IECA does not object to the CFTC issuing guidance that describes what information each DCM is required to collect and report to the CFTC and to market participants as part of the listing process for each new VCC derivative contract. Ensuring that DCMs collect and report such information can be helpful to ensure the integrity of markets.

However, the CFTC is not an environmental regulator and should not be defining terms like "additionality" or "permanence." The non-profit Registries who established incredibly detailed protocols for projects eligible for VCCs, should be recognized for the expertise they bring to VCCs and derivative contracts for whom such VCC is the underlying commodity.

We believe that the Commission proposed guidance would benefit from further detail as to when a DCM is considered to have discharged its obligations under the Core Principles as concerns VCCs.

Specifically, and as the Commission has described, the existing voluntary carbon standards (*e.g.*, Verra's VCS Program; Gold Standard; American Carbon Registry) (the "**Carbon Standard**"), which issue VCCs under specified crediting programs and administer the registry accounts into which VCCs are physically settled, operate detailed rules which must be met and observed for projects to be registered and credits to be issued under the relevant Carbon Standard. These rules include ensuring quality control, including criteria for establishing whether relevant GHG emission reductions or removals are real, measurable, additional, permanent, independently verified, conservatively estimated, uniquely numbered, and transparently listed on the relevant registry. Independent validation/verification bodies review the project both during the project validation stage and to verify the amount of emission reductions and removals a project has achieved. Mechanisms such as buffer reserves address GHG emission reductions or removals.

Further, while offtake agreements in the primary voluntary carbon markets ("**VCMs**") contain risk allocation provisions in respect of the above, typically given by project developers to project offtakers, offtake agreements in the secondary VCMs contain more limited representations and warranties, namely as to VCC

ownership, the satisfaction of certain specifications (type, methodology, co-benefits/VCC labels, and vintage), and the existence, due issuance, and non-retirement of VCCs. VCC purchasers are expected to satisfy themselves as to the underlying qualities of the VCCs, and all relevant information regarding the project and required for such diligence is available on the website of the relevant Carbon Standard. Such qualities, in addition to market factors, dictate the price for VCCs. We believe the same logic would apply to diligence of the underlying VCCs by participants in the derivatives market for such VCCs.

The Commission is right to point out that different registries operate different rules and methodologies, and the VCM has experienced significant controversy, including overcrediting issues, which is why accreditations and standards have been developed and are now being incorporated as 'labels' applied to various projects that have received such accreditations. Typically, VCCs issued from projects that have received a greater level of accreditation may carry a higher price.

We support the need for transparency in any contract for VCCs as this goes directly to the nature of the commodity being acquired. In particular, as new Carbon Standards are developed, DCMs will need to consider whether they are sufficiently credible for VCCs deriving from projects registered with such Carbon Standards to be traded. However, if a Carbon Standard and/or VCC category has received accreditation by a credible program, a DCM should not be required to further diligence such Carbon Standard or VCC category in order for trading in such VCC derivatives to be enabled beyond reporting its accreditation and acceptance by the market. Neither a DCM nor the Commission is likely to have sufficient expertise to make a more accurate assessment of quality than the ICVCM or another accepted, private sector-led accreditation program.

Additionally, given the wide availability of information on the VCCs through the Carbon Standards, by which secondary market participants typically satisfy themselves regarding VCC quality, we ask the Commission to consider whether the market or the Commission would benefit if DCMs included as much detail as is being proposed in either VCC derivative contracts or their submissions to the Commission. We would not expect any market participant to enter into any primary or secondary offtake agreement relating to VCCs issued or to be issued by a Carbon Standard that does not publish full and publicly available information on the relevant project/VCCs.

IV. Correspondence Regarding These Comments

Please direct correspondence concerning these Comments to:

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V. CONCLUSION.

The IECA appreciates the opportunity to submit these Comments in response to the CFTC's Proposed Guidance. The IECA respectfully requests that the Commission consider these Comments as the Commission moves forward to improve its regulations affecting the commodity markets, market participants, and the fundamental benefits to our economy provided by well-functioning commodity markets. We would welcome the opportunity to discuss these Comments further should you require any additional information on any of the topics discussed herein.

