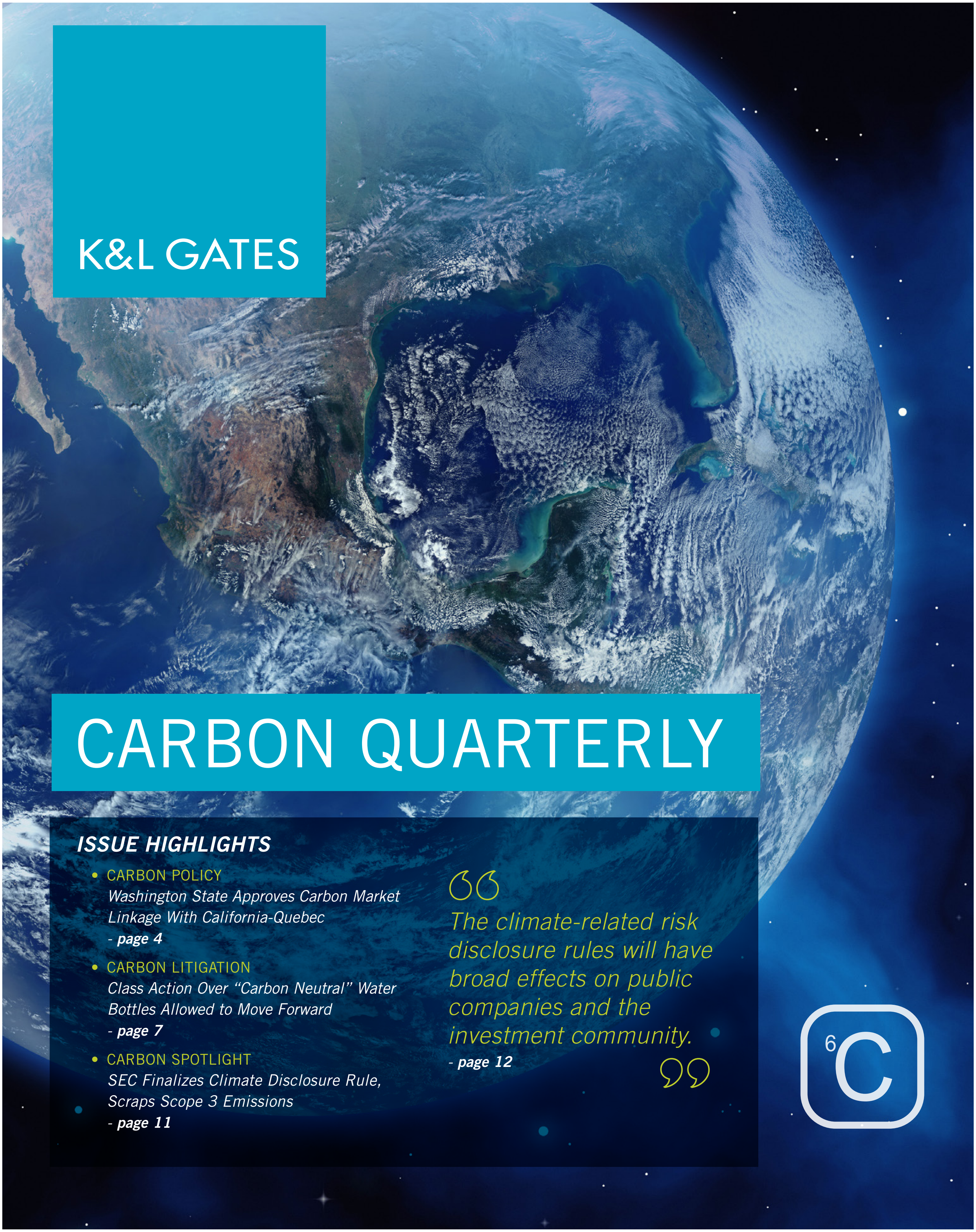

K&L GATES

CARBON QUARTERLY

ISSUE HIGHLIGHTS

"The climate-related risk disclosure rules will have broad effects on public companies and the investment community."
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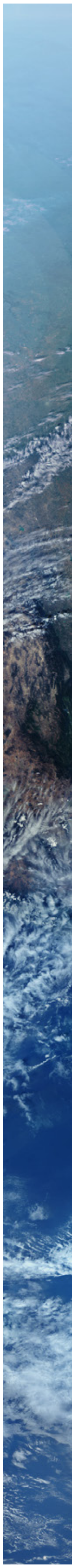


What's Inside

No matter your views on climate change policy, there is no avoiding an increasing focus on carbon regulation, resiliency planning, and energy efficiency at nearly every level of government and business. Changes in carbon—and, more broadly, greenhouse gas—policies have the potential to broadly impact our lives and livelihoods.

Covering developments in carbon policy, law, and innovation, *Carbon Quarterly* is a collaborative effort of our lawyers in the Asset Management and Investment Funds; Corporate; Energy, Infrastructure, and Resources; Real Estate; and Policy and Regulatory practice groups.

Carbon Policy

DEPARTMENT OF ENERGY SUED OVER CRYPTO MINING DATA COLLECTION

In February 2024, a pair of cryptocurrency groups sued the US Department of Energy (DOE) over the agency's plans to begin tracking electricity consumption by crypto mining operators.[i] The lawsuit comes on the heels of the DOE's Energy Information Administration's emergency data request issued in January 2024, amid rising concerns about energy consumption, strained grids, power prices, and emissions tied to cryptocurrency mining.[ii] The complaint was filed by the New Civil Liberties Alliance, a conservative legal nonprofit, on behalf of the Texas Blockchain Council and Riot Platforms, a bitcoin mining firm.[iii] Backed by the Chamber of Digital Commerce, the complaint asked a Texas district court judge to block the emergency data request, arguing that it was "unlawfully approved" by the Office of Management and Budget.[iv]

The DOE has since dropped its emergency power-use survey, ending the litigation against the effort.[v] An agreement filed with the Texas district court judge states that the Energy Information Administration will destroy any information received to date.[vi] The agency is still hopeful about providing the public with a better understanding of cryptocurrency's energy usage, and it will revive data gathering efforts after going through a formal regulatory notice-and-comment process.[vii]

Recent events, such as the inception of recent SEC-approved bitcoin exchange-traded funds have continued to drive cryptocurrencies into the mainstream, and it is likely that the DOE will increase its focus on the sector's energy usage as a result. Additionally, publicly traded cryptocurrency mining companies will likely fall within the ambit of the SEC's newly adopted climate-related risk disclosure rule, as discussed in the "Climate Spotlight" portion of this newsletter.[viii]

HOW MUCH CARBON DOES ONE CARBON CREDIT HOLD?

