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Editorial

Editorial Offices
630 Central Ave., New Providence, NJ 07974 (908) 464-6800
201 Mission St., San Francisco, CA 94105-1831 (415) 908-3200
www.lexisnexis.com

MATTHEW BENDER

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California Enacts Novel Disclosure Requirements for the Voluntary Carbon Market and Green Claims

By Maureen F. Gorsen, Samuel B. Boxerman, Heather M. Palmer, Marie E.A. Allison and Brittany A. Bolen*

In this article, the authors discuss a new California law imposing novel disclosure requirements relating to voluntary carbon offsets and a host of environmental marketing claims.

California Governor Gavin Newsom has signed Assembly Bill (AB) 1305 into law, triggering novel disclosure requirements related to voluntary carbon offsets (VCOs) and a suite of environmental marketing claims. According to the bill sponsors, AB 1305 aims to reduce "greenwashing" by requiring entities operating in California to report certain information on the VCOs they market, sell, purchase, or use, including those used to achieve reduced or net zero emissions. AB 1305 also requires disclosure of other environmental marketing claims made without VCOs, including claims of net zero, carbon neutrality, or significant emissions reductions. Bill sponsors cited a growing concern regarding the validity of emissions offsets and a desire to ensure that VCOs companies purchase to offset their carbon emissions are genuine, given that the voluntary carbon market is unregulated in the United States.

This law marks a growing trend requiring public and private companies to disclose climate change-related information as well as regulation in both mandatory and voluntary carbon markets. California is at the forefront of this trend, with the governor signing two other climate-related disclosure laws on the same day he signed AB 1305: the Climate Corporate Data Accountability Act, SB 253, and the Climate-Related Financial Risk Act, SB 261.

At the federal level, the U.S. Securities and Exchange Commission (SEC) proposed rules in March 2022 that would require domestic and foreign registrants to include extensive climate-related disclosures, including the use of VCOs, in their registration statements and periodic reports. Green marketing claims have also come under increased scrutiny under the Federal Trade Commission (FTC) "Green Guides," which are currently under review[1] for potential revision.

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* Maureen F. Gorsen, Samuel B. Boxerman, Heather M. Palmer and Brittany A. Bolen, attorneys with Sidley Austin LLP, may be contacted at maureen.gorsen@sidley.com, sboxerman@sidley.com, hpalmer@sidley.com and bbolen@sidley.com, respectively.

[1] https://www.ftc.gov/news-events/news/press-releases/2022/12/ftc-seeks-public-comment-potential-updates-its-green-guides-use-environmental-marketing-claims.

In addition, the U.S. Commodity Futures Trading Commission (CFTC) recently formed the Environmental Fraud Task Force to focus on fraud and manipulation in carbon credit markets and other forms of greenwashing, including misrepresentations about environmental, social, and governmental (ESG) investment strategies.

REQUIRED DISCLOSURES UNDER AB 1305

AB 1305[2] applies to business entities that market or sell VCOs in the state of California as well as entities that purchase or use VCOs sold within the state that make emissions marketing claims (i.e., claims that the entity, a related entity, or a product has achieved net zero emissions, is carbon neutral, does not add net carbon dioxide (CO2) or greenhouse gases (GHGs) to the climate, or has made significant reductions to its CO2 and GHG emissions (collectively, Emissions Marketing Claims)) and entities that make Emissions Marketing Claims within the state. Notably, these disclosure requirements apply to any entity operating in California that makes these regardless of size, which is much broader than the reporting entities subject to the recently enacted SB 253 (which applies to U.S. companies doing business in California with over $1 billion in total annual revenues) and covered entities subject to SB 261 (which applies to U.S. companies doing business in California with over $500 million in total annual revenues).

AB 1305 defines a VCO as any product sold or marketed in California 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 GHGs present in the atmosphere or that prevents the emission of GHGs into the atmosphere that would have otherwise been emitted. VCOs do not include products that are legally mandated.

The specific disclosure requirements depend on the activities of the business entity and the claims that it makes related to VCOs or its business practices.