Yours truly,
INTERNATIONAL ENERGY CREDIT ASSOCIATION

<u>/s/ Phillip G. Lookadoo</u>	*<u>/s/ Jeremy D. Weinstein</u>*
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Exhibit A

See attached excerpts from the Federal Trade Commission's deliberations in 75 Fed. Reg. 63594 -63597, and the CFTC's deliberations in 75 Fed. Reg. 23689.

occurred.[531] In one commenter's view, sellers should disclose prominently that the reductions caused by their products will occur in the future.[532]

In addition to concerns about consumer understanding, many commenters raised concerns about the certainty of future projects.[533] With forestry-based offsets, for instance, events such as fire or insect infestation may damage trees and release carbon stored within them.[534] Because of these uncertainties, one commenter stated that offsets for unverified emission reductions should not be allowed.[535] Others suggested that offset sellers take steps to account for such uncertainties, such as using accounting practices to reflect the risks associated with future projects.[536]

c. Substantiating Carbon Offset Claims – Additionality

One of the most contentious issues surrounding the substantiation of carbon offset claims is the concept of "additionality," specifically, whether reductions associated with a carbon offset product would have occurred without the offset sale.[537] Both the workshop participants and comments discussed this issue at length, with most agreeing that offset sellers have a duty to demonstrate that their underlying GHG reduction projects are additional.[538] Without such a showing, the underlying projects do not produce meaningful GHG reductions.[539]

The concept of additionality raises difficult technical and policy challenges, which have generated substantial disagreement among experts. In particular, the commenters did not form a consensus regarding which tests industry members should use to determine whether an offset project is additional. In fact, according to various commenters, industry members rely on numerous, different tests, alone or in combination. Examples of these various tests include:[540]

- *Regulatory/Legal Test*: Addresses whether the project, and, thus, the emissions reductions, are required by law. If they are required by law, the project is not additional.
- *Investment Test:* Addresses whether the revenue from carbon offset sales was a decisive factor in the project's implementation or whether the project would have yielded a lower than acceptable rate of return without offset revenue. If either is true, the project is additional.
- *Common Practice Test:* Addresses whether the project involves widely-used technologies and is merely a "business as usual" project. If so, the project is not additional.
- *Technology Test:* Addresses whether the project involves a technology that is not considered "business as usual" or whether the primary benefit yielded by the technology is a reduction in emissions. If so, the project is additional.
- *Timing Test:* Addresses whether the project began after a specific date. This test eliminates older projects which could not have been implemented with the intent of reducing emissions. If the project began after the established date, it is additional.
- *Barriers Test:* Addresses whether there are barriers, such as local opposition or lack of knowledge, that must be overcome to implement the project. If the project succeeds in overcoming unusual barriers such as these, the project is additional.
- *Performance Test:* Addresses whether the project achieves a level of performance (*e.g.*, an emission rate, a technology standard, or a practice standard) with respect to emission reductions and/or removals that is significantly better than "business as usual." If so, the project is additional.[541]

The commenters variously criticized these tests as vague, subjective, and likely to yield undesirable outcomes. For example, one commenter noted that the investment test requires "subjective analyses of the intent of the project developer or the sufficiency of a project's investment return . . . [and ignores] market realities as they relate to capital formation and the tenure of commercial arrangements which make private activity projects feasible."[542] Such subjective criteria encourage "gaming" and usually result in increased costs.[543] Another criticized the common practice, technology, and barrier tests because they all involve "complex counter-factual questions of what constitutes the baseline scenario . . . and how the offset project differs."[544] Still another noted that the timing test may create incentives to delay much-needed investments until an offset system is established.[545] Some workshop participants, however, supported the regulatory additionality test because it offers an objective standard (*i.e.*, if the law requires the project, one cannot sell offsets from it).[546] But even this approach drew criticism when one panelist explained that multiple regulations can apply to a project, making it difficult to determine whether regulations actually require a particular technology investment.[547]

[531] *See*, *e.g.*, AgRefresh, Comment 533254-00004 at 1, 6; TerraPass, Inc. ("TerraPass"), Comment 533254-00045 at 5.

[532] AgRefresh, Comment 533254-00004 at 1, 6.

[533] Climate Clean, Comment 533254-00039 at 5; *see* Wiley Barbour, Environmental Resources Trust, Inc. ("ERT"), Carbon Offsets Workshop Tr. at 216 ("There are real differences of opinion about whether or not a forestry project, which is going to take fifty years to grow, . . . should be counted as a reduction today.").

[534] Offset Quality Initiative, Comment 533254-00047 at 8.

[535] AgRefresh, Comment 533254-00004 at 6.

[536] For example, one commenter stated that "[s]elling emission offsets before they are created is not inherently problematic . . . . However, forward crediting should be done transparently and provisions made for failure of delivery." Gillenwater, Comment 533254-00005 at 3.

[537] Some commenters noted that it is difficult to define additionality, and FTC staff have set forth merely one variation (examining whether the emission reduction project would have gone forward without the additional revenue stream associated with the sale of carbon offsets). Another variation examines whether the project causes emissions beyond what is required by law or beyond "business as usual." *See*, *e.g.*, Anadarko Petroleum Corp. ("Anadarko"), Comment 533254-00058 at 4. The Commission discusses these differences in more detail below.

