DON'T WORRY, THE CFTC CAN TAME THE VOLUNTARY CARBON MARKET WITHOUT OVERSTEPPING ITS BOUNDARY

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ABSTRACT

Nowadays, even the most substantial contributors to global greenhouse gas ("GHG") emissions establish net-zero objectives committed to mitigating carbon dioxide concentrations in the atmosphere. Among other mechanisms, the preeminent platform to pursue these objectives has been the global voluntary carbon market. Within this framework, entities invest in environmentally sustainable solutions while purchasing emissions reductions in the form of a tradable commodity, "carbon credit", generated by other market participants. The United Nations Climate Change Conference in 2021 has recognized the function of this growing market in bridging the gap between nationally determined contributions under the Paris Agreement and the global goal of achieving net zero by 2050.[1]

Nevertheless, the absence of a regulatory framework and enforceable rules within this open market structure has given rise to issues concerning transparency and credibility. In order to fortify the integrity of the voluntary carbon market, this Article proposes that the Commodity Futures Trading Commission ("CFTC" or "Commission") assume a role as a governing authority in the United States. Leveraging the extensive enforcement powers and limited regulatory oversight granted by the Commodity Exchange Act ("CEA") over derivative commodity markets, the CFTC is well-positioned to address these challenges effectively. The Article delves into potential strategies utilizing these authorities. By exercising its enforcement capabilities, the CFTC can

[1] *What You Need to Know About Article 6 of the Paris Agreement*, THE WORLD BANK (May 17, 2022), https://www.worldbank.org/en/news/feature/2022/05/17/what-you-need-to-know-about-article-6-of-the-paris-agreement; COP26: Together for our planet, UNITED NATIONS, https://www.un.org/en/climatechange/cop26 (last visited Nov. 20, 2023).

prosecute fraudulent and manipulative practices, safeguarding the integrity of the carbon market. Alternatively, the CFTC may adopt a more proactive role by promulgating regulations designed to prevent market dysfunctions. These interventions are essential for cultivating a robust market ecosystem, fostering increased participation, and encouraging innovations.

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I. INTRODUCTION

Annually, an escalating number of private companies declare net-zero commitments, targeting to achieve a balance between the amount of emissions produced and those removed from the atmosphere.[2] In December 2020, 417 companies within the Forbes Global 2000 pledged to achieve net-zero goals, and the figure surged to 929 by June 2023.[3] The increase underscores the strategic alignment of such initiatives not only with the corporate social responsibility objectives but also with the broader business imperatives.

A pivotal driver behind the exponential increment of emissions reduction targets lies in the practice of carbon credit trading in carbon markets. These markets are majorly categorized into (1) compliance carbon markets ("compliance markets") and (2) voluntary carbon markets ("voluntary markets"). Unlike the compliance market governed by regulatory authorities, the voluntary market operates without regulatory oversight, offering a more accessible avenue for companies seeking to exceed entities' GHG reduction capacities.

However, concomitant with the growth is an apprehension regarding transparency and credibility within the voluntary market. The absence of overseeing authorities and binding regulations has generated uncertainties about the honesty and fairness of market practices. Moreover, the lack of a uniform verification standard for assessing carbon offset projects has raised concerns among consumers about the reliability of representations made by sellers. The resultant erosion of trust and susceptibility to fraudulent activities poses significant challenges. The growing distrust may elevate the transaction costs, impede market innovation and expansion, and increase the risk of litigation.

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[2] *What is net zero?*, NET ZERO CLIMATE, https://netzeroclimate.org/what-is-net-zero-2/ (last visited Nov. 30, 2023).
[3] *Net zero targets among world's largest companies double, but credibility gaps undermine progress*, NET ZERO TRACKER (June 12, 2023), https://zerotracker.net/insights/net-zero-targets-among-worlds-largest-companies-double-but-credibility-gaps-undermine-progress.

Currently, no federal agency overseeing carbon credit trading in the voluntary market exists in the United States. In comparison to other relevant agencies such as the Environmental Protection Agency ("EPA"), the Department of Energy ("DOE"), the Securities and Exchange Commission ("SEC"), and the Federal Trade Commission ("FTC"), the CFTC is uniquely positioned to address fraudulent and manipulative practices in the United States derivative markets. Accordingly, this Article explores potential actions the Commission can take to rectify and prevent existing market problems. This inquiry is particularly timely considering the recent initiative the Commission has demonstrated with regard to the voluntary carbon market. In June 2022, the Commission published a "Request for Information ("RFI") on Climate-Related Financial Risk" to identify the Commission's role in the market.[4] While extant legal literature has examined federal regulations adaptable to the voluntary market, no prior work has thoroughly examined the CFTC's role or provided concrete recommendations to the Commission.[5] Therefore, this Article contributes distinct value to the ongoing legal discourse by proposing original and tailored solutions for the Commission's consideration.

The rest of the Article proceeds in five parts. Part II introduces the fundamental concepts related to the voluntary carbon market and market ecosystem. This encompasses the introduction of carbon credits, carbon markets, and primary stakeholders involved and the examination of prevalent limitations and challenges in the voluntary market. Following this, the Article provides

[4] Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856 (June 8, 2022), https://www.cftc.gov/sites/default/files/2022/06/2022-12302a.pdf.

[5] The article by Healy very briefly discusses regulatory initiatives and solutions by federal agencies but does not analyze in detail. Also, CFTC is not suggested as a potential agency to solve the problems in the voluntary carbon market. Thomas P. Healy, *Clearing the Air: Pursuing a Course to Define the Federal Government's Role in the Voluntary Carbon Offset Market*, 61 ADMIN. L. REV. 871, 882–89 (2009); Franki's article suggest regulations by federal agencies to address the voluntary carbon market. The author recommends the CFTC to collaborate with the Environmental Protection Agency but does not further elaborate types of cooperation or kinds of regulations should be made. Nicole Franki, *Regulation of the Voluntary Carbon Offset Market: Shifting the Burden of Climate Change Mitigation from Individual to Collective Action*, 48 COLUM. J. ENV'T L. 177, 202–05 (2022).

a background of the CFTC in relation to the voluntary carbon market. Part III is dedicated to the analysis of the first legal question—whether the CEA granted the CFTC jurisdiction over the voluntary carbon market.[6] The Commission's statutory authority is the threshold issue before making any recommendations, given its contentious nature as evidenced by the comments submitted to the RFI.[7] Subsequently, Part IV delves into the implication of the major questions doctrine on the Commission's future rulemaking based on the case law analysis of *West Virginia v. EPA* and the review of the comment by the West Virginia Attorney General. Part V presents two recommendations for the Commission's consideration. Finally, Part VI wraps up the Article. The discussions in this Article will provide substantial groundwork for the CFTC's future engagement in the voluntary market by addressing jurisdictional questions brought up in the comments in response to the Commission's RFI and proposing practical options to uphold the integrity of the voluntary carbon market.

