CALIFORNIA MOVES TO REDUCE GREENWASHING IN THE VOLUNTARY CARBON OFFSETS MARKET AND IN NET-ZERO CLAIMS

On October 7, California Governor Gavin Newsom signed into law three pieces of first-in-the-nation mandatory climate-related disclosure requirements, SB 253 (governing disclosure of Scope 1, Scope 2 and Scope 3 GHG emissions), SB 261 (governing disclosure of climate-related financial risks) and AB 1305 (designed to bring some order to the voluntary carbon offset ("VCO") and more broadly to combat greenwashing around carbon neutral and similar claims). While the first two bills have commanded significant attention (*see* my September 20 briefing note), the third less so, but is equally newsworthy.[1]

AB 1305 (which adds Section 44475 to Division 26 of the California Health and Safety Code) is an effort to combat greenwashing in the VCO market by imposing new transparency and disclosure requirements for both purchases and marketers/sellers of VCOs. A carbon offset allows a purchaser of an offset (a carbon emitter) to compensate for its owns emissions with the eliminated or avoided GHG emissions from other activities or dedicated carbon offset projects. Offsets can be used by governments or businesses, and can be mandatory or voluntary.[2] VCOs form part of the burgeoning voluntary carbon market (VCM) in which project developers initiate projects to remove carbon and then resell a carbon offset to an enterprise that is then able to include a emission reduction or removal as part of its own emission reduction/removal targets.

There is increasing concern that VCOs, particularly low-quality offsets, facilitate greenwashing. VCOs have been described by some as the "Wild West" of carbon markets. *See* reporting, for example, by the Financial Times ("Critics to aim at 'wild west' offset market"), and in-depth reporting by The Guardian ("Revealed: more than 90% of rainforest carbon offsets by biggest certifier are worthless, analysis shows"), that calls into question the efficacy of offset credits purchased by internationally renowned companies touting "carbon neutral products" or assuaging consumers their purchased products or services are not contributing adversely to the climate crisis.

AB 1305 Disclosure Requirements

AB 1305 is intended to prompt more rigorous diligence before making climate-related sustainability claims and to prompt higher-quality offsets that better approximate emission reduction or removal. It targets not the mandatory offset market (*e.g.,* state cap and trade programs), which is regulated, but rather the unregulated VCO market. As the author of the legislation noted in Senate Floor Analysis (9/11/23), "With a variety of recent reports all demonstrating consistent over-crediting and lack of legitimate additionality in voluntary offset projects, there is a clear and pressing need for increased accountability and transparency." AB 1305 "will combat greenwashing and give consumers a meaningful tool to decide which projects are worth investing in to reduce their carbon footprint." Concerns about the market abound notwithstanding 2012 Federal Trade Commission guidance on

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1 A fourth bill, SB 390 (which would proscribe various specific claims in the context of sales of VCOs that would be false or misleading), was vetoed by the Governor.

2 Note that carbon offsets are different from carbon credits, which are a centralized mechanism for the decarbonization of certain high-GHG emitting sectors. Carbon credits are given to businesses allowing them to emit GHGs, and can be traded, for example through the EU Emissions Trading System.

appropriate marketing of environmental claims, including carbon offsets (*see* Senate Judiciary analysis (7/7/23)).

The legislation has three sets of disclosure requirements – one aimed at businesses marketing or selling VCOs in California, a second aimed at purchasers and users of VCOs operating in California or that purchase/use VSOs sold in California, and a third aimed at companies operating in California that make net-zero claims in California.[3] These requirements all call for public disclosure on corporate websites, and are to be updated no less than annually.

Marketers/sellers of VCOs (subsection 44475)

Any business marketing or selling VCOs "within California" is required to disclose:

(a) Details regarding the applicable carbon offset project, including all of the following information:

- The specific protocol[4] used to estimate emissions reductions or removal benefits.
- The location of the offset project site.
- The project timeline.
- The date when the project started or will start.
- The dates and quantities when a specified quantity of emissions reductions or removals started or will start, or was modified or reversed.
- The type of project, including whether the offsets from the project are derived from a carbon removal, an avoided emission, or, in the case of a project with both carbon removals and avoided emissions, the breakdown of offsets from each.
- Whether the project meets any standards established by law or by a nonprofit entity.
- The durability period (*i.e.,* the duration of time over which an offset project operator commits to maintain its GHG reductions and GHG removal enhancements, as applicable, exclusive of any aspirational outcomes that exceed or extend beyond the mandatory outcomes required of the offset project pursuant to its offset protocol) for any project that the seller knows or should know that the durability of the project's GHG reductions or GHG removal enhancements is less than the atmospheric lifetime of carbon dioxide emissions.
- Whether there is independent expert or third-party validation or verification of the project attributes.

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[3] For this purpose, a VCO is defined as "any product sold or marketed in the state that claims to be a 'greenhouse gas emissions offset,' a 'voluntary emissions reduction,' a 'retail offset,' or any like term, that connotes that the product represents or corresponds to a reduction in the amount of greenhouse gases present in the atmosphere or that prevents the emission of greenhouse gases into the atmosphere that would have otherwise been emitted." A VCO does not include products that represent or correspond to legal or regulatory mandates for reduction of the amount of GHG present in the atmosphere or prevention of the emissions of GHGs into the atmosphere.