[538] *See*, *e.g.*, Anadarko, Comment 533254-00058 at 3; Derik Broekhoff, World Resources Institute ("WRI"), Carbon Offsets Workshop Tr. at 123-125, 165; COPC, Comment 533254-00032 at 5; CRS, Comment 533254-00049 at 11; EcoSecurities, Comment 533254-00044 at 4; Gillenwater, Comment 533254-00005 at 3; Hydrodec, Comment 533254-00046 at 6; Offset Quality Initiative, Comment 533254-00047 at 4; TerraPass, Comment 533254-00045 at 5.

[539] *See*, *e.g.*, TerraPass, Comment 533254-0045 at 5.

[540] *See* Anadarko, Comment 533254-00058 at 4; EcoSecurities, Comment 533254-00044 at 9; Gillenwater, Comment 533254-00006 at 8; Green Power Partnership, Carbon Offsets Workshop Tr. at 241-242; Holt, Carbon Offsets Workshop Tr. at 154-155; Hydrodec, Comment 533254-00046 at 4-5; Maurice LeFranc, EPA ("LeFranc EPA"), Carbon Offsets Workshop Tr. at 143; Offset Quality Initiative, Comment 533254-00047 at 4-8; WRI, Carbon OffsetsWorkshop Tr. at 123-125; Mark Trexler, Derik Broekoff, and Laura Kosloff, *A Statistically-Driven Approach to Offset-Based GHG Additionality Determinations: What Can We Learn?*, Sustainable Development Law and Policy (Winter 2006) at 30, *available at* (*http://conserveonline.org/workspaces/climate.change/carbonmarkets/AdditionalityOffset*).

[541] The EPA Climate Leaders program recommends this approach for use in evaluating offsets by its partners. *See* (*http://www.epa.gov/stateply/*); LeFranc EPA, Carbon Offsets Workshop Tr. at 143.

[542] COPC, Comment 533254-00032 at 3. Another commenter explained that the investment test is subjective because there are no industry-specific metrics on whether an internal rate of return is "'attractive' or not to project developers." Anadarko, Comment 533254-00058 at 6.

[543] COPC, Comment 533254-00032 at 3. A workshop participant also noted that it may be difficult to determine which source of funding "made a difference." Green Power Partnership, Carbon Offsets Workshop Tr. at 242.

[544] Anadarko, Comment 533254-00058 at 6.

[545] Hydrodec, Comment 533254-00046 at 5.

[546] Anadarko, Comment 533431-00032 at 4; Renewable Choice, Carbon Offsets Workshop Tr. at 262; *see also* LeFranc EPA, Carbon Offsets Workshop Tr. at 143.

[547] ERT, Carbon Offsets Workshop Tr. at 254-256; *see also* Anja Kollmus, Stockholm Environmental

Many commenters urged the FTC to refrain from issuing guidelines that address additionality. They suggested that a combination of legislative action, efforts by agencies with greater expertise, and evolving market practices are the best means for addressing these questions.[548] For example, one commenter warned that the "FTC risks becoming entangled in highly complex policy issues at the core of ongoing discussions concerning the design of market-based mechanisms addressing climate change."[549] Another argued that, because pending legislation would assign the role of addressing additionality standards to agencies other than the FTC, it would be neither "appropriate nor productive for the FTC to take a stance on the issue" at this time.[550]

d. Substantiating Carbon Offset Claims – Use of RECs

Some carbon offsets are based on the purchase of renewable energy certificates ("RECs"). The practice of using RECs to create carbon offsets is controversial and garnered significant attention at the workshop and in the comments.[551]

Some workshop panelists and commenters approved of using RECs to substantiate offset claims.[552] In their view, renewable energy generation (represented by RECs) creates emission reductions by causing fossil fuel-fired facilities to produce less energy and, therefore, fewer emissions.[553]

Others argued that RECs should not be used for offsets because the two are distinctive commodities and conflating them could mislead consumers.[554] They provided three main arguments to support their position. First, they argued that there is little or no evidence that renewable energy generation always reduces traditional power generation[555] because the actual emission reductions associated with grid power vary considerably across the United States, and there are no uniform standards for calculating the emissions displaced by renewable energy.[556] Second, even if such displacement occurs, sellers cannot prove that renewable energy generation, and any associated GHG emission reductions, are additional.[557] Some argued that RECs merely subsidize existing projects and do not contribute sufficiently to a project's income stream to create a market for new renewable energy generation.[558] Third, the critics questioned whether the renewable energy generators can take credit for the emission reductions that occur at fossil fuel-fired facilities.[559] There is currently no mechanism to establish who owns such emission reductions – the renewable energy generator or the fossil fuel-fired generator.[560] Therefore, the comments raised concerns about double counting if both generators take credit for the same emission reduction.[561]

3. Consumer Perception Evidence

Some commenters emphasized the need to research consumer understanding of specific terms and claims in carbon offset advertisements.[562] The commenters, however, did not identify existing consumer perception data in this area.[563] Therefore, the Commission tested certain issues related to carbon offset claims in its consumer research. The study split respondents into two groups – asking one about carbon offsets and the other about carbon neutrality. The research explored respondents' understanding of these terms, whether respondents had seen advertisements for carbon offsets or for products or services described as carbon neutral, and whether they had ever purchased such items.