Presumptively, one carbon credit is supposed to represent one ton of carbon dioxide (CO_2) emissions sequestered or avoided. But calculating credits for a forest carbon credit system is anything but straightforward. This issue is front and center in a greenwashing lawsuit brought against Delta Airlines for claims it made about net neutrality based on forest carbon credits. In that case, Delta Airlines was accused of relying on overvalued offsets derived from projects claiming to prevent rainforest deforestation.[xi] (See the Carbon Litigation section below for details on this litigation.)

At the most basic level, a forest carbon project developer must demonstrate how much more carbon was sequestered as a result of its carbon sequestration project (e.g., improved forest management practices) than would have occurred under business-as-usual circumstances (e.g., clear-cut harvests).[x] This concept is referred to as "additionality." But how much carbon a forest sequesters depends on numerous factors, including forest age; composition of tree-species; harvest rotation schedule; what timber products are produced from harvesting and how long those products store carbon; and natural disturbances, such as fire and disease, or man-made disturbances, such as thinning, among many others.[xi]

Because this calculation can be complex, no forest will have the same ideal forest management practices, which makes investment decisions challenging for third-party investors.

On the one hand, many groups have challenged the climate value of forest carbon credit programs, frequently raising claims that the number of credits produced are highly inflated from the amount of carbon actually sequestered.[xii]

On the other hand, the Washington Forest Protection Association (WFPA), a Washington state trade association of private timberland owners, in partnership with other timber trade organizations, argues the sequestration potential of wood products is grossly underestimated.[xiii] WFPA makes the argument in the newly released "Working Forests Carbon Blueprint" for why more forest land in the state should be actively managed the way large private forests are managed due to the increased carbon storage potential.[xiv] The blueprint argues, in addition to carbon storage potential, actively managed forests have reduced mortality, are at less risk to wildfire, and are less pressured by market forces for housing development.[xv] Furthermore, wood as a building material requires less fossil-fuel energy to use than other building materials. The blueprint sets three goals for Washington forests: (1) grow markets for forest products; (2) grow healthy productive forests; and (3) improve the carbon footprint across the value chain.[xvi]

Oregon State University conducted a study to identify the optimal harvest period to maximize carbon sequestration of working forests.[xvii] The study found, for highly productive stands, the stands that add biomass quickest—60-year rotation periods with low-intensity thinning at 40 years—led to the greatest carbon storage, whereas on less productive stands, the stands that grow more slowly—rotation periods of 80–120 years with multiple thinnings—were more optimal.[xviii] Many timberlands are harvested when they reach maximum annual growth rate, usually around 40 years.[xix] But growth continues beyond this point and, as this research demonstrates, carbon sequestration potential does as well.[xx]

Others emphasize the carbon sequestration value of letting trees grow old. Professor Runsheng Yin from Michigan State University argues in his new book—"Global Forest Carbon: Policy, Economics and Finance"—that reforestation after timber harvest will not counteract the carbon output created by cutting down the trees in the first place.[xxi] Professor Yin recognizes the uncertainty in carbon credit calculations and calls for more rigorous accounting and assessments of forest carbon storage schemes.[xxii] A scientific study in *Nature* published

November 2023 seems to support Professor Yin's position stating, "reductions in harvesting intensity and forest degradation can deliver important climate benefits."[xxiii]

As these technical issues are resolved, investors and buyers of carbon credits will be faced with tough questions regarding the accuracy and durability of forest-based credits.

STATES RESPOND TO THE TIMBER TAX GAP

States and local governments are responding to the increasing number of timberlands that are being tied up in carbon credit programs out of concern for the loss of local tax revenue and employment in the wood products industry.

On 28 February 2024, with bipartisan support, the West Virginia Senate passed SB 618, which would require forest carbon credits generated from property in the state to be registered and sold on a state-controlled carbon credit exchange administered by the Division of Forestry.[xxiv] The West Virginia Senate quashed a companion bill that would have implemented a severe excise tax on carbon credits generated in the state and a 20-year limit on agreements to capture or sequester carbon.[xxv] As of 15 April 2024, SB 618 remains under review in the West Virginia House of Delegates.

Similar action is playing out differently in New Hampshire. Concerned about timberlands being locked up for long periods of time, a proposed bill, HB 1697, set a two-year moratorium on new carbon trading programs in the New Hampshire House of Representatives was introduced. The bill was ultimately replaced with an impact study on the effects of carbon credit programs on timber tax revenues and the creation of a registry for property enrolled in carbon credit programs.[xxvi] Other proposed legislation includes a tax on uncut trees above the baseline during normal timber harvest operations.[xxvii] The New Hampshire Senate held a hearing to review HB 1697 on 9 April 2024.[xxviii]

According to Charles Levesque, president of Innovative Natural Resource Solutions, LLC, only 10 properties, covering less than 200,000 acres in New Hampshire, are enrolled in carbon credit programs.[xxix] However, the consequences for local governments that rely heavily on timber taxes could be substantial. The town of Pittsburg, New Hampshire, is the site of one of the largest carbon credit programs in the state.[xxx] Twenty percent of Pittsburg's budget comes from timber taxes.[xxxi] With an anticipated 50% drop in harvest under the new carbon credit program, Pittsburg is looking at a substantial budget hole.[xxxii] The loss of jobs associated with logging and milling may lead to a further drop in the town's tax revenue.

