Client Alert

January 2024

New California Law Mandates Disclosure about Voluntary Offsets and Climate Claims

In brief

Much of the focus around climate legislation coming out of the latest California legislative session has been on new, far-reaching requirements pertaining to disclosure of climate data and climate-related financial risk. However, California also adopted a third law related to climate change last year – AB 1305 - which has received somewhat less attention but may well have a wider and more immediate effect. Intended to address greenwashing claims, particularly related to voluntary carbon offsets ("VCO"), the Voluntary Carbon Market Disclosure Act (the "VCMDA" or "Act") mandates disclosure by entities that: (1) sell VCO credits in California; (2) buy or use VCO credits sold in California; and/or (3) make climate claims about corporate performance or products.

Contents

Overview

Much of the focus around climate legislation coming out of the latest California legislative session has been on new, far-reaching requirements pertaining to disclosure of climate data and climate-related financial risk. However, California also adopted a third law related to climate change last year – AB 1305 - which has received somewhat less attention but may well have a wider and more immediate effect. Intended to address greenwashing claims, particularly related to voluntary carbon offsets ("VCO"), the Voluntary Carbon Market Disclosure Act (the "VCMDA" or "Act") mandates disclosure by entities that: (1) sell VCO credits in California; (2) buy or use VCO credits sold in California; and/or (3) make climate claims about corporate performance or products. It appeared that public and private companies operating in California would be required to post responsive information relating to these topics on their websites commencing on January 1, 2024, although the legislation's primary author, Jesse Gabriel, issued a letter at the end of last year indicating that the intended compliance date is January 1, 2025.

Significantly, critical aspects of the Act are left undefined creating some uncertainty and risk related to the applicability of the law and the scope of disclosure required. Importantly, the VCMDA does not define what it means to buy or sell VCOs in California or to make climate claims in California. Nor does it explain the intended reach of the phrase "operating in California." Further, the Act does not delegate to any state agency (such as the California Air Resources Board), the authority or responsibility to develop implementing rules. Instead, the Act authorizes the California Attorney General to pursue enforcement actions against noncomplying entities, issuing fines of up to $2,500 a day subject to a maximum annual amount of $500,000. While it is likely that entities will petition the Attorney General Office for guidance regarding fundamental questions, in the near term entities operating in California will need to make their own assessment of the necessary measures to assure for compliance, bearing in mind that generally California has construed broadly its authority under environmental and consumer protection statutes.

What the Act Requires

Carbon Credit Sellers

1. **Requirements**

Any business entity that is marketing or selling VCOs in California must disclose specific information on its website about the underlying project creating the VCOs. "VCO" means any product sold or marketed that claims to be a "greenhouse gas emissions offset," "voluntary emissions reduction," "retail offset" or any other term that suggests the product represents or connotes a reduction in the amount of carbon dioxide or greenhouse gases (collectively "GHG") in the atmosphere or prevented the emission of GHG emissions that otherwise would have been emitted.

The Act requires disclosure of the following:

- Details about the location of the project, project type, applicable protocol, compliance with applicable standards, project timeline and start date, estimated reduction or removal volumes, permanence, and expert or third-party validation or verification of the project and its attributes.
- Information regarding accountability measures if the project is not completed, fails to achieve anticipated emission reductions, or involves the reversal of any credits and the actions the entity will take to address non-performance.
- Information about the data and calculation methods to enable independent replication and verification of emission reductions or removal credits issued under the project protocol.

2. **Issues**

Key issues remain unresolved in the Act. For example, it is not clear whether the VCDMA applies only to future credits that are marketed or sold or whether it extends to past credits that have already been sold. It would seem inapplicable to credits that have been sold for past vintage years, but potentially may be construed to apply to past VCO sales that pertain to future vintage years. The Act also provides no guidance as to the intended meaning of marketing or selling VCOs in California. While marketing or selling directly to entities based in California or entering into sales agreements subject to California laws or jurisdiction would seemingly constitute activities subject to VCDMA, less clear is whether posting information about VCOs or the seller entity on a website accessible to the California market represents "marketing" in California. Similarly, it is unclear if a sale to a buyer headquartered outside of California but with California operations involves marketing or selling in California. Finally, while VCMDA may cover only marketing or sales relating to future vintage years, the disclosure obligations of buyers may well extend to VCOs already purchased if referenced in current disclosures about climate commitments and performance, such that sellers may be pressed by buyers to provide additional information regarding past sales.

In short, there are meaningful interpretative judgments to be made by sellers regarding whether, what and how to disclose VCO marketing and sales information. Irrespective of the ultimate determinations, a VCO seller may need to consider explaining its disclosure approach and rationale.

Carbon Credit Buyers

1. **Requirements**

Any entity that purchases or uses a VCO sold in California and makes any public statement in relation to achievement of net zero emissions, carbon neutrality or similar claims (including claims about significant advancements toward these goals), must post specific information about the credits on its website. The disclosure obligation is triggered by any statements suggesting that the entity or a product does not add to GHG emissions or has made a significant reduction in such emissions; in the absence of such claims, no disclosure about VCOs that are purchased or used by the entity is required under the Act.