A significant percentage of respondents demonstrated a general understanding of carbon offsets when they chose from a list of possible descriptions, but a much smaller percentage could describe a carbon offset in their own words. Specifically, in response to a closed-ended question, 41 percent identified a carbon offset as "a way of reducing carbon dioxide and other greenhouse gases," while 35 percent stated that they were not sure

Institute ("SEI"), Carbon Offsets Workshop Tr. at 258-259.

[548] AF&PA, Comment 533254-00042 at 2-3; Anadarko, Comment 533254-00058 at 2; Clean Air Conservancy, Comment 533254-00027 at 1; COPC, Comment 533254-00032 at 3; Edison Electric Institute, Comment 533254-00055 at 11-13; Exelon Corp., Comment 533431-00059 at 2-3; Hydrodec, Comment 533254-00046 at 5-6; REMA, Comment 533254-00028 at 12; The Fertilizer Institute, Comment 533254-00052 at 5; Weyerhaeuser, Comment 533431-00084 at 2.

[549] Anadarko, Comment 533254-00058 at 2.

[550] Hydrodec, Comment 533254-00046 at 6.

[551] Carbon Offsets Workshop participant Edward Holt provided an overview of the issues involved in using RECs to form the basis for carbon offset claims. Holt, Carbon Offsets Workshop Tr. at 150-158.

[552] Adam Stern, TerraPass ("TerraPass"), Carbon Offsets Workshop Tr. at 227-228 (stating that there are reputable organizations such as "the World Resources Institute, The Union of Concerned Scientists, Natural Resources Defense Council, that have all indicated a support for using RECs as an offset value"); Eric Carlson, Carbonfund.org, Carbon Offsets Workshop Tr. at 229-230; CRS, Comment 533254-0049 at 9; Edison Electric Institute, Comment 533254-00055 at 6.

[553] Carbonfund.org, Carbon OffsetsWorkshop Tr. at 229-230; CRS, Comment 533254-00049 at 4; Edison Electric Institute, Comment 533254-00055 at 6. One commenter argued that it "is universally accepted that the generation of renewable energy can displace and reduce the emission of carbon and other greenhouse gases" from conventional facilities. The commenter further stated that the practice is recognized by international offset programs including the United Nations' Clean Development Mechanism of the Kyoto Protocol, the Gold Standard, and the Voluntary Carbon Standard. CRS, Comment 533254-00049 at 11. Some of these commenters, however, cautioned that RECs do not always equate to reduced emissions from conventional facilities, and offset sellers must demonstrate that the reduced emissions are additional. COPC, Comment 533254-00032 at 2-3; CRS, Comment 533254-0049 at 3-7; Offset Quality Initiative, Comment 533254-00047 at 11.

[554] Climate Clean, Comments 533254-00038 at 1-3, 533254-00039 at 3 (stating that use of RECs as offsets is a "uniquely American practice"); Gillenwater, Comment 533254-00006 at 15-16; 533254-00007 at 5 (stating that there is an incentive to rely on RECs as a source of offsets because RECs are generally less expensive than most offset projects); SEI, Carbon Offsets Workshop Tr. at 226-227.

[555] Gillenwater, Comment 533254-00006 at 16 (stating that "the effect of an input of electricity from a renewable generator on other grid-connected generators [*e.g.*, fossil fuel plants] is difficult to quantify"); EcoSecurities, Comment 533254-00044 at 3-4.

[556] *Id.*

[557] EcoSecurities, Comment 533254-00044 at 4 (stating that RECs "are subject to no . . . additionality testing requirements, and require no reference to whether or not the REC market was instrumental in the development of the project"); Climate Clean, Comments 533254-00038 at 2, 533254-00039 at 2-3; *see also* NREL, Carbon Offsets Workshop Tr. at 75-76 (explaining the concept of additionality for RECs).

[558] *Id.*

[559] ERT, Carbon Offsets Workshop Tr. at 225 ("[W]hat you're saying is [that] you own a reduction on someone else's property."); *see also* Gillenwater, Comment 533254-00006 at 14.

[560] Holt, Carbon Offsets Workshop Tr. at 151-152. In contrast, other emission reduction projects have a clear owner who can take credit for the reductions or sell the reductions.

[561] EcoSecurities, Comment 533254-00044 at 10. For example, a renewable energy generator might claim that its RECs represent a reduction in traditional electricity generation and a corresponding reduction in emissions. However, these reductions actually occur at the fossil fuel plant. The fossil fuel plant could argue that, because it produced less energy, it caused the reduction in emissions. The fossil fuel plant could sell offsets that represent the same emission reduction as the RECs.