II. BASICS OF THE VOLUNTARY CARBON MARKET

a. Key concepts and market ecosystem

A carbon credit is a certificate representing the removal of one metric ton of carbon dioxide or GHG emissions in the atmosphere or the reduction or avoidance of an equivalent amount of carbon dioxide emissions to the atmosphere.[8] For instance, if an airline company finds itself unable to meet its emission reduction targets independently, the company can achieve its goal by determining the additional amount of reduction needed and procuring the equivalent amount of carbon credits from the carbon market.

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[6] Commodity Exchange Act, 7 U.S.C. §§ 1–26 (1994).

[7] *See Comments for Orders and Other Announcements 87 FR 34856*, CFTC, https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7279&ctl00_ctl00_cphContentMain_MainContent_gvCommentListChangePage=1_50 (last visited Nov. 20, 2023).

[8] *What is the Voluntary Carbon Market?*, CARBONCREDIT.COM, https://carboncredits.com/what-is-the-voluntary-carbon-market/ (last visited Nov. 20, 2023); Client Earth USA, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34757.

As mentioned in Part I, there are two kinds of carbon markets: compliance market and voluntary market. The compliance market is typically operated by national, regional, or international regimes, acting as oversight authority.[9] Each compliance market typically employs a cap-and-trade system where the governing authority imposes the upper limit of allowable emissions amount of GHG, the *cap*, on certain industries and annually lowers the limit of "allowances," which acts like a permit to emit.[10] The allowances are *traded* in the form of carbon credits between entities that overachieve their emissions reductions and those that exceed their emissions quota. The price of carbon credits is determined by the mix of government control, regulation, and supply and demand of carbon credits in the market.[11]

In contrast, the voluntary market is entirely regulation-free. There is no governing authority, and thus, GHG emissions are not capped.[12] Rather, companies voluntarily establish net zero goals, and the attainment of the targets is not obligated. Despite the lack of mandatory force that triggers climate efforts, market mechanisms encourage the private sector's commitment to carbon neutrality and participation in the voluntary market. Companies, as part of their corporate social responsibility, promise to reduce carbon emissions, which attracts potential investors who are concerned about the financial, reputational, physical, transition, and legal risks associated with climate change.[13] This PR and marketing effect motivates companies to invest even more in technologies and operational changes required for internal transformation to decarbonize and

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[9] Tim Archer, *Understanding the Compliance and Voluntary Carbon Trading Markets*, DELOITTE (July 4, 2023), https://www2.deloitte.com/uk/en/blog/risk-powers-performance/2023/understanding-the-compliance-and-voluntary-carbon-trading-markets.html.
[10] *Id.*
[11] *How is the Price of Carbon Determined?*, CARBON CREDIT CAPITAL, https://carboncreditcapital.com/how-is-the-price-of-carbon-determined/ (last visited Nov. 20, 2023).
[12] *What is the Voluntary Carbon Market*, *supra* note 8.
[13] *Redefining corporate responsibility: Major companies push for a net zero nature-positive world*, CLIMATE CHAMPIONS (May 24, 2023), https://climatechampions.unfccc.int/redefining-corporate-responsibility-major-companies-push-for-a-net-zero-nature-positive-world/.

address residual emissions in their operations. Furthermore, if an entity reduces, avoids, or removes carbon emissions more effectively than other entities, the entity can financially benefit by selling carbon credits to other entities. Because the voluntary market, unlike the compliance market where carbon credits are typically transacted within the same industry and where the number of carbon credits to be issued is regulated, allows cross-industry transactions and an infinite supply of carbon credits, this voluntary scheme provides a more accessible and easier way for entities to contribute to emissions reductions.[14]

Currently, the major actors in the voluntary markets consist of project developers, consumers, registries/verifiers, and retail providers/brokers.[15] *Project developers* are individuals or corporations that implement carbon offset projects that earn carbon credits by reducing or avoiding emissions or removing GHG from the atmosphere.[16] Renewable energy, natural climate solutions such as reforestation, avoided deforestation, or agroforestry, energy efficiency, and carbon capture, usage, and sequestration ("CCUS") are major sources of carbon credits.[17] *Consumers*, mostly the private sector, are the end users of carbon credits.[18] They purchase carbon credits and consume them to achieve their climate goals. *Registries/verifiers*, which are run by third-party organizations, inspect carbon offset projects, issue and certify carbon credits, and keep track of transfer, retirement, and cancellation of the issued carbon credits.[19] Lastly, *retail providers/brokers* facilitate transactions of carbon credits between project developers and consumers in return for commissions. Many times, they purchase carbon credits on behalf of

[14] Archer, *supra* note 9.
[15] *What is the Voluntary Carbon Market*, *supra* note 8.
[16] *Id*.
[17] *Id*.
[18] *Id*.
[19] Center for American Progress, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34741; ISDA, VOLUNTARY CARBON MARKETS: ANALYSIS OF REGULATORY OVERSIGHT IN THE US (June 2022), https://www.isda.org/a/93WgE/Voluntary-Carbon-Markets-Analysis-of-Regulatory-Oversight-in-the-US.pdf.

consumers from verifiers/registries or keep an inventory of carbon credits to sell them directly to consumers.[20]

The lifecycle of carbon credits begins when project developers apply for offset projects to be inspected by and listed in verifiers/registries. If the offset projects pass the verification standards, verifiers/registries will issue carbon credits. Consumers then purchase carbon credits directly from project developers or through retail providers/brokers. Once consumers claim the underlying carbon outcome to meet their climate goals, the carbon credits are retired from the registries so that they cannot be claimed multiple times.