WASHINGTON STATE APPROVES CARBON MARKET LINKAGE WITH CALIFORNIA-QUEBEC

On 28 March 2024, the governor of Washington signed a bill to link Washington's carbon market, established in the Climate Commitment Act of 2021 (CCA), with the California-Quebec carbon market, sometimes referred to as the Western Climate Initiative (WCI).[xxxiii] According to a Washington Department of Ecology (Ecology) analysis report, combining the markets would stabilize carbon allowance prices and likely lead to lower costs for industry compliance. The state hopes that by combining its market, the price of energy and automotive gas will decline.[xxxv]

The CCA had linkage with WCI in mind when it was created. The CCA directs the Washington Ecology to "seek to enter into linkage agreements with other jurisdictions" and charges Ecology's director with negotiating and signing such an agreement.[xxxvi] In response to this directive, Ecology announced on 2 November 2023 that it would pursue linkage with WCI.[xxxvii] Ecology proposed the bill, which was signed on 28 March, to tweak the CCA to better facilitate linkage with WCI.[xxxviii]

Although the bill has been signed into law, market linkage will still require negotiation and approval with the California and Quebec governments through the procedures outlined in the WCI framework.[xxxix]

This is happening while Washingtonians will be asked to decide on a voter-led initiative to repeal the CCA in November.[xl]

CALIFORNIA PROVIDES GRANT TO CITRUS GROWERS IN SUPPORT OF HEALTHY SOILS

As part of California's ongoing Healthy Soils Block Grant Program, the California Department of Food and Agriculture authorized a US$5 million grant to the California Citrus Quality Council (CCQC) specifically to support citrus growers' implementation of healthy soils management practices.[xli] Among other benefits, the Healthy Soils Block Grant Program is intended to support and encourage the establishment of healthy soils that serve as natural carbon sinks, reducing atmospheric CO_2.[xlii]

To qualify for the grant, applicants must commit to implementing at least one conservation management practice authorized by the Healthy Soils Block Grant Program, which includes planting pollinator hedgerows, cover crops, compost application, mulching, whole orchard recycling, and windbreak establishment.[xliii]

The grant is available to citrus growers in nine California counties: Fresno, Ventura, Kings, Kern, San Bernardino, Imperial, Riverside, Tulare, Santa Barbara, Placer, and San Diego.[xliv] Individual grants to citrus growers may be up to US$200,000.[xlv] Enrollment opened 25 March 2024, and the grant period is expected to run from July 2024 to November 2027.[xlvi] The grant is administered by the California Farm Bureau through its science and research nonprofit, the California Bountiful Foundation.[xlvii]

WASHINGTON DEPARTMENT OF NATURAL RESOURCES DESIGNATES 10,000 ACRES OF FORESTLAND FOR INCLUSION IN CARBON MARKETS

Washington's Department of Natural Resources (DNR) is entering the carbon market, as it has moved an estimated 10,000 acres of Western Washington forestland into conservation status to store carbon and generate revenue for state trust land beneficiaries.[xlviii] The DNR has taken the designated acres immediately out of all future harvest plans, and it will lease the forests for carbon sequestration and storage activities at a price reflective of the economic value of logging.[xlix] According to the DNR, it is the first state agency in the United States to use the carbon markets to protect critical forest areas by removing stands from the planned harvest schedule.[l]

The DNR estimates that more than 900,000 carbon offset credits will be generated from this project in the first 10 years, equivalent to more than two billion miles driven by gas-powered cars.[li] The DNR has partnered with Finite Carbon as the developer for the project. The first phase of this project will launch in Whatcom, Thurston, King, and Grays Harbor counties.[lii]

USDA HITS ANOTHER MILESTONE IN IMPLEMENTATION OF THE GROWING CLIMATE SOLUTIONS ACT

On 27 February 2024, the US Department of Agriculture (USDA) published the "Justification Report: Intent to Establish the Greenhouse Gas Technical Assistance Provider and Third-Party Verifier Program" (the Report) as the latest deliverable under the Growing Climate Solutions Act (GCSA), which was signed into law on 29 December 2022 as part of the Consolidated Appropriations Act of 2023.[liii] This follows the USDA's publication of "A General Assessment of the Role of Agriculture and Forestry in the U.S. Carbon Markets" (the General Assessment) on 23 October 2023.[liv]

The GCSA is intended to establish frameworks and systems by which the USDA can assist farmers, ranchers, and forest landowners to generate carbon credits by adopting practices to reduce emissions or sequester carbon.[lv] The General Assessment, as the first deliverable under the GCSA, identified a number of barriers that have hindered the participation of landowners in carbon markets, and it discussed the USDA's role in facilitating participation.[lvi] The barriers identified included market confusion, limited return on investment, high transaction costs, limited opportunities for early adopters to access markets, stringent permanence requirements, small scale of agriculture projects, and lack of demand.[lvii]

The Report explains the USDA's reasoning in moving forward with establishing the Greenhouse Gas Technical Assistance Provider and Third-Party Verifier Program (the Program) as authorized by the GCSA. Ultimately, the USDA's decision to establish the Program was based on the determination that the Program will lessen barriers to voluntary carbon market participation and create new opportunities for farmers, ranchers, and private forest landowners.[lviii] While the Report acknowledges that the Program cannot address all barriers identified in the General Assessment, it will enable the USDA to serve as a trusted authority on relevant carbon market information.[lix] The Program will provide educational resources and greater transparency of carbon credit market opportunities in the agriculture and forestry markets.[lx] Further, the Program will provide greater information on basic market structure and roles and qualifications of different entities within carbon markets, as well as relevant contact information for market participants, including technical assistance providers and third-party verifiers.[lxi]

The USDA is seeking public comment prior to implementation of the Program.[lxii]

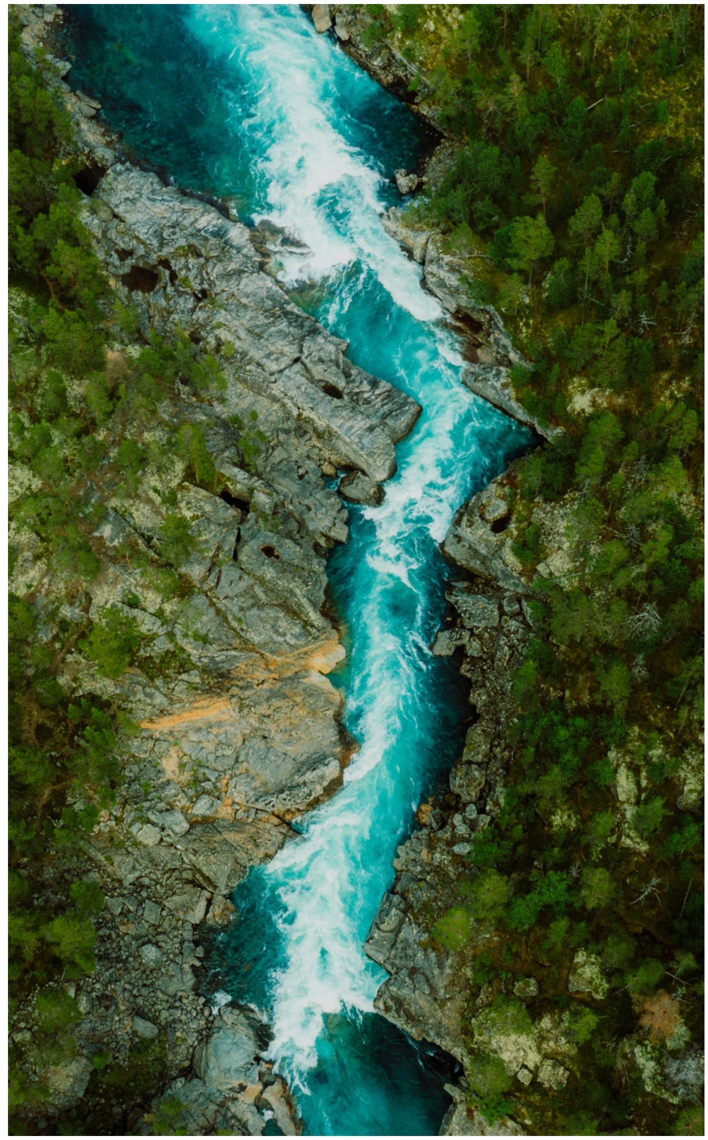
DOE ISSUES CHALLENGE TO BUY CARBON CREDITS

On 14 March 2024, the DOE launched a Voluntary Carbon Dioxide Removal Purchasing Challenge (CO_2 RP Challenge).[lxiii] The CO_2 RP Challenge calls on private organizations to join the DOE in purchasing high-quality CO_2 removal (CDR) credits.[lxiv] Previous DOE programs for CDR research and development target the supply of CDR credits, such as the "Carbon Negative Shot" initiative announced at COP26 in 2021.[lxv] In contrast, the CO_2 RP Challenge focuses on increasing demand for carbon credits.[lxvi]

The DOE is asking private organizations to join it following its August 2023 announcement of the CDR Purchase Prize.[lxvii] The CDR Purchase Prize is a first-of-a-kind government purchasing program for permanent CDR credit purchasing.[lxviii] The CDR Purchase Prize will award up to US$35 million of CDR credit purchases across four areas of interest: (1) direct air capture; (2) enhanced CO_2mineralization; (3) biomass carbon removal with storage; and (4) other planned and managed carbon sinks with secure geological storage or equivalent.[lxix] The DOE is considering applications submitted in December 2023 and will announce the 25 semifinalists for the highest-quality CDR Credit Concept proposals in the spring of 2024.[lxx]

To join the CO_2 RP Challenge, buyers need to purchase and retire permanent CDR annually, aligned with the requirements and assessment criteria of the DOE's purchases, starting no later than 2025.[lxxi] Buyers will also need to disclose to the DOE every associated CDR purchase in a public inventory.[lxxii] The CO_2 RP Challenge is intended to consolidate CDR credit purchasing efforts across private organizations that align with the DOE's Negative Carbon Shot implementation strategy.[lxxiii]

The DOE also will consider another round of suppliers using the process implemented for the CDR Purchase Prize; however, no additional funds will be awarded.[lxxiv] By conducting a second-round evaluation of suppliers, the DOE will connect viable projects with the potential buyers from the CO_2 RP Challenge.[lxxv]



Carbon Litigation

CLASS ACTION OVER "CARBON NEUTRAL" WATER BOTTLES MOVES FORWARD

On 10 January 2024, US District Judge Nelson Roman for the Southern District of New York ruled that Danone Waters of America (Danone), the maker of Evian-branded water bottles, must face a lawsuit over its "carbon neutral" claim on the label of its Evian spring water.[lxxvi] The putative class-action lawsuit claims that the water bottles are not actually carbon neutral due to alleged emissions of CO_2 during the manufacturing process. Plaintiffs claim that, had they known this fact, they would not have bought the Evian-branded water at a premium price.[lxxvii] Danone had argued that the logo was independently certified by the Carbon Trust and that no reasonable consumer would believe that producing and shipping the product is a CO_2-free process.[lxxviii] Rather, Danone relied on Merriam-Webster's dictionary definition of "carbon neutral" as "having or resulting in no net addition of carbon dioxide to the atmosphere."[lxxix]

In the 30-page decision, the judge cited ambiguity in the term "carbon neutral" and said that Danone "expects too much" of consumers.[lxxx] The judge noted that the plaintiffs may pursue fraud, unjust enrichment, and breach of express warranty claims, along with other claims under California and Massachusetts consumer protection laws. Comparable claims under New York laws were dismissed, but the judge granted plaintiffs leave to amend their complaint.[lxxxi]

Brands should pay close attention to sustainable advertising claims due to the rapidly increasing litigation in this area. The lawsuit is among hundreds of proposed class actions filed every year challenging the labeling practices of food producers.

DELTA AIRLINES SUED FOR "GREENWASHING"

On 28 March 2024, in the latest development to the ongoing class action against Delta Airlines for alleged "greenwashing," the US District Court for the Central District of California dismissed two California statutory claims under the state's False Advertising Law and Unfair Competition Law.[lxxxii] The court allowed plaintiffs leave to amend to seek an alternative remedy or continue seeking equitable relief for future harms rather than past harms alleged.[lxxxiii] The class action complaint was originally filed against Delta Airlines on 30 May 2023, alleging that Delta Airlines' environmentally friendly representations were false and misleading due to an unreliable carbon offset market.[lxxxiv]

The original complaint, filed by Mayanna Berrin as representative for the putative class of consumers, alleged that Delta Airlines is "grossly misrepresenting the total environmental impact of its business operation in its advertisements, corporate announcements, and promotional materials, thereby attaining undeserved market share and extracting higher prices from consumers."[lxxxv] The suit was filed in the US District Court for the Central District of California and cites violation of three California consumer protection statutes:

1. Consumers Legal Remedies Act (California Civil Code § 1750, et seq.)
2. False Advertising Law (Business and Professions Code § 17500, et seq.)
3. Unfair Competition Law (Business and Professions Code §17200, et seq.)

Carbon neutrality claims have become more common as of late due to the reliability issues plaguing the carbon offset market. Plaintiffs argue that these markets suffer from inaccuracies in accounting; questionable crediting practices; delayed emissions reductions; and impermanent projects susceptible to disease, natural disasters, and human intervention.[lxxxvi]

Greenwashing suits have risen in recent years in tandem with an increase in disclosures related to ESG metrics.[lxxxvii] Companies seeking to promote carbon reduction achievements should exercise caution in their public disclosures to avoid overstatements that could lead to such litigation.

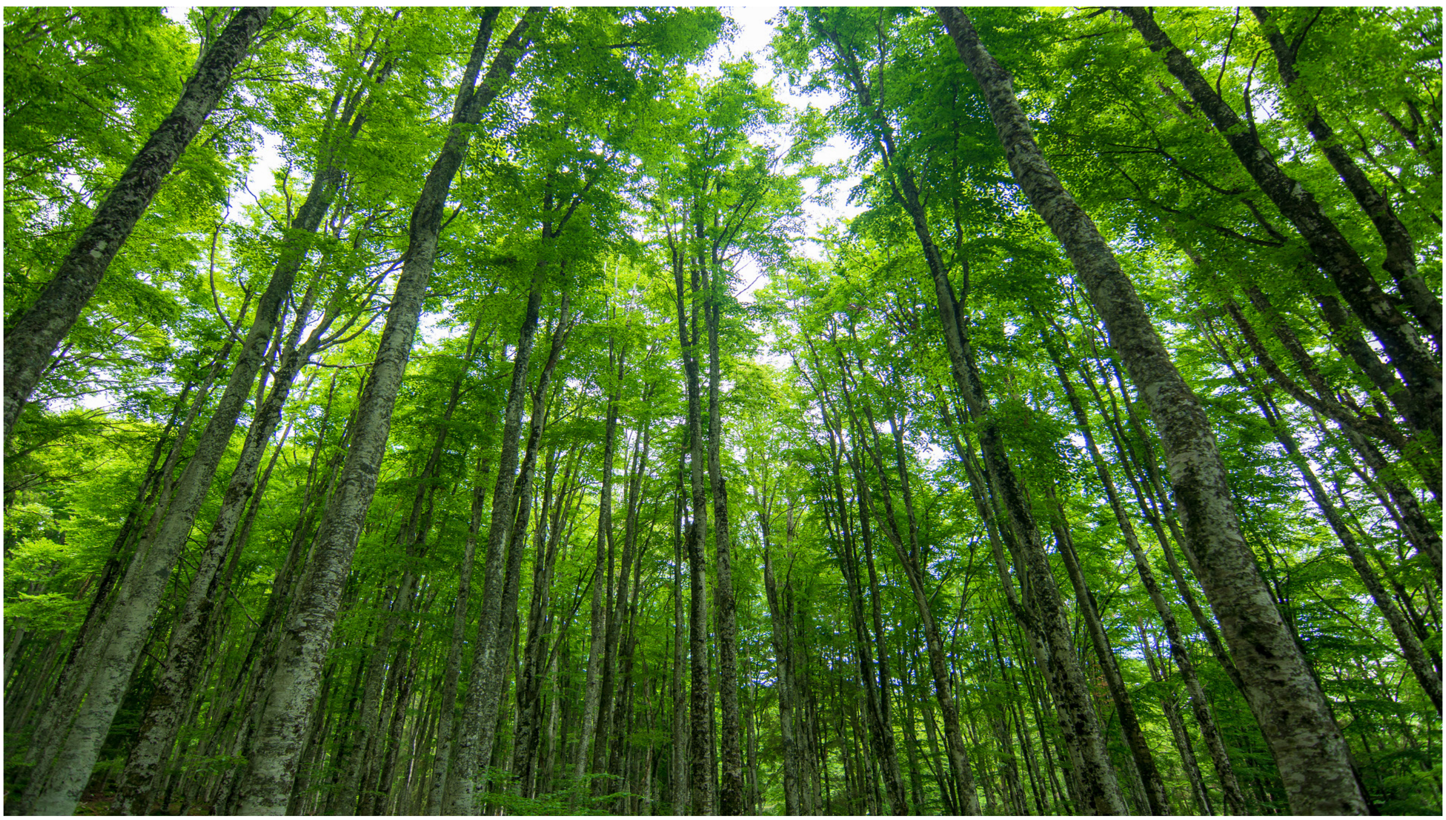
FOREST SERVICE IN LAWSUIT DEFENDING ITS ACCOUNTING FOR CARBON IN NATIONAL FOREST SYSTEM PROJECTS

On 26 February 2024, conservation groups filed a lawsuit in the US District Court for the District of Columbia alleging the USDA and the US Forest Service (USFS) set a goal to increase timber harvest nationally without accounting for the aggregate carbon effects of this goal, in violation of the National Environmental Policy Act (NEPA).[lxxxviii] The conservation groups allege that when the USFS considers carbon effects at the individual project level, it finds them too small to be consequential because it is only looking at one project at a time.[lxxxix] Worse, they argue, in most projects the USFS does not consider carbon effects at all.[xc] The conservation groups are asking the court to declare the USDA and USFS actions a violation of NEPA and enjoin the defendants from offering new timber sales in specified regions or implementing certain timber-harvest projects until a proper review can be conducted.[xci]

A similar case recently decided in Washington challenged the state's DNR for considering the general effects of timber sales in the state as a net positive for climate mitigation but failing to consider the negative climate effects of harvesting a specific tract of mature second-growth forest.[xcii] The King County Superior Court halted the timber sale at issue in a ruling on 28 March 2024.[xciii] The Court held DNR's Determination of Nonsignificance for the project's climate impacts was clearly erroneous because DNR did not quantify the project-specific emissions or assess the loss of sequestration capacity from logging the sale area.[xciv] This is in contrast to the USFS case where the plaintiffs allege the USFS only considered climate impacts at the project-level.

A change to regional or national accounting for carbon storage in the National Forest System, as demanded in the USFS litigation, would likely slow down project development in the environmental review process. It is unknown whether it would result in a reduction in timber targets.

Permitting reform—specifically NEPA—has been a central topic in Washington, and similar discussions have been ongoing in various state governments.[xcv] With the burst of infrastructure projects following the Bipartisan Infrastructure Bill and the Inflation Reduction Act, a substantial backlog in the permitting process has arisen.[xcvi] California and New York have revised their environmental permitting processes to require permits to be issued under strict timelines and require interagency coordination to avoid duplicitous review. Bipartisan groups of US lawmakers, led by Senator Joe Manchin, have called for similar reforms at the national level, although those efforts have stalled in Congress.[xcvii]



Carbon Trading and Investment

CFTC ISSUES PROPOSED GUIDANCE REGARDING THE LISTING OF VOLUNTARY CARBON CREDIT DERIVATIVE CONTRACTS

On 4 December 2023, the Commodity Futures Trading Commission (CFTC) proposed new guidance regarding the listing for trading of voluntary carbon credit (VCC) derivative contracts.[xcviii] The proposal outlines factors that designated contract markets (DCMs), which are CFTC-registered derivatives exchanges, should consider under statutory "Core Principles," set forth in the Commodity Exchange Act (CEA) and applicable CFTC rules and regulations, in determining whether to list VCC derivatives contracts.[xcix]

VCCs, which represent the reduction or removal of one metric ton of CO_2 from the atmosphere, are tradable intangible instruments. VCCs are regulated as "commodities" by the CFTC, in the same manner as oil, gold, wheat, and certain types of digital assets. The CFTC has the authority to police fraud and manipulation in the VCC physical (spot and forward) contract markets, but the CFTC's broader regulatory authority applies only to derivatives based on underlying VCCs.

Following the Voluntary Carbon Market Convenings, held by the CFTC on 2 June 2022 and 19 July 2023, the CFTC received input from industry participants about the lack of universal standards for high-integrity VCCs.[c] According to CFTC Chairman Rostin Behnam, the feedback received by the CFTC reflected broad agreement regarding the need to "strengthen market integrity, transparency, and liquidity for derivatives with underlying VCCs that are real, additional, permanent, verifiable, and represent unique metric tons of greenhouse gase (GHG) emissions reduced or removed from the atmosphere."[ci] Although the CFTC cannot directly regulate the quality of VCCs underlying derivatives contracts, the proposed guidance sets out obligations that DCMs must consider in determining whether to list VCC derivative contracts for trading.[cii] Under the proposal, DCMs would be obligated to review and evaluate the requirements applicable to the issuance of the underlying VCCs.[ciii] This process would require DCMs to consider, among other factors, the quality of the VCCs, the delivery points and facilities related to the VCCs, and the third-party validation and verification practices applied to the VCCs.[civ]

DCMs would also need to ensure that a VCC derivative contract's terms and conditions align with the latest certification standards and be able to provide the CFTC with a thorough, qualitative explanation regarding the VCC derivative contract's satisfaction of the listing requirements under the CEA and the applicable CFTC rules.[cv]

The period for submission of public comments on the proposed guidance closed on 16 February 2024.[cvi] Various groups commented that the CFTC was actually trying to regulate carbon credits themselves, rather than the derivatives contracts based on those credits, and warned the CFTC that DCMs do not have the expertise required to evaluate the quality of carbon credits.[cvii] Other commenters praised the CFTC's efforts to push DCMs to verify the quality of underlying carbon credits.[cviii]

The final guidance regarding the listing for trading of VCC derivative contracts will likely be published in 2024 after the CFTC has reviewed the public comments.

ISDA PUBLISHES VERSION 2.0 OF ITS VERIFIED CARBON CREDIT DEFINITIONS

On 7 February 2024, the International Swaps and Derivatives Association (ISDA)—a global derivatives industry trade association—published Version 2.0 of its Verified Carbon Credit (VCC) Definitions.[cix] Like the "voluntary carbon credits" defined by the CFTC, "verified carbon credits," as defined by ISDA, represent the removal, reduction, avoidance, sequestration, or mitigation of one metric ton of CO_2 equivalent (CO_2e).[cx] The VCC Definitions are part of ISDA's broader effort to support the transition to a green economy by developing robust legal and risk management standards for transactions related to ESG activities.[cxi]

Specifically, the VCC Definitions—like the other definitions published by ISDA for a variety of asset classes—are a standard set of terms that can be used by derivatives market participants in all over-the-counter transactions that incorporate the VCC Definitions by reference.[cxii] The VCC Definitions are intended to be used in trade confirmations for physically settled spot, forward, or option verified carbon credit transactions, and ISDA has published template confirmations for these types of transactions as well.[cxiii] Importantly, the VCC Definitions are drafted generically so that they can be used in any jurisdiction, and they are carbon standard and registry agnostic.[cxiv]

Unlike the CFTC, as mentioned in the previous article, ISDA chose to use the term "verified" rather than "voluntary" to refer to verified carbon credits due to a growing market preference for the term.[cxv] This preference reflects acceptance of the premise that the project generating the relevant reduction, removal, sequestration, or avoidance of GHG emissions from the atmosphere must be verified by a carbon standard as a condition to issuance of a verified carbon credit.[cxvi]

Version 2.0 of the VCC Definitions allows parties to specify a fixed payment date (rather than payment occurring a certain number of days after delivery) and, in respect to a verified carbon credit spot transaction or verified carbon credit forward transaction, to elect "prepayment" so that payment will take place before delivery.[cxvii] Under the updated payment provisions of Version 2.0, unless otherwise specified in the confirmation, payment must occur two (instead of five) currency business days after delivery of the verified carbon credits.[cxviii] Version 2.0 also expanded the nonexhaustive list of definitions in Section 10 of the VCC Definitions to include labels relating to the Core Carbon Principles (CCPs) published by the Integrity Council for the Voluntary Carbon Market, making it easier for parties to reference CCP characteristics.[cxix]

The VCC Definitions, including Version 2.0, are found online on ISDA's interactive web-based user interface, MyLibrary.[cxx]

CLIMATE SMART INVESTMENT FUND SEEKS ENVIRONMENTAL AND FINANCIAL RETURNS FOR INVESTORS

On 24 January 2024, Exemplary Forestry Management and its partners launched a new investment fund with the acquisition of 3,000 acres of timberlands in Maine.[cxxi] The new fund seeks to provide both financial returns as well as environmental returns in the form of carbon sequestration, conservation of forest ecosystems, and sustainable timber management.[cxxiv]

The fund relies on "Natural Capital," an investment category including timberland assets as well as other earth resources and ecosystems, which has seen a marked uptick over the last two years following the rise of the ESG movement.[cxxiii] Institutional investors are looking to forests as investment opportunities, including Apple, asset manager Oak Hill Advisors, and insurer Manulife Financial Corporation, a multinational insurance company and financial services provider.[cxxiv] Estimates on the carbon sequestration potential of the Earth's forests range as high as 16 billion metric tons of CO_2 per year.[cxxv] Investors believe, through carbon credits and the monetization of other nature-based products, that timberland investments provide attractive levels of income and overall financial returns.[cxxvi] Timberland Investment Resources, LLC believes there are four reasons for the surge in popularity of timber investments:

1. Private timberland is plentiful and accessible to investors. An estimated 120 million to 150 million acres of forests worldwide are suited for institutional investment.
2. There is a strong positive perception of forests in the public.
3. Forests can produce carbon credits, clean the air, protect watersheds, enhance and preserve biodiversity, generate clean energy, and provide opportunities for public and private recreation.
4. Forests can provide sustainable cash flow through sustainable timber harvests.[cxxvii]

Timber investment managers are balancing investment portfolios based on investors' emphasis on ESG goals.[cxxviii] Strategies range from "ESG Compliant," meaning most funds are ESG compliant but the emphasis is still on financial returns; to "ESG Focused," meaning the portfolio has equal emphasis on financial and environmental returns; to "Impact First," meaning ESG goals take priority over financial goals.[cxxix] In timberland spaces, this could mean ESG-compliant portfolios emphasize sustainable commercial timber production, ESG-focused portfolios emphasize carbon credit generation, and "Impact First" portfolios emphasize carbon offsets to the investor's operations.[cxxx]

The fund launched by Exemplary Forestry Management represents an alternative method to encourage forestry management that balances timber and carbon resources. To avoid competition with large carbon credit projects, the fund is targeting acquisitions of less than 20,000 acres.[cxxxi]

While timberland investments have seen a recent boom in demand, there has also been a backlash from the environmental community with claims of greenwashing.[cxxxii] Third-party certification, such as through the Sustainable Forestry Initiative, Forest Stewardship Council, and others, can verify the quality of the environmental returns and help investors avoid potential liability for consumer protection claims.[cxxxiii]

THE LARGEST PRIVATE LANDOWNER ENTERS THE CARBON CREDIT MARKET

Weyerhaeuser, owner or operator of over 11 million acres of timberlands in the United States, has officially entered the carbon credit business. In December 2023, Weyerhaeuser sold 32,000 forest carbon credits produced from a forest in Maine as part of an improved forest management project.[cxxxiv] Weyerhaeuser is projecting two more carbon credit projects from timberlands in the southern United States will be approved in early 2024.[cxxxv] Weyerhaeuser's credits sold for US$29/credit.[cxxxvi]

Weyerhaeuser is also looking at additional subsurface carbon sequestration projects. On 27 February 2024, Weyerhaeuser announced an agreement with Lapis Energy LP to explore five potential sequestration sites in Arkansas, Louisiana, and Mississippi.[cxxxvii] This follows carbon capture and sequestration projects Weyerhaeuser announced in March and December 2022 with Oxy Low Carbon Ventures and Denbury, Inc., respectively.[cxxxviii]

As the largest private landowner in the United States, Weyerhaeuser has the potential to dramatically shift the amount of land available for carbon sequestration projects. Big players like Weyerhaeuser investing resources in carbon sequestration suggests a further maturation of the nascent market for carbon credits.

WORLD'S LARGEST CARBON REMOVAL FACILITY BEGINS OPERATIONS

In February 2024, Graphyte opened an Arkansas-based plant designed to permanently store captured carbon, with the largest capacity of any such facility worldwide.[cxxxix] Once fully online, the facility is expected to remove 50,000 tons of CO_2e per year.[cxl] Graphyte emphasizes it can operate at the affordable costs of US$100/ton with minimal energy requirements and can be scaled to remove billions of tons of carbon with today's technology.[cxli] This is hundreds of dollars cheaper per ton than other technologies operating on the market.[cxlii]

Graphyte's success is in its simplicity. Graphyte gathers waste from paper and rice mills—waste that is largely carbon and would otherwise decompose, releasing that carbon back into the atmosphere—and it compresses it into bricks.[cxliii] It then wraps and stores these bricks underground.[cxliv] Graphyte avoids the energy costs associated with removing carbon from the atmosphere by relying on photosynthesis, a challenge for other carbon-capture technologies.[cxlv]

As part of the Carbon Negative Shot program, the DOE set a goal of US$100/ton of CO_2e removed.[cxlvi] This is a key part of the Biden administration's goal of a net-zero economy by 2050.[cxlvii]

Carbon Spotlight

SEC FINALIZES CLIMATE DISCLOSURE RULE, SCRAPS SCOPE 3 EMISSIONS

On 6 March 2024, the US Securities and Exchange Commission (SEC) released its long-awaited final rulemaking titled, "The Enhancement and Standardization of Climate-Related Disclosures for Investors."[cxlviii] The release of the final rules mark a pivotal moment for the SEC and Chair Gary Gensler, who has made climate and environmental, social, and governance (ESG) investing a top priority of the agency over the past few years. The final rules reflect the SEC's response to investor demand for more "consistent, comparable, and reliable information about the financial effects of climate-related risks" on public companies and how those risks are being managed.[cxlix] Significantly, the final rules will require disclosure about a public company's climate-related risks that have materially impacted, or are reasonably likely to have a material impact on, the company's business strategies, operations, and financial condition.[cl] The final rules are less prescriptive than those initially proposed, as described below.

To achieve these objectives, the new SEC rules amend provisions under the Securities Act of 1933 and Securities Exchange Act of 1934, requiring registrants to provide climate-related information in their registration statements and annual reports.[cli] As a result, public companies will now be required to disclose, among other things, material climate-related risks; measures taken to mitigate or adapt to such risks; information about the registrant's board of directors' oversight of climate-related risks and management's role in managing material climate-related risks; and information on any climate-related targets or goals that are material to the registrant's business, results of operations, or financial condition.[clii]

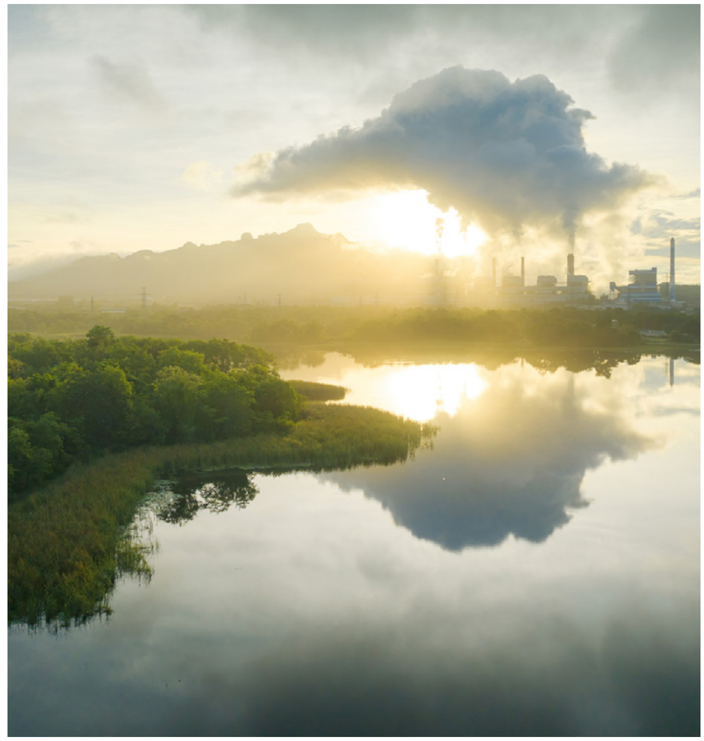
The final rules further require large registrants to disclose Scope 1 and Scope 2 GHG emissions (to the extent material) on a phased-in basis. The categories of emissions—"Scopes"—are sourced largely from the Greenhouse Gas Protocol's standards for corporate accounting and reporting.[cliii] Scope 1 accounts for direct emissions from sources that are owned or controlled by an organization.[cliv] For example, Scope 1 emissions for manufacturing processes would include direct emissions associated with fuel combustion in boilers or emissions from production at the manufacturing facility.[clv] Scope 1 emissions would also include those emissions associated with delivery of manufactured products.[clvi] By contrast, Scope 2 accounts for indirect GHG emissions resulting from the production of electricity purchased by a registrant.[clvii] For example, Scope 2 emissions for a manufacturing process would include emissions associated with the electricity consumed by the manufacturing facility—i.e., the emissions related to offsite power generation.[clviii] The rules provide that registrants must file an attestation report covering the required disclosure of Scope 1 and Scope 2 emissions, as well as disclosure of the financial statement effects of severe weather events and other natural conditions, including, for example, costs and losses resulting from such events and conditions.[clix]

The SEC received numerous comments challenging its authority to adopt and enforce the rules. The SEC and the US Supreme Court view "materiality" through the lens of an objective assessment into whether there is a substantial likelihood that a fact would be important to the reasonable investor.[clx] The final rules require that registrants only need to report emissions to the extent this materiality standard is satisfied, meaning that some larger companies that are otherwise covered by the rules will not have to report Scope 1 and Scope 2 emissions at all. However, to make these materiality determinations, these registrants will nonetheless need to take steps to assess their emissions to see if they satisfy this materiality standard.

The final rulemaking also scraps the requirement to report Scope 3 emissions, which are all indirect emissions that are not included within Scope 2 and that result from the activities of a company but are generated by sources not owned or controlled by that company.[clxi] Scope 3 emissions were a highly contentious component of the proposed rules, and the proposed requirement to disclose such emissions was the focus of many public comments received by the SEC. The elimination of the Scope 3 emissions reporting requirement, like many other changes from the proposed rules, represents a pragmatic effort by the SEC to insulate the rules from inevitable legal challenges. Those challenges have already begun on a variety of fronts, including a challenge to the rules by 11 state attorney generals under the US Supreme Court's newly strengthened "Major Questions Doctrine." The doctrine hamstrings the ability of agencies to regulate certain issues that have "large economic and political significance" without clear congressional authorization to do so, sweeping many, if not most, federal rulemakings under its purview. On 19 March 2024, the SEC petitioned to consolidate the legal challenges into a single circuit through a lottery process, and the US Court of Appeals for the Eighth Circuit was randomly selected as the venue to hear the consolidated challenges.[clxii] On 4 April 2024, the SEC voluntarily stayed the effectiveness of the rules pending completion of the judicial review of the consolidated Eighth Circuit actions.[clxiii]

The climate-related risk disclosure rules will have broad effects on public companies and the investment community. Large public companies, especially those in industrial and manufacturing sectors, will need to track and potentially disclose their material GHG emissions. Processes around corporate reporting obligations will need to be revamped to accommodate the newly prescribed data disclosures. On the other hand, the rules will provide numerous benefits within the asset management and investment funds space. Portfolio managers will have access to an influx of information generated by the new disclosures, allowing for more informed investment decisions related to ESG funds and climate-impact investment products. Similarly, institutional investors can now request more information on emissions and tracking of their impact investments.

The final rules include a phased-in compliance period for all registrants, with the compliance date dependent on the registrant's filer status and the content of the disclosure.[clxiv] For a deeper dive into the final rules and to see what did and did not make it from the rules as proposed in March 2022, please see our client alert, "**Threading the Needle: The US Securities and Exchange Commission's Final Climate-Related Disclosure Rules**" written by Corporate partners Julie Rizzo and Sean Jones, and Asset Management and Investment Funds partner Lance Dial.[clxv]



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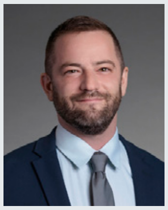

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