[562] Vermont Office of Attorney General ("Vermont AG"), Comment 553254-00051 at 5 (writing on behalf of the Offices of the Attorneys General of Arkansas, California, Connecticut, Delaware, Illinois, Maine, Mississippi, New Hampshire, Oklahoma, and Vermont).

[563] *See* Georgia-Pacific, Comment 553254-00059 at 2 ("We do not know of specific, credible surveys or even market sensing studies on this matter."); Rebecca Tushnet, Georgetown University Law Center, Carbon Offsets Workshop Tr. at 82-83 (stating that companies' consumer research is likely to be part of a marketing initiative and, therefore, proprietary). In considering potential consumer research, some noted that consumer interpretation of claims may change over time. *Id.*; Alan Levy, FDA, Carbon Offsets Workshop Tr. at 80; GE AES Greenhouse Gas Services LLC, Comment 533254-00043 at 2.

what a carbon offset was.[564] When asked to describe a carbon offset in their own words, only 18 percent provided an answer which communicated a general understanding of the term, while 58 percent stated that they did not know or provided no response to the question.[565] A much smaller number (11 percent) reported seeing an advertisement for an offset and only two percent actually recalled purchasing a carbon offset.[566]

In a closed-ended question, the study also asked respondents to identify what it meant to be "carbon neutral." Thirty-nine percent of respondents answered that greenhouse gases, such as carbon dioxide, were offset. Twenty-five percent were not sure what "carbon neutral" meant.[567] When asked to describe the term in their own words, 22 percent provided an answer that demonstrated a general understanding of the term, and 35 percent stated that they did not know or provided no answer.[568] Similar to the carbon offset results, few respondents (only 10 percent) recalled seeing an advertisement for carbon neutral products or services, and only four percent stated that they had purchased a product or service at least partly because it was advertised or labeled carbon neutral.

For the subset of respondents who generally understood that carbon offsets were a way to reduce greenhouse gas emissions, the study attempted to gauge their understanding about the timing of greenhouse gas emission reductions.[569] The study asked each respondent to consider an airline advertisement that states: "For every flight you take with us, we will buy carbon offsets to offset the greenhouse gas emissions from your flight." The study explained that the offsets in question involve capturing and destroying methane. It then described two methane projects that both result in reduced emissions, but in different timeframes. The study attempted to gauge respondents' views on whether the timing of the emission reductions was material. For each project, the study asked whether respondents agreed or disagreed with the airline's statement that it offsets the emissions from their flight. When the methane was to be captured "within the next few months," 53 percent of respondents agreed that the airline was offsetting emissions from the flight and 20 percent disagreed.[570] But when the equipment used to capture methane had not yet been installed and the methane was not to be captured "for several years," only 28 percent of respondents agreed that the airline was offsetting emissions from the flight, while 43 percent disagreed.[571]

4. Analysis and Guidance

The Commission proposes to provide only limited guidance regarding carbon offsets in the Guides.[572] Although many commenters urged the Commission to provide detailed advice or extensive regulatory requirements, such an approach is not appropriate at this time given the extent of the Commission's authority, the available consumer perception evidence, and the ongoing policy debates among experts in the field concerning the appropriate tests to substantiate offset claims. However, it is appropriate for the Commission to provide advice to marketers regarding some aspects of carbon offset marketing and we discuss these below. Regardless of the Guides' scope, the Commission may take law enforcement action to stop deceptive practices involving carbon offset marketing pursuant to Section 5 of the FTC Act. For example, clearly deceptive activity, such as knowingly selling the same offset to multiple purchasers, does not need to be addressed in the Guides and, indeed, is best addressed through enforcement actions.

a. Consumer Interpretation of Claims and Disclosures

Some commenters asked the Commission to define terms such as carbon offsets and require sellers to disclose to consumers certain characteristics of their offsets. As previously discussed, under the FTC Act, the Commission has authority to combat deceptive and unfair practices. It does not have authority to develop environmental policies or regulations. Accordingly, the Commission does not create definitions or standards for environmental terms. Rather, it provides guidance to marketers on how consumers understand those terms. The Commission's study suggests that some consumers have a general understanding of carbon offsets and products advertised as carbon neutral, but few reported seeing advertisements for such items, and even fewer have actually purchased them. The study did not identify any pattern of confusion among respondents about what a carbon offset is that would warrant any general FTC guidance. The Commission, therefore, does not believe a discussion about consumer understanding of these terms in the Guides would be useful to marketers. In addition, any such guidance could become obsolete quickly given this rapidly evolving market.

Marketers also requested more detailed FTC guidance with respect to the identification of allowable offset projects and the establishment of uniform methodologies for calculating emission reductions. Such guidance, however, would place the Commission in the role of setting environmental policy, which is outside the agency's authority. The Commission, therefore, declines to do so.