b. Current systematic flaws and growing problems

Transparency and credibility of carbon transactions are key to a well-functioning voluntary market in the long run. However, as the global voluntary market grows in size and value, there are increasing concerns that the current system in the market does not ensure those two factors and that the market is becoming more susceptible to fraudulent activities and manipulations.[21] In the current market, third-party verifiers/registries independently create verification standards that determine what legitimate carbon offset programs and quality carbon credits are. Accordingly, each verifier/registry has distinct standards, which creates a possibility of subpar standards allowing low-quality carbon credits to enter into the voluntary market.[22] Some project developers may also select the most advantageous, but below-average standards for their offset projects, which, without an oversight authority, is hard to detect unless consumers conduct enhanced diligence to

[20] Amazon Watch et al., Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34762.
[21] Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856, 34856–62 (June 8, 2022), https://www.cftc.gov/sites/default/files/2022/06/2022-12302a.pdf.
[22] Barbara K. Haya et al., *Comprehensive review of carbon quantification by improved forest management offset protocols*, 6 FRONTIERS IN FORESTS AND GLOBAL CHANGE 1, 5 (2023), https://www.frontiersin.org/articles/10.3389/ffgc.2023.958879/full.

examine the offset projects.[23] The intangible nature of emissions only makes it harder for consumers to spot fraudulent measurements and false or misleading claims by other actors, exposing their investments in emissions reductions to greater risks. These vulnerabilities not only limit market growth but undermine environmental outcomes. Some criticize the carbon credit system as contributing to greenwashing,[24] and one study even concluded that only 56% of the offsetting claims are trustworthy and 44% are misleading.[25]

Non-additionality, double counting, leakage, and non-permanence are known as the primary problems existing in the voluntary markets, and due to the lack of governing authorities or regulations, these problems pose increasing threats to market transparency and credibility.

i. Non-additionality

Carbon credits must be issued only when the emissions reduction/removal/avoidance is *additional*. The additionality requires a *but-for* relationship between the climate benefits created by the offset projects and the carbon credit incentives. To examine this relationship, verifiers inspect if the GHG reductions would *not* have occurred in the absence of the carbon credit incentives.[26] If a project developer's emissions reductions would have taken place anyway, purported reduction/removal/avoidance from the mitigation activity is not additional.[27] For

[23] *Id*.
[24] *Permanence in carbon credits: why it matters, and how to evaluate it*, SYLVERA (Dec. 16, 2022), https://www.sylvera.com/blog/permanence-carbon-credits; *Greenwashing – the deceptive tactics behind environmental claims*, UNITED NATIONS, https://www.un.org/en/climatechange/science/climate-issues/greenwashing (last visited Nov. 20, 2023) (Greenwashing is the act of making false or misleading statements about the environmental benefits, thereby "misleading the public to believe that a company is doing more to protect the environment than it is".); Press Release, CFTC, Opening Statement of Commissioner Christy Goldsmith Romero: The CFTC's Role with Voluntary Carbon Credit Markets (July 19, 2023), https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement071923b#fntref7 ("Some companies have pivoted away from carbon markets entirely out of concerns that using carbon credits leaves them open to accusations of greenwashing.").
[25] Mireia Guix et al., *Trustworthy or misleading communication of voluntary carbon offsets in the aviation industry*, 88 TOURISM MGMT 1, 1, 6–7 (2022).
[26] *Additionality*, CARBON OFFSET GUIDE, https://www.offsetguide.org/high-quality-offsets/additionality/ (last visited Nov. 20, 2023).
[27] *Id*.

instance, JP Morgan purchased carbon credits equivalent to the value of one million dollars to protect a mountainous region in Pennsylvania.[28] However, it turned out that the land was never threatened and the trees were already well-preserved, thereby failing to meet the additionality requirement.[29]

This problem is complicated due to three factors. First, the additionality examination is complicated. GHG-reducing activities can occur for a lot of reasons.[30] It may be required by other laws and regulations. For example, a CCUS project can be triggered by either tax incentives under the Inflation Reduction Act and the Bipartisan Infrastructure Law or carbon credit incentives.[31] Or an entity may launch a mitigation activity simply because it is a profitable investment from a business standpoint—many solar or wind projects expand for the carbon credit purpose but for business profitability. Therefore, it is not easy to determine a but-for relationship between offset projects and carbon credit incentives. Secondly, verifiers who examine additionality use different standards.[32] One report criticized that even the major registries[33] known to have robust standards are systematically over-crediting projects and accepting low-quality carbon credits.[34] Lastly, the

[28] Ben Elgin, *There Trees Are Not What They Seem: How the Nature Conservancy, the world's biggest environmental group, became a dealer of meaningless carbon offsets*, BLOOMBERG (Dec. 9, 2020), https://www.bloomberg.com/features/2020-nature-conservancy-carbon-offsets-trees/.
[29] *Id*.
[30] U.S. DEP'T OF ENERGY, THE INFLATION REDUCTION ACT DRIVES SIGNIFICANT EMISSIONS REDUCTIONS AND POSITIONS AMERICA TO REACH OUR CLIMATE GOALS (Aug. 18, 2022), https://www.energy.gov/sites/default/files/2022-08/8.18%20InflationReductionAct_Factsheet_Final.pdf.
[31] *Id*.
[32] *Carbon Offset Registries: An Overview*, CARBON BETTER (July 13, 2022), https://carbonbetter.com/story/carbon-offset-registries/; Shane Shifflett, *Companies Are Buying Large Numbers of Carbon Offsets That Don't Cut Emissions*, THE WALL STREET JOURNAL (Sept. 8, 2022), https://www.wsj.com/articles/renewables-carbon-credits-do-not-cut-emissions-united-nations-verra-gold-standard-11662644900?st=9wb1m73angup5xv&reflink=desktopwebshare_permalink; Environmental Defense Fund, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34768.
[33] The major established third-party verifiers/registries are (1) Verified Carbon Standard by Verra, (2) Gold Standard, (3) American Carbon Registry, and (4) Climate Action Reserve. Jennifer, L, *The 4 Best Carbon Offset Programs for 2023*, CARBONCREDITS.COM (June 29, 2022), https://carboncredits.com/the-4-best-carbon-offset-programs-for-2023/.
[34] Haya et al., *supra* note 22, at 4–5.

data that verifiers need to examine additionality is typically private information of project developers. Verifiers calculate the quality and amount of carbon credits based on the information provided by project developers by comparing the expected emissions reductions and the business as usual ("BAU") level.[35] Project developers can take advantage of this asymmetric information system, attempting to receive more carbon credits.