[4] A protocol is a documented set of procedures and requirements to quantify ongoing GHG reductions or GHG removal enhancements achieved by an offset project and to calculate the project baseline, including specification of relevant data collection and monitoring procedures, emission factors, and methodologies used to conservatively account for uncertainty and activity-shifting and market-shifting leakage risks associated with an offset project.

- Emissions reduced or carbon removed on an annual basis.

(b) Details regarding accountability measures if a project is not completed or does not meet the projected emissions reductions or removal benefits, including, but not limited to, details regarding what actions the entity, either directly or by contractual obligation, shall take under both of the following circumstances: if carbon storage projects are reversed or if future emissions reductions do not materialize.

(c) The pertinent data and calculation methods needed to independently reproduce and verify the number of emissions reduction or removal credits issued using the protocol.

Purchasers/users of VCOs (subsection 44475.1)

Any business that purchases or uses VCOs and makes claims regarding the achievement of net zero emissions, claims that the entity, related entity, or a product is "carbon neutral," or makes other claims implying the entity, related entity, or a product does not add net carbon dioxide or GHGs to the climate or has made significant reductions to its carbon dioxide or GHG emissions is required to disclose:

- The name of the business entity selling the offset and the offset registry or program.
- The project identification number, if applicable.
- The project name as listed in the registry or program, if applicable.
- The offset project type, including whether the offsets purchased were derived from a carbon removal, an avoided emission, or a combination of both, and site location.
- The specific protocol used to estimate emissions reductions or removal benefits.
- Whether there is independent third-party verification of company data/claims listed.

These disclosure requirements do not apply to purchasers/users of VCOs that "do not operate within California" *or* "do not purchase or use VCOs sold within California."

Makers of net-zero claims (subsection 44475.2)

In addition, any business that makes claims regarding the achievement of net zero emissions, claims that the entity, a related or affiliated entity, or a product is "carbon neutral," or makes other claims implying the entity, related or affiliated entity, or a product does not add net carbon dioxide or GHGs (as defined in Section 38505 of the California Health and Safety Code), to the climate or has made significant reductions to its carbon dioxide or GHG emissions (as described in Section 38505) will be required to disclose:

- All information documenting how, if at all, a "carbon neutral," "net zero emission," or other similar claim was determined to be accurate or actually accomplished, and how i***nterim progress*** toward that goal is being measured.[5]
- Whether there is independent third-party verification of the company data and claims listed.

These disclosure requirements do not apply to entities that either "do not operate within California" *or* "do not make [covered] claims in California." It appears that this provision

[5] This information may include, but not be limited to, disclosure of independent third-party verification of all of the GHG emissions, identification of science-based targets for the emissions reduction pathway, and disclosure of the relevant sector methodology and third-party verification used for the science-based targets and emissions reduction pathway.

applies regardless of whether reporting entity is a purchaser/user of VCOs – the legislative history description refers to "any entity" making emissions claims and the disclosure requirements for users/purchasers is in a separate subsection even though the scope is largely similar but for the omission of references to purchase or use of VCOs. A business operating in California that makes relevant claims in California and is a purchaser/user of VCOs sold in California apparently would then comply with both subsections 44475.1 and 44475.2.

In contrast to SB 253 and SB 261 (whose coverage has been quantified), it is impossible to estimate the number of companies that would be covered by AB 1305 obligations.

Concluding Thoughts

As is the case for SB 253 and 261, the coverage of AB 1305 is broad, and not limited to California corporations. While SB 253 and 261 apply to domestic public and private companies based on revenue thresholds, AB 1305's requirements are not limited to domestic US companies and have no revenue threshold. What this then means is that there is potential for overlapping disclosure requirements, including SEC requirements when they see the light of day (*see* my March 22, 2022 briefing note), as well as the requirements of the EU Corporate Sustainability Reporting Directive (via European Sustainability Reporting Standard (ESRS) E1[6] – *see* my March 5, 2023 briefing note and March 6, 2023 briefing note) – both of which address carbon offsets. This in turn will require alignment and consistency across disclosure regimes.

Separately, I note that in his signing statements for SB 253 and SB 261, Governor Newsom expressed concern with the implementation deadlines and reporting protocols, and directed his administration to work with the legislature to address these issues. No signing statement was issued for AB 1305.

In contrast to voluminous rulemaking releases issued by the SEC and painstaking attention to wording, the California bills are short and cursory. One can imagine a number of interpretive questions (what does it mean to "operate in California" or "make claims in California," and what indeed will be deemed a "claim") and challenges in the coming months.

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[6] ESRS E1 (Climate change) addresses GHG removals and GHG mitigation projects financed through carbon credits in Disclosure Requirement E1-7 (paragraphs 56-61), and calls for disclosure of among other items removal and storage of GHGs from projects it may have developed in its own operations or contributed to in its upstream and downstream value chain, and GHG emission reductions or removal from climate change mitigation projects outside its value chain that it has financed or intends to finance through purchase of carbon credits. (See also Appendix A, AR (application requirements) 56-64.

The European Union has also proposed a regulation on EU certification of carbon removals.