Except as described below, the Commission does not propose advising offset sellers to make certain disclosures, such as the type of projects funded by the offset sales. Although such disclosures may provide helpful information to potential purchasers, there is no evidence on the record to conclude that they are necessary to prevent consumer deception. This distinction is critical under FTC law. Pursuant to the FTC Act, advertisers must disclose information that is necessary to prevent consumers from being misled – not all information that

[564] The other responses were: a way of eliminating all pollution that results from using a product or service; a method for replacing scarce carbon resources; a way of reducing chemical pollutants in water; a way of making carbonated beverages; a laundry additive for removing pencil and ink stains from clothing; and none of the above.

[565] These figures are based on FTC staff's more detailed analysis of responses rather than Harris' general findings. Examples of responses that indicate an understanding of the term include: "A way to reduce greenhouse gases"; "Trees are planted or other environmental restoration is performed to supposedly make up for environmental damage being caused by other activities"; and "A credit on the amount of carbon used in manufacturing process."

[566] Of those few who purchased an offset, 21 percent stated that they were offsetting airline travel, 15 percent automobile travel, and 15 percent lighting.

[567] The other responses were: no pollution was generated in making the product; carbon resources were not used in making the product; water pollutants were reduced to improve water quality; clothing that resists pencil and ink stains; soft drinks that were made without carbonation; and none of the above.

[568] These findings are based on FTC staff's more detailed analysis of responses rather than Harris' general findings. Examples of responses that indicate an understanding of the term "carbon neutral" include: "The amount of carbon created in producing the product is offset by other means that eliminates carbon"; "doesn't have a negative impact in terms of carbon emissions"; and "does not leave a carbon footprint."

[569] As mentioned above, the study asked approximately half of all respondents about carbon offsets (and the remainder about carbon neutral claims). Of the 1,879 respondents who answered carbon offset questions, 770 generally understood carbon offsets. Only these 770 respondents answered questions about the timing of emission reductions.

[570] Additionally, 16 percent stated that they neither agreed or disagreed and 11 percent stated that they were not sure.

[571] Additionally, 16 percent stated that they neither agreed or disagreed and 12 percent stated they were not sure. These figures add up to 99 percent because of rounding.

[572] This proposed guidance can be found in 16 CFR 260.5.

consumers may deem useful.[573] Therefore, the Commission declines to advise marketers to provide such information in every offset advertisement.[574]

b. Timing of Emission Reductions

Some commenters suggested that the Commission advise marketers to disclose the fact that their offsets reflect emission reductions scheduled to occur in the future. The Commission's study, therefore, explored respondents' views on the timing of emission reductions. The results suggest that this timing is important to consumers.[575] Specifically, when emission reductions did not occur for several years, 43 percent of respondents indicated that the carbon offset claim was misleading.[576] Accordingly, marketers may need to qualify their offset claims to avoid deceiving consumers. Absent evidence that consumers view their claims differently, the Commission proposes advising marketers to disclose if the offset purchase funds emission reductions that will not occur for two years or longer.[577] The Commission, however, requests comment on this proposed disclosure.

c. Substantiating Carbon Offset Claims – Tracking Offsets

Like all marketers, carbon offset marketers must ensure that their advertising claims are truthful, not misleading, and substantiated. Section 260.2 of the proposed, revised Guides explains that substantiation for environmental marketing claims often requires competent and reliable scientific evidence. Carbon offset sellers – particularly those new to the market – must pay special attention to this substantiation requirement given the complexities of substantiating offsets. For example, marketers must employ sophisticated accounting protocols to properly quantify the GHG emission reductions that result from a project, as well as rigorous tracking methods to ensure that the reductions are not sold more than once. Although savvy carbon offset marketers likely have these procedures in place already, the Commission proposes adding this point to the Guides to ensure that new market participants are fully informed of their responsibilities.

d. Substantiating Carbon Offset Claims – Additionality

Many aspects of the additionality debate raise unresolved technical and environmental policy issues. Because the Commission does not set environmental standards or policy, establishing a specific additionality test or tests appears to be outside of the FTC's purview. However, in accordance with its responsibility to ensure that consumers are not misled, the Commission proposes issuing guidance regarding regulatory additionality.