ii. Non-permanence

The effects of GHG are long-lived. About 25% of the carbon dioxide emitted remains in the atmosphere for hundreds to thousands of years.[36] Therefore, if we were to create climate-enduring benefits, the carbon offsets and offset projects must be similarly permanent. The United Nations' Intergovernmental Panel on Climate Change provides a 100-year timeframe for monitoring permanence.[37]

The problem is that through many, avoidable or unavoidable reasons, offset projects are destroyed, and removed carbon is released back into the atmosphere, a process known as *reversal*.[38] The vulnerability to reversal varies depending on the project type. For example, forestry projects are particularly susceptible to reversal as a variety of occasions, such as flooding, droughts, wildfires, and changes in land use after the expiration of leases, can cause carbon reversal.[39] Avoidable reversals are due to intentional activities and must be compensated for directly by the project developer, while unavoidable reversals are due to force majeure events beyond the control

[35] *Carbon Credits Explained*, SOUTH POLE, https://www.southpole.com/sustainability-solutions/carbon-credits-frequently-asked-questions (last visited Nov. 20, 2023).
[36] *Permanence*, CARBON OFFSET GUIDE, https://www.offsetguide.org/high-quality-offsets/permanence/ (last visited Nov. 20, 2023).
[37] *IPCC Updates to Methodology for Greenhouse Gas Inventories*, IPCC (May 13, 2019), https://www.ipcc.ch/2019/05/13/ipcc-2019-refinement/.
[38] *Permanence in carbon credits: why it matters, and how to evaluate it*, *supra* note 24.
[39] *Forestry & Agriculture*, CARBON OFFSET GUIDE, https://www.offsetguide.org/avoiding-low-quality-offsets/vetting-offset-projects/forestry-agriculture/ (last visited Nov. 24, 2023).

of the project developer.[40] While it is important to incorporate such reversal risks when inspecting the offset projects, verifiers use different standards to calculate this aspect, increasing the possibility of overestimation of carbon credits.

iii. Double counting

The lack of a centralized oversight mechanism increases the risk of double counting—one carbon credit being claimed multiple times.[41] In the voluntary market, double counting is prone to occur by brokers/retail providers. When they purchase carbon credits from registries, they might report themselves as the consumer and retiree of the carbon credits. If consumers that subsequently purchase the carbon credits from brokers/retail providers claim the carbon credits again, the carbon credits are double counted as they do not confer any additional value.[42] Currently, because of the absence of an oversight mechanism, there is no effective way to guarantee that brokers/retail brokers are not engaging in double-counting.

iv. Leakage

Leakage describes another circumstance where climate benefits are canceled out. It occurs when emissions reductions within a project area lead to an increase of GHG emissions outside the project boundary.[43] For instance, an offset project to stop deforestation can simply shift to deforestation elsewhere. Continuous monitoring and auditing of offset projects is required to prevent leakage from occurring.

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[40] CLIMATE ACTION RESERVE, OPTIONS FOR MANAGING CO2 REVERSALS (Sept. 10, 2010), https://www.climateactionreserve.org/wp-content/uploads/2010/09/Options_for_Managing_CO2_Reversals_093010.pdf.
[41] Tabitha Whiting, *What is double counting in carbon offsetting? And why is it important?*, LUNE (Mar. 5, 2023), https://lune.co/blog/what-is-double-counting-in-carbon-offsetting-and-why-is-it-important/.
[42] Amazon Watch et al., *supra* note 20, at 7–8; Center for American Progress, *supra* note 19, at 12.
[43] *What is Carbon Leakage?*, CLEAR CENTER: CLARITY AND LEADERSHIP FOR ENVIRONMENTAL AWARENESS AND RESEARCH AT UC DAVIS (Apr. 24, 2020), https://clear.ucdavis.edu/news/what-carbon-leakage.

c. Recent movement by Commodity Futures Trading Commission

Domestically, there is no federal agency that oversees carbon credit transactions in the voluntary market. Several agencies operate programs that encourage the private sector's carbon neutrality commitments or require disclosure of GHG emissions-related information on a voluntary basis, but none is extensive enough to regulate market practices.[44] On the other hand, the CFTC is in a unique position to oversee the voluntary markets.[45] Established in 1974 under the CEA, the enabling statute,[46] to promote the integrity, resilience, and vibrancy of the United States derivatives markets through sound regulations[47], the CFTC bears the responsibility to protect the public from fraud, manipulation, and abusive practices related to the sale of commodity and financial futures and options, and foster open, competitive, and financially sound futures and option markets.[48]

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[44] The EPA administered a Climate Leaders Program from 2002 to 2010, offering technical assistance to entities in the development of a GHG inventories and the establishment of GHG reduction goals. Similarly, the DOE oversees the Voluntary Reporting of Greenhouse Gas Emissions Program, requiring the documentation of the outcome of voluntary reduction, avoidance, or sequestration of GHG emissions. Both programs operate on a voluntary basis, exclusively engaging with entities that elect to participate. Also, the programs do not cover market practices, the trading carbon credits in the voluntary carbon market. In the realm of consumer protection, the FTC pursues legal actions against marketing or advertising fraud and misrepresentation, guided by the Green Guides. The 2012 revision of the Green Guides introduced guidance on carbon offsets, yet the section's generality and vagueness limit its informativeness for market participants. Furthermore, the FTC's focus on marketing and advertising leaves other fraudulent and manipulative practices unaddressed. Lastly, the SEC has proposed the Climate Rule mandating the disclosure of Scope 1 and 2 GHG emissions for all companies and material Scope 3 GHG emissions for major corporations. If a public company employs carbon offsets, it must furnish information as to how the offsets contribute to achieving their Net-Zero goals. While this initiative enhances transparency within the voluntary market, its primary objective is investor protection, representing a noteworthy yet confined stride in the regulatory landscape. *See EPA Center for Corporate Climate Leadership*, EPA, https://www.epa.gov/climateleadership/climate-leadership-awards (last visited Nov. 20, 2023); Thomas P. Healy, *Clearing the Air: Pursuing a Course to Define the Federal Government's Role in the Voluntary Carbon Offset Market*, 61 ADMIN. L. REV. 871, 880 (2009); FTC Green Guides, 16 C.F.R. § 260.5 (2009); Press Release, SEC, SEC Proposes Rules to Enhance and Standardize Climate-Related Disclosures for Investors (Mar. 21, 2022), https://perma.cc/3YNL-W6VU.

[45] Press Release, CFTC, Public Statements & Remarks, Opening Statement of Commissioner Christy Goldsmith Romero: The CFTC's Role with Voluntary Carbon Credit Markets (July 19, 2023), https://www.cftc.gov/PressRoom/SpeechesTestimony/romerostatement071923b.