Entities Marketing or Selling VCOs

If an entity markets or sells VCOs in California, it must make specific disclosures on its website in relation to VCOs. Among other requirements, disclosures must describe:

- Details of the project related to the VCO, including the protocol used to estimate emissions, location, duration and dates of the project and its associated emissions reductions, project type, whether the project meets third-party standards or independent certification, and quantity of emissions removed annually;

[2] https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240AB1305.

- Accountability measures if the offset project is not completed or does not provide the anticipated emissions benefits; and
- Data and calculation methods necessary to reproduce and verify the emissions reduction associated with the VCO.

Entities That Purchase or Use VCOs and Make Emissions Marketing Claims

If an entity purchases or uses VCOs and makes Emissions Marketing Claims about its business, or those of a related entity or product, it is required to make certain disclosures on its website on an annual basis. Disclosed information must include details of the business that sold the VCO, including the registry or program, project name, type, protocol used to estimate emissions reductions, identification number (if applicable), and whether the claims are third-party verified.

Entities Making Emissions Marketing Claims

If an entity makes Emissions Marketing Claims about itself, a related or affiliated entity, or a product, its website must describe the basis for its claims and update such disclosures annually. The entity must provide 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 interim progress toward that goal is being measured." This may include whether there has been third-party verification of company data and claims.

While AB 1305 took effect on January 1, 2024, the law is silent as to when disclosures are required. The bill's author has indicated his intent that the online disclosures commence on January 1, 2025, to allow reporting entities sufficient time to align their business practices with the stated objectives of AB 1305. Clarifying legislation is expected in the first quarter of 2024. Violations of AB 1305 are subject to a civil penalty up to $2,500 per day per violation for each day that information on the entity's website is either inaccurate or unavailable (not to exceed $500,000).

NEXT STEPS

The following practical guidance is provided for consideration by businesses operating in California or buying or using VCOs within the state:

- Require increased documentation when purchasing VCOs. Entities that purchase or use VCOs in California will be required to disclose detailed information about the VCO, including details of the business that sold the offset, including the registry or program, project name, type, protocol used to estimate emissions reductions, identification number (if applicable), and whether the claims are third-party verified. Entities should confirm this and other required information prior to purchasing VCOs.
- Require documentation of VCOs in use. AB 1305 does not specify what it means to be an "entity that uses" VCOs, but this likely applies to VCOs that

are currently in use and not just future purchases. Entities should consider obtaining additional information about current VCOs or adjusting their VCO portfolios prior to when disclosure requirements apply.

- Prepare to publicly substantiate Emissions Marketing Claims. In addition to obtaining information about VCOs that they own, entities should consider planning whether and how to best present disclosures on their websites and seek advice of counsel where necessary. If an entity makes Emissions Marketing Claims, it should start preparing documentation to substantiate those claims.

WHAT'S NEXT?

While Governo Newsom signed AB 1305, he vetoed[3] its companion bill, SB 390,[4] which would have made it unlawful to verify a VCO project; certify or issue a VCO; maintain a VCO on a registry; or market, offer for sale, or sell a VCO without certain disclosures and substantiation. SB 390 would also have allowed for civil actions by the state, including penalties up to $2,500 per day for each violation, and citizen suits for injunctive relief. Gov. Newsom expressed concern that if passed as written, the bill would inadvertently affect well-intentioned offset sellers and create significant turmoil in the offsets market. Notwithstanding the veto, SB 390 is legislation that may be reintroduced in the next legislative session. Legal challenges to AB 1305 may also inform the fate of a future SB 390.

The passage of both AB 1305 and SB 390 during the past legislative session demonstrate California's increased focus on regulating voluntary carbon markets and emissions-related representations that companies make about their operations, products, and services. Enactment of AB 1305 may mark the beginning of follow-on legislation in California and similar legislation in other states regulating voluntary carbon markets and environmental marketing claims. In the near term, attention will certainly shift to the federal level, where the SEC is preparing its final rules for climate-related disclosures, the FTC is drafting revisions to its Green Guides, and the CFTC continues to explore possible regulation of carbon offsets and prevention of fraud and manipulation in carbon credit markets.

[3] https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-390-Veto.pdf.

[4] https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB390.