When consumers purchase carbon offsets, they expect that they are supporting a reduction in greenhouse gas emissions. If the law mandates a particular emission reduction, however, that reduction will occur whether or not someone buys an offset for the activity. In other words, if a company sells an offset based on a mandatory emission reduction, the purchaser is essentially funding that company's regulatory compliance activities.[578] Therefore, in such situations, the proposed Guides advise marketers that offset sales are deceptive.[579]

The Commission does not propose promulgating guidance on which specific additionality tests sellers must meet to substantiate offset claims. Even if consumers have a vague expectation of "additionality," it is still unclear which test is appropriate to substantiate that interpretation.[580] In addition, there is no consensus among experts in the field about which tests are appropriate. Of course, marketers are free to provide consumers with information about how and why their offset products are additional. While such disclosures may, or may not, be required to prevent deception, depending on the context, they may aid consumers in differentiating various offsets on the market.

e. Substantiating Carbon Offset Claims – Use of RECs

Similar to additionality, the use of RECs as a basis for offset claims involves unresolved technical and policy issues. These issues include the methods marketers should use to demonstrate that the RECs they purchase cause the claimed GHG reductions and which additionality tests they should apply. Further, it is unclear which entity owns the GHG reductions – the renewable energy generator or the fossil fuel-fired facility. Because of this uncertainty, there is a risk of double counting the emission reductions.

It is unlikely that the Commission can provide general guidance on these issues without setting environmental policy, which is beyond the agency's purview. Nevertheless, as with other environmental claims, marketers must substantiate their offset claims. Given the complexity of the issues related to the use of RECs as a basis for offsets, marketers should be cautious that they possess competent and reliable scientific evidence to substantiate their claims and ensure that the emission reductions are not double counted.

VII. Request for Comment

The Commission invites comment on all issues raised in this Notice, including all aspects of the proposed, revised Green Guides. In addition, the Commission requests responses to the following specific questions:

1. Do consumers interpret general environmental claims, when qualified by a particular attribute, to mean that the particular attribute provides the product with a net environmental benefit? Please provide any relevant consumer perception evidence. Should the Commission advise marketers that a qualified-general environmental claim is deceptive if a particular attribute represents an environmental improvement in one area, but causes a negative impact elsewhere that makes the product less environmentally beneficial than the product otherwise would be? Why or why not?
2. Would it be helpful to include an example in the Guides illustrating a qualified general environmental claim that is nevertheless deceptive? For example, a marketer advertises its product as "Eco-friendly sheets - made from bamboo." Consumers would likely interpret this claim to mean

[573] FTC Deception Policy Statement, 103 F.T.C. at 165.

[574] In some contexts, sellers may nevertheless wish to disclose this information to differentiate their offsets.

[575] As discussed above, this finding is based on the subset of respondents who generally understood carbon offsets. Despite the smaller sample size, the Commission relies on these findings because they provide the only available consumer perception evidence upon which to base guidance.

[576] The study asked respondents about an airline's statement that it would buy carbon offsets to offset the greenhouse gas emissions from their flight.

[577] Additionally, the Commission proposes advising offset marketers that they should not state or imply that their products have already reduced emissions or will do so in the near future if, in fact, the reductions will occur at a significantly later date.

[578] *See* Anadarko, Comment 533254-00058 at 5 (stating that it is reasonable for consumers to assume, absent any disclaimers to the contrary, that the GHG reduction was not taken to meet regulatory requirements).

[579] The Commission notes that this guidance represents its interpretation of the FTC Act. In the future, other agencies may issue comprehensive carbon offset regulations that address these issues more specifically.

[580] *See* Holt, Carbon Offsets Workshop Tr. at 165 (stating that consumers expect their carbon offset purchase to "make a difference," and that "making a difference means that it's additional to what would have happened otherwise," but noting that there is still a debate about how to determine what is additional); WRI, Carbon Offsets Workshop Tr. at 166.

with respect to the applicability of section 2(h)(7) to the CFI contract.[17]

Weinstein opines that the CCX offset project protocols "do not conform to the stringent additionality [18] and leakage standards [19] that are in the carbon offset contracts * * * accepted by the broader market." Consequently, Mr. Weinstein asserts that "the absence from the CCX CFI contract of the most essential requirements for commonality with other carbon offset contract prevents market participants from using the CFI contracts for material price reference, arbitrage, and settlement and execution of transactions." The environmental requirements of the CCX offset protocols are beyond the scope of the Commission authority, and this inquiry was limited to an evaluation whether the CCX CFI contract might satisfy the material liquidity and material price reference statutory criterion for a SPDC determination.

ICE expressed an opinion that "the CFI does not serve a significant price discovery function and the Commission may exceed its jurisdiction if it determines that the CFI serves as a significant price discovery contract." ICE observed that the CCX CFI contract fails the threshold for material liquidity because "each [CCX CFI contract] vintage may trade less than twice a day." Consequently, ICE concluded that "a trade every couple of hours does not equate to the "ability to transact immediately" or "a more or less continuous stream of prices." As noted above, after a thorough review of supplemental data provided for the CCX CFI contract, Commission staff concluded that different CCX CFI vintages should be considered as separate CCX contracts. When analyzed in this manner, the CCX CFI contracts do not meet the material liquidity criterion for SPDC determination.