[46] 7 U.S.C. §§ 1–26.

[47] CFTC, *About the CFTC*, https://www.cftc.gov/About/AboutTheCommission (last visited Nov. 20, 2023); 7 U.S.C. §§ 2(a)(2)(A), 5(b) (1994).

[48] 7 U.S.C. §5(b).

In recent years, the CFTC has manifested its regulatory and enforcement initiative to promote the integrity of the voluntary carbon market. On July 19, 2023, the Commission held the second Voluntary Carbon Convening after the first one on June 2, 2022.[49] During the convening, the CFTC discussed recent private sector initiatives for high-quality carbon credits and market participants' perspectives on how the CFTC can promote integrity for carbon credit derivatives.[50] On June 20, 2023, the CFTC launched a whistleblower program providing monetary incentives encouraging individuals or entities to report potential frauds and manipulations in the voluntary market.[51] Less than two weeks after this, the CFTC announced the formation of a new DOE's Environmental Fraud Task Force to "combat environmental fraud and misconduct in derivatives and relevant spot markets."[52]

More importantly, on the same day that the CFTC held the first Voluntary Carbon Convening in June 2022, the CFTC announced the RFI seeking public comment on a broad range of issues potentially bearing on adjustments to regulations to account for climate-related risk.[53] The Commission stated that it "may use this information to … issu[e] new or amended guidance, interpretations, policy statements, regulations, or other potential Commission action within its authority under the CEA as well as its participation in any domestic or international fora."[54] The

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[49] Press Release, CFTC, CFTC Announces Second Voluntary Carbon Markets Convening on July 19 (June 27, 2023), https://www.cftc.gov/PressRoom/PressReleases/8731-23.
[50] *Id.*
[51] CFTC, CFTC WHISTLEBLOWER ALERT: BLOW THE WHISTLE ON FRAUD OR MARKET MANIPULATION IN THE CARBON MARKETS (June 20, 2023), https://www.whistleblower.gov/sites/whistleblower/files/2023-06/06.20.23%20Carbon%20Markets%20WBO%20Alert.pdf ("Under the Whistleblower Program of the CFTC, individuals can become eligible for both financial awards and certain protections by identifying potential CEA violations connected to fraud or manipulation in the carbon markets.").
[52] Press Release, CFTC, One Team Will Address Cybersecurity and Emerging Technology, Another to Combat Environmental Fraud (June 29, 2023), https://www.cftc.gov/PressRoom/PressReleases/8736-23?utm_source=govdelivery.
[53] Press Release, CFTC, CFTC Releases Request for Information on Climate-Related Financial Risk (June 2, 2022), https://www.cftc.gov/PressRoom/PressReleases/8541-22.
[54] *Id.*

comment period was subsequently extended to October 7, 2022.[55] Diverse stakeholders voiced their opinion, ranging from oil and gas industry stakeholders, to third-party verifiers, to non-governmental organizations working on environmental agendas, such as Natural Resources Defense Council and Environmental Defense Fund, and Attorney Generals represented by West Virginia Attorney General, to Senates.[56] The most heated discussion centered around defining the jurisdictional boundary of the Commission. Some commenters, such as the West Virginia Attorney General, were strongly against any CFTC's intervention arguing that the CFTC lacks sufficient authority.[57] Xpansiv, a market infrastructure platform in the voluntary market, also commented that carbon credit transactions are not regulable by the Commission because they fall within the forward exclusion.[58] (Forward exclusion is discussed in detail in Part III.a.) On the other side of the spectrum, some opined that the CFTC has sufficient rulemaking power to establish a regulatory framework and enforcement power to police fraud and manipulations in the market.[59] There were also perspectives contending that the CFTC has an enforcement power to oversee fraud and manipulation but does not have, or has only very limited, regulatory power to promulgate rules in the voluntary market.[60] For example, American Petroleum Institute and Eversheds Sutherland LLP

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[55] Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 43501, 43501–02 (July 21, 2022), https://www.govinfo.gov/content/pkg/FR-2022-07-21/pdf/2022-15621.pdf (Extension of comment period).

[56] *See Comments for Orders and Other Announcements 87 FR 34856*, CFTC, https://comments.cftc.gov/PublicComments/CommentList.aspx?id=7279&ctl00_ctl00_cphContentMain_MainContent_gvCommentListChangePage=1_50 (last visited Nov. 20, 2023).

[57] West Virginia Attorney General, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34785.

[58] American Petroleum Institute, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34756.

[59] Carbon Business Council, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 4, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34726; Congress of the United States, Comment Letter on Request for Information on Climate-Related Financial Risk (Sept. 16, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34724; United States Senate, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 13, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34819.

[60] The Commercial Energy Working Group, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34773; Better Markets, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34758; American Petroleum Institute, Comment Letter on

expressed concerns that despite the legitimate regulatory authority, premature involvement could create onerous barriers to market entry, thereby impeding the growth of this emerging and expanding market.[61] Accordingly, Part III analyzes the CEA to draw the statutory boundary of the Commission.

III. STATUTORY ANALYSIS – DOES THE CFTC HAVE JURISDICTION OVER TRANSACTIONS IN THE VOLUNTARY CARBON MARKET?

a. Regulatory authority: Exclusive jurisdiction over carbon credit transactions of future delivery

Pursuant to Section 2(a)(1)(A) of the CEA, the CFTC has exclusive authority concerning "accounts, agreements, and transactions involving swaps or contracts of sale of a *commodity for future delivery*."[62] It is important to note from this language that the exclusive authority only extends to swaps or contracts of sale of a commodity for *future delivery*. Sales of future delivery indicate derivatives transactions; thus, the CEA does not grant authority to regulate commodities transacted in a *spot* market.[63] Also, the CEA provides a definition of *commodity* that enumerates a long list of specific commodities, including "all services, rights, and interests … in which contracts for future delivery are presently or in the future dealt in."[64] Because the carbon credit is a right or interest to claim associated emissions reduction,[65] carbon credit is a regulable commodity under the CEA. To summarize, while the CFTC may regulate transactions of carbon credits subject to

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Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34756.

[61] American Petroleum Institute, *supra* note 60.

[62] 7 U.S.C. § 2a(1)(A) (1994) (emphasis added).

[63] *See* CFTC, Div. of Trading & Markets, CFTC Letter No. 98-73 (Oct. 8, 1998), https://www.cftc.gov/sites/default/files/idc/groups/public/@lrlettergeneral/documents/letter/98-73.pdf ("In a spot transaction, immediate delivery of the product and immediate payment for the products are expected on or within a few days of the trade date.").

[64] 7 U.S.C. § 1a(9).

[65] Verra, Comment Letter on Request for Information on Climate-Related Financial Risk (Jan. 5, 2023), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34837.

future delivery, if transactions result in immediate or near-immediate delivery of the commodity, it is beyond the CFTC's reach.

One caveat to this regulatory authority over derivative commodities is the "forward exclusion"—the CEA carves out *forwards* from the definition of *swaps*.[66] The CEA explicitly states that swaps do "not include any sale of a cash commodity for deferred shipment or delivery."[67] In a forward transaction, the contract price is set in the present, yet the delivery and payment will occur at a future date, which is also determined in the present.[68] This is unlike a future transaction where the future delivery is not promised.[69] To fall within the forward exclusion, a transaction must include (1) a *nonfinancial* commodity, (2) *deferred shipment or delivery* of such nonfinancial commodity, and (3) an *intent* to *physically deliver* the nonfinancial commodity.[70]

A nonfinancial commodity is a "commodity that can be physically delivered and that is an exempt commodity[71] or an agricultural commodity."[72] The CFTC has recognized "intangible commodity" to qualify as a nonfinancial commodity so long as "*ownership of the commodity can be conveyed ... and the commodity can be consumed*."[73] The Commission further noted that ownership of the environmental commodity[74], which includes carbon credit, is transferred in the voluntary market "so that the buyer can consume the commodity in order to comply with the terms

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[66] 7 U.S.C. §§ 1a(47)(B)(ii), 1a(27); Matthew F. Kluchenek, *The Status of Environmental Commodities under the Commodity Exchange Act*, 5 HARV. BUS. L. REV. ONLINE 39, 42 (2014-2015).
[67] 7 U.S.C. § 1a(47)(B)(ii).
[68] Rebecca Lake, *What Is a Forward Contract and How Do They Work? Definition and Example*, SMARTASSET (Apr. 20, 2023), https://smartasset.com/investing/forward-contract.
[69] *Futures Contract*, CORPORATE FINANCE INSTITUTE, https://corporatefinanceinstitute.com/resources/derivatives/futures-contract/ (last visited Dec. 2, 2023).
[70] Kluchenek, *supra* note 66, at 43.
[71] *See* 77 Fed. Reg. 48208, 48232, n.264 (Aug. 13, 2012), https://www.govinfo.gov/content/pkg/FR-2012-08-13/pdf/2012-18003.pdf ("The CEA defines an 'exempt commodity' as 'a commodity that is not an excluded commodity or an agricultural commodity.'").
[72] 7 U.S.C. § 1a(20).
[73] 77 Fed. Reg. at 48233 (emphasis added).
[74] Environmental commodity is not a defined term but includes emissions allowances, carbon offsets/credits, or renewable energy certificates. *Id*. at 48233.

of mandatory or voluntary environmental programs"; thus, carbon credit, an intangible commodity, falls within the scope of nonfinancial commodity[75] The second element regarding deferred delivery simply excludes spot transactions. Lastly, for the "intent to physically deliver" element, the CFTC has applied a "facts and circumstances" test.[76] In *CFTC v. Co Petro Mktg. Group, Inc.*, Co Petro, a gasoline broker, entered into an agreement with a customer, where "the customer (1) appointed Co Petro as his agent to purchase a specified quantity and type of fuel at a fixed price for delivery at an agreed future date, and (2) paid a deposit based upon a fixed percentage of the purchase price. Co Petro, however, did not require the customer to take delivery of the fuel. Instead, at a later specified date, the customer could appoint Co Petro to sell the fuel on his behalf."[77] In determining that this contract constituted a future delivery contract, not a forward contract, the Ninth Circuit Court reasoned that there was no intent to physically deliver because the agreement on the delivery was made "merely for speculative purposes and [was] not predicated upon the expectation [of] delivery of the actual commodity" by Co Petro.[78] Applying this to carbon credit transactions, if a consumer promises to purchase a certain amount of carbon credits on a future date from a project developer *if* the project developer successfully creates them, this contract will likely constitute a future contract regulable by the CFTC because parties recognize that the delivery may not happen if the offset project fails to create promised amount and quality of carbon credits. On the other hand, if the transfer of ownership is promised to occur on a specific future date, it will likely constitute a forward contract and fall outside the jurisdictional auspices of the CFTC.

[75] *Id*. at 48233–34.
[76] Kluchenek, *supra* note 66, at 45.
[77] Commodity Futures Trading Comm'n v. Co Petro Mktg. Grp., Inc., 680 F.2d 573, 576 (9th Cir. 1982).
[78] *Id*. at 579.

b. Enforcement authority: Broad jurisdiction to police the whole voluntary carbon market

Unlike the regulatory authority, the CFTC's enforcement authority to file lawsuits against fraudulent and manipulative activities is broad and less disputed. Section 5(b) of the CEA charges the Commission with a broad policing role.[79] It states that Congress established the Commission "to deter and prevent price manipulation or any other disruptions to market integrity; to ensure the financial integrity of all transactions subject to [the CEA] and the avoidance of systemic risk; to protect all market participants from fraudulent or other abusive sales practices and misuses of customer assets…."[80] Unlike the statutory language granting the regulatory power, the term *market* used in this provision does not distinguish spot or derivative markets, thereby allowing the CFTC to exercise enforcement authority over both markets.

The CEA then describes what practices are subject to prosecution.[81] Section 9(1) makes it unlawful for a person to commit or attempt to commit "any manipulative or deceptive device or contrivance … in connection with any swap, or a contract of sale of any commodity in interstate commerce, or for future delivery."[82] Furthermore, the CEA makes it unlawful "to cheat or defraud or attempt to cheat or defraud" other market participants[83] and a felony "to manipulate or attempt to manipulate the price of any commodity" through false, misleading, or knowingly inaccurate reports.[84]

To summarize the overall authority, the CFTC is tasked to address problems in the voluntary carbon market. Whenever the Commission witnesses any fraud or manipulation in the

[79] 7 U.S.C. § 5(b) (1994).
[80] *Id*.
[81] 7 U.S.C. § 9(1).
[82] *Id*.
[83] 7 U.S.C. § 6.
[84] 7 U.S.C. §13.

voluntary market, the CFTC is entitled to prosecute the individual or entity committing the problematic behavior. Unlike this broad enforcement authority, the regulatory authority is trickier. The statutory texts indicate that only the carbon credits traded in the derivatives market—futures, options, and swaps—are regulable. Also, under the forward exclusion, transactions involving an actual intent to physically deliver carbon credits on a future date lie outside of the CFTC's jurisdiction.

IV. ANTICIPATING FUTURE DISCUSSION – WILL CFTC'S RULEMAKING INVOKE THE MAJOR QUESTIONS DOCTRINE DISCUSSION?

In Part IV, the Article examines the jurisdictional issue from the lens of major questions doctrine. The major questions doctrine will not be brought up until the CFTC actually creates rules and unless someone challenges the CFTC's authority concerning such rulemaking activity. However, understanding the Commission's jurisdiction in connection with the major questions doctrine is valuable because the Supreme Court of the United States, in *West Virginia v. EPA*, repealed the EPA's climate regulation, Clean Power Plan ("CPP"), and some may view the CFTC's rule as a climate regulation of similar nature. Therefore, this Part compares the CPP with the CFTC's potential rule and examines any implications on the current situation. Lastly, the comment by the West Virginia Attorney General on major questions doctrine will be reviewed.

a. Case comparison: *West Virginia v. EPA*

Under the major questions doctrine, an agency must abide by a statute that grants the agency regulatory authority. When an agency's rulemaking is challenged for exceeding its authority, the court can invoke the major questions doctrine if the rule is deemed to have "vast economic and political significance," such as climate change, and the agency is regarded as

"asserting highly consequential power beyond what Congress could reasonably be understood to have granted."[85]

In *West Virginia*, the issue was whether the Clean Air Act ("CAA") authorized the EPA to regulate GHG emissions from *existing* power plants by pushing for system-wide moves away from coal power generation and toward cleaner forms of electricity production.[86] CAA Section 111 is "known as the *New* Source Performance Standards program," but Section 111(d) "authorizes regulation of certain pollutants from *existing* sources."[87] Accordingly, under Section 111(d), the EPA issued the CPP in 2015 to reduce carbon emissions from *existing* coal and natural gas plants, the actual effect of which would have forced dirtier power sources to retire and shift to cleaner energy sources, such as natural gas-fired plants and solar and wind energy ("generation shifting").[88] The Supreme Court recognized this as a major questions case because the generation-shifting scheme represented a "transformative expansion of [EPA's] regulatory authority"[89] and concerned a matter of great political significance.[90] It was specified that the rule would have incurred "billions in compliance costs, raise[d] retail electricity prices, require[d] retirement of dozens of coal plants, and eliminate[d] tens of thousands of jobs.[91] In concluding that the EPA overstepped its authority[92], the Court pointed out that the EPA's role was "limited to ensuring the efficient pollution performance …. Under that paradigm, if a source was already operating at that

[85] KATE R. BOWERS ET AL., CONG. RSCH. SERV., LSB10745, THE SUPREME COURT'S "MAJOR QUESTIONS" DOCTRINE: BACKGROUND AND RECENT DEVELOPMENTS (2022); West Virginia v. EPA, 142 S. Ct. 2587, 2605, 2609 (2022); Alabama Ass'n of Realtors v. Dep't of Health & Hum. Servs., 141 S. Ct. 2485, (2021); Nat'l Fed'n of Indep. Bus. v. Dep't of Lab., Occupational Safety & Health Admin., 595 U.S. 109 (2022).
[86] *West Virginia*, 142 S. Ct. at 2594.
[87] *Id*. at 2601–02.
[88] *Id*. at 2602.
[89] *Id*. at 2594.
[90] *Id*. at 2620.
[91] *Id*. at 2593.
[92] *Id*. at 2615–16.

level, there was nothing more for the EPA to do."[93] Because the CPP would have demanded emissions reductions by "forcing coal plants to shift away virtually all of their generation[94] rather than by improving existing systems or facilities, the Court ruled that this is "not only unprecedented[95][, but] it also effected a 'fundamental revision of the statute'" and struck down the EPA's authority.[96]

The Commission, when issuing the RFI, has explicitly mentioned that it would implement its role within its statutory authority.[97] Thus, it is likely that the Commission will establish a regulatory framework governing just derivatives market, as authorized by the CEA. For the purpose of this analysis, the Article assumes that the regulations are similar to those in compliance markets, which employ monitoring, reporting, and verification ("MRV") requirements.

The CFTC's rules will be distinguishable from the CPP. Although the rules will affect a market that reached the value of two billion dollars in 2021,[98] they will not disrupt the market by causing huge job losses or fundamental changes to the market system. Unlike the CPP which would have forced regulated entities, coal power plants, to go out of business, the CFTC's regulation will not work against the regulated entities. In contrast, it is employed to help them by increasing transparency and credibility in the market. If the regulation mandates unrealistically ambitious net zero goals by regulated entities or imposes such high minimum criteria for verification standards that it becomes too onerous for project developers to meet, the rule may invoke the major questions doctrine. However, compliance markets with MRV requirements tell us that such regulations have

[93] *Id*. at 2612.
[94] *Id*.
[95] *Id*. at 2610 ("It had never devised a cap by looking to a 'system' that would reduce pollution simply by 'shifting' polluting activity 'from dirtier to cleaner sources.'").
[96] *Id*. at 2612, 2616.
[97] Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856, 34858 (June 8, 2022), https://www.cftc.gov/sites/default/files/2022/06/2022-12302a.pdf.
[98] Anders Porsborg-Smith et al., *The Voluntary Carbon Market Is Thriving*, BCG (Jan. 19, 2023), https://www.bcg.com/publications/2023/why-the-voluntary-carbon-market-is-thriving.

not destroyed any industries nor incurred onerous compliance costs. Thus, it is unlikely that the CFTC's rules will have economic and political significance comparable to the EPA's CPP.

In addition, the Supreme Court in *West Virginia* stated that the EPA's CPP was unprecedented.[99] Although the CFTC has not regulated carbon credit transactions before, Congress has acknowledged the evolving role of the Commission. As introduced in Part II.c.i, the predecessor of the Commission regulated derivative markets of agricultural commodities, which later expanded to energy and metals commodities and financial products.[100] Congress further passed the Commodity Futures Modernization Act of 2000 to amend the CEA to grant the authority to regulate securities-related futures contracts to the Commission.[101] In the aftermath of the 2008 financial crisis, Congress passed the Dodd-Frank Wall Street Reform and Consumer Protection Act to expand the Commission's jurisdiction over bilateral swaps.[102] This development indicates that Congress intended the CFTC to adjust its roles and responsibilities to address high-risk and high-stakes transactions in the commodity derivatives markets. Climate-related financial risks in the voluntary market are not much different from risks that induced previous expansions. Thus, the attempt of the CFTC to regulate carbon credit derivative transactions will not be considered unprecedented.

b. Comment by West Virginia Attorney General

West Virginia's Attorney General, Patrick Morrisey, in his comment, expressed the opposition to any CFTC's attempt to create a regulatory framework.[103] He contended that "any CFTC policy or rulemaking that would aim to produce an 'orderly transition to a low-carbon

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[99] West Virginia Attorney General, *supra* note 57.
[100] COMMODITY FUTURES TRADING COMMISSION (CFTC), JOURNAL OF REGULATION & COMPLIANCE, https://thejournalofregulation.com/en/article/us-commodity-futures-trading-commission-cftc/ (last visited Nov. 20, 2023).
[101] *Id.*
[102] *Id.*
[103] West Virginia Attorney General, *supra* note 57.

economy' would constitute a 'fundamental revision' of the Commodity Exchange Act." The Attorney General claimed that the CFTC would be violating the major questions doctrine because while the CEA "is a remedial statute that serves the crucial purpose of protecting the innocent individual investor … from being misled or deceived", what the agency is trying to do has little to do with this remedial function.

This statement assumes that the CFTC attempts to act like an environmental regulator, such as the EPA, and contribute to environmental protection and combatting climate change. However, this assumption is incorrect. The intent behind CFTC's future rulemaking can be inferred from the RFI and its background and is purely remedial and preventive. When announcing the RFI, the CFTC stated that transitions to a low-carbon economy presented climate-related financial risks.[104] The concern about these risks was initiated by President Biden's Executive Order 14030.[105] Executive Order 14030, issued on May 20, 2021, noted that "the failure of financial institutions to appropriately and adequately account for and measure physical and transition risks[106] threaten[ed] the competitiveness of U.S. companies and markets."[107] Thus, the government directed the Financial Stability Oversight Council ("FSOC") to identify its member agencies' effort "to integrate consideration of financial risk in their policies and programs."[108] In October 2021, the FSOC published a Climate-Related Financial Risk Report recommending that the agencies "expand their respective capacities to *define, identify, measure, monitor, assess, and report* on

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[104] Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. 34856, 34857 (June 8, 2022), https://www.cftc.gov/sites/default/files/2022/06/2022-12302a.pdf.
[105] *Id.*
[106] *Id.* ("Physical risks generally are characterized by harm caused by acute, climate-related events such as hurricanes, wildfires, floods, and heatwaves; and chronic shifts in precipitation patterns, sea level rise, and ocean acidification. … Transition risks generally are characterized by stresses to certain financial institutions or sectors that result from shifts in policy, regulations, customer and business preferences, technology, credit or insurance availability, or other market or social forces that can affect business operations.").
[107] *Id.*
[108] *Id.*; Exec. Order No. 14030, 87 FR 27968 (2021).

climate-related financial risks and their effects on financial stability."[109] The CFTC, as one of the member agencies, later issued the RFI to seek comments and information as to how the Commission could implement this recommendation within its statutory authority.[110] The CFTC specified its intention to address "heightened market volatility, disruptions of historical price correlations, and challenges to existing risk management assumptions[,]" which would "directly or indirectly impact … the derivatives market and the underlying commodities markets []."[111] This background indicates that the whole process including the issuance of RFI was initiated by preventive and remedial purposes to address manipulation and fraud in the voluntary carbon market.

Also, the characteristic of this movement is different from environmental regulations. While environmental regulations typically encourage regulated entities to reduce GHG emissions, the CFTC's potential rules will not intervene in the carbon neutrality commitment. The MRV requirements, as mentioned in the previous section, may result in a bigger climate outcome since they will allow only good quality carbon credits to be transacted in the market, this is merely an incidental effect of the rules whose original motive is to prevent fraud and manipulation. Therefore, it is erred to say that the nature of the current CFTC's movement is inconsistent with the CEA or that the CFTC's regulation will be an environmental regulation.[112]

Based on the analysis of the major questions doctrine, the Article concludes that it is unlikely that the CFTC will encounter major questions criticism as long as the rules regulate the carbon credit derivatives market and aim to remedy and prevent financial risks caused by fraud and manipulation in the voluntary market.

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[109] Request for Information on Climate-Related Financial Risk, 87 Fed. Reg. at 34858.
[110] *Id.*
[111] *Id.*
[112] West Virginia Attorney General, *supra* note 57.

V. RECOMMENDATIONS

In Part V, the Article proposes two options of recommendation to the CFTC. Each relies on different authorities of the CFTC: enforcement authority and regulatory authority. These two options allow the Commission to determine the level of intervention it hopes to make in the voluntary market. If the Commission believes that, despite the legitimate regulatory power, the current voluntary market is too premature for strict regulations and that regulations may frustrate the market's functions as a gap filler to attain global carbon neutrality, thereby offsetting the benefits of preventing fraud and manipulation, it can opt to focus on the enforcement power ("Play-safe option"). On the other hand, if the Commission is confident that a regulatory framework will effectively prevent fraud and manipulation and boost market integrity, it can choose to establish a regulatory framework ("Be-brave option").

a. Play-safe option: Focus on the enforcement power, but with the support of a guidance document

The first option is to rely on the CFTC's enforcement power. The Commission's enforcement power is broad and undisputed compared to the regulatory power; thus, the CFTC may prosecute fraudulent and manipulative practices in the voluntary market without facing much jurisdictional criticism. However, the limitation of this approach is that it addresses problems retrospectively. In other words, it cures fraud and manipulation only after they have already taken place. To overcome this shortcoming, the Article suggests employing a guidance document to create an effective deterrent effect. A guidance document is a statement issued by an agency to inform the regulated entities of the agency's interpretations of statutes and regulations.[113] Although guidance is not legally binding,[114] it serves valuable functions of providing clarity as to how the

[113] GAO, GUIDANCE DOCUMENTS FROM FEDERAL AGENCIES (2015