In relation to a VCO subject to the Act, the entity must provide the following information:

- The entity selling the offset and the offset registry or program
- Project name
- Offset project type
- Protocol used to estimate the volume of emission reductions or removals
- Whether the information has been third party verified

2. **Issues**

With respect to claims, VCO buyers will need to determine whether they are making any net zero, carbon neutral or "similar claims" that fall within the scope of the Act. While it would be reasonable to assume the Act's intended focus is (and the likely focus of any eventual enforcement actions would be) on claims that are based on or related to VCOs purchased or used in the state, the text of the Act does not clearly indicate there must be a link between the relevant claims and VCOs purchased or used in the state. As a result there is some uncertainty as to whether any statements by a business entity suggesting that the entity or a product does not add to GHG emissions or has made a significant reduction in such emissions will trigger disclosure obligations about any VCOs purchased or used in the state (whether or not there is a link between the claims and the credits).

With respect to the credits, VCO buyers will face the same jurisdictional question as sellers regarding whether their VCOs were sold in California. VCO buyers with activities or operations in California will also need to consider, without any guidance from the Act itself on this point, whether a VCO purchased outside the state could be deemed to have been used in California. As a result of the foregoing analysis, entities covered by the Act may find it necessary to include additional language in publicly available sustainability and climate reports regarding any referenced purchase or use of VCOs to support a conclusion that the VCOs are not subject to the Act, or, if it appears the relevant credits were purchased or used in California, of if unclear, to provide the required disclosures.

Climate Claims

1. **Requirements**

In the most far reaching and impactful aspect of the Act, any entity that operates in California and makes a "carbon neutral," "net zero emissions," or "other similar claim" in the state must post information on its website regarding those claims including:

- How the entity determined the accuracy of the statement or accomplishment
- How progress has been measured (e.g., the methodology)
- The identification of the entity's science-based targets
- Whether the information has been verified

2. **Issues**

Although not explicit, it appears that this disclosure obligation applies both to achieved climate goals as well future-looking aspirations. Entities will need to be prepared to disclose data, analyses, methodologies, metrics and assessments to substantiate claims made. While the meaning of "similar claims" is not defined in the Act, potentially it could be interpreted to apply to any climate statement about corporate performance and products including emission reductions and removals. Similarly, it is not clear what is meant by operations or claims "made in California." Generally though, California has construed broadly the reach of its environmental and consumer protection laws.

Accordingly, for companies with California operations that post ESG, climate or sustainability reports on their website with claims about climate goals, progress and performance, such statements would appear to be covered by the rule. Whether the information included in such reports is deemed sufficient to satisfy this disclosure obligation will require a close review. An entity will need to consider carefully the range of statements its makes about climate performance and progress towards goals to assess which claims are subject to the specific disclosure requirements. For any such statements, the entity will then need to decide if current explanatory language suffices to satisfy VCMDA requirements or if further explanation is needed.

Recommendations and Next Steps

1. **Enhance due diligence and recordkeeping around VCO transactions**. Both buyers and sellers will need to provide greater detail about VCO transactions and the underlying facts and methodologies, as well as evaluating the efficacy of current systems to meet expanded disclosure demands.

   Buyers and sellers will need to review their current and past VCO transactions to assess whether and which VCOs fall within the scope of the rule, and whether the current disclosure of any covered VCOs satisfies VCMDA requirements. Particularly given the uncertainty around aspects of the rule, it is likely that entities will arrive at varied interpretations and disclosure determinations, leading to inconsistent reporting in the marketplace and inquiries about the disclosure methodology. Accordingly, it is advisable to consult with inside or external counsel in devising the responsive strategy, including whether and when to disclose the approach and its rationale.

2. **Evaluate current climate related statements and the adequacy of underlying information** to support such claims. With the applicability of this Act likely to be construed broadly, entities should be prepared to review all publicly available statements, filings, reports, advertisements and materials that convey climate information about the entity or its products, and assess whether additional explanatory information is needed.

   In light of the varied climate disclosure requirements emerging around the globe, such as the EU's CSRD program and potential SEC regulations, that review and implementation plan needs to be part of an integrated overall climate disclosure strategy involving senior management including legal and finance personnel. Especially for US public companies, any decision relating to California climate disclosure should be aligned with securities filings and other regulatory considerations. For those companies, satisfaction of California's requirements may require only limited tinkering with current reports and filings. For other entities less experienced with public disclosures, greater attention may be needed to develop internal processes and strategies to review and disclose additional and accurate climate related information.

3. **Consider third party retention to assess, audit and/or validate claims and processes**. In light of the growing scrutiny of climate statements and the potential for regulatory or litigation challenges, entities may wish to consider mitigating risk by engaging third parties to conduct independent reviews.

4. **Determine the appropriate timing for posting information** responsive to the VCDMA requirements. Jesse Gabriel's recent letter to the California Assembly Chief Clerk indicating an intended commencement date of January 1, 2025 and plans to pursue changes to that effect raises questions as to the timing of compliance. While that letter may support deferring compliance until 2025, there remains some risk that it would not be a definitive defense against an enforcement action. Entities should weigh carefully the risks of deferring compliance and seek internal or external counsel in that consideration. Similarly, entities may wish to consider consulting with internal and external legal resources in assessing whether to approach the California Attorney General's Office requesting guidance regarding the scope and meaning of various aspects of the VCMDA.

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