When analyzing the material price reference factor for a CCX CFI SPDC determination, ICE commented that "under the Commission's theory, any spot contract automatically serves as a material price reference, simply because the *contract references itself*" (emphasis in original). Additionally, ICE expresses an opinion that "by making this determination [the CCX CFI contract is a SPDC], the Commission is broadly asserting jurisdiction over the spot market if the spot contract is electronically traded." In response, the Commission notes that Section 2(h)(7), refers to "any agreement, contract or transaction conducted in reliance on the exemption" in Section 2(h)(3) and does not require that the Commission find that a potential SPDC contract is a commodity futures or options contract. The determination to list particular instruments in reliance on the Section 2(h)(3) exemption is made by the ECM, not the Commission, when the ECM files notice with the Commission, under Section 2(h)(5), of its reliance on such exemption. Section 2(i) of the CEA reinforces the view that instruments traded on 2(h)(3) markets may include non-futures products; that section states that there is no presumption that an agreement, contract or transaction exempted under section 2(h)(3) "is or would otherwise be subject to this chapter."

VI. Findings and Conclusion

In consideration of the initial and supplemental information provided by CCX, the comments received in connection with the **Federal Register** notice and all other relevant information, the Commission has determined that the CCX CFI contract does not, at this time, perform a significant price discovery function. Accordingly, as set forth in the Commission's Order, CCX is not required to comply with Commission Rule 36.3(c)(4) applicable to ECMs with SPDCs, or otherwise to assume the statutory and regulatory responsibilities of a registered entity with respect to the CFI contract. The Reauthorization Act amended the CEA to require that the Commission evaluate not less than annually all agreements, contracts and transactions conducted on an ECM in reliance on the exemption in section 2(h)(3) to determine whether they serve a significant price discovery function.[20] In addition, the Commission routinely monitors contracts traded or executed in reliance on section 2(h)(3) and reviews all ECM submissions on an ongoing basis for the presence of SPDCs. Accordingly, like all ECMs, CCX remains responsible for compliance with the reporting requirements described in Rule 36.3(a) and (b).

VII. Related Matters

A. Paperwork Reduction Act

The Paperwork Reduction Act of 1995 ("PRA") [21] imposes certain requirements on federal agencies, including the Commission, in connection with their conducting or sponsoring any collection of information, as defined by the PRA. Certain provisions of final Commission Rule 36.3 impose new regulatory and reporting requirements on ECMs, resulting in information collection requirements within the meaning of the PRA; OMB previously has approved and assigned OMB control number 3038–0060 to this collection of information.

B. Cost-Benefit Analysis

Section 15(a) of the CEA [22] requires the Commission to consider the costs and benefits of its actions before issuing an order under the Act. By its terms, section 15(a) does not require the Commission to quantify the costs and benefits of an order or to determine whether the benefits of the order outweigh its costs; rather, it requires that the Commission "consider" the costs and benefits of its action. Section 15(a) further specifies that the costs and benefits shall be evaluated in light of five broad areas of market and public concern: (1) Protection of market participants and the public; (2) efficiency, competitiveness, and financial integrity of futures markets; (3) price discovery; (4) sound risk management practices; and (5) other public interest considerations. The Commission may in its discretion give greater weight to any of the five enumerated areas and could in its discretion determine that, notwithstanding its costs, a particular order is necessary or appropriate to protect the public interest or to effectuate any provisions or accomplish any of the purposes of the Act.

When a futures contract begins to serve a significant price discovery function, that contract, and the ECM on which it is traded, warrants increased oversight to deter and prevent price manipulation and other disruptions to market integrity, both on the ECM itself and in any related futures contracts trading on DCMs. An Order finding that a particular contract is a SPDC triggers

requests that firms be required to have collateral in excess of two times their average end of daily trade value in order to participate in this market. CL 01.

[17] *See* supra note 7. The commenters who raised substantive issues with respect to the applicability of section 2(h)(7) to the CFI contract are Jeremy D. Weinstein, Esq., owner of the law offices of Jeremy D. Weinstein, a professional corporation located in Walnut Creek, California and IntercontinentalExchange, Inc., operator of regulated exchanges, trading platforms and clearing houses serving the global markets for agricultural, credit, currency, emissions, energy and equity index markets headquartered in Atlanta, Georgia, U.S.

[18] There are a number of interpretations of the additionality concept in application to the environmental offset projects. The most popular interpretations are "environmental additionality" where a project is additional if the emissions from the project are lower than the baseline, and "project additionality" where the project must not have happened without the Clean Development Mechanism (CDM).

[19] Leakage generally refers to the increase in emissions outside the project boundary that occurs as a consequence of the project activity's implementation.

[20] Section 2(h)(7)(D)(ii), 7 U.S.C. 2(h)(7)(D)(ii).

[21] 44 U.S.C. 3507(d).

[22] 7 U.S.C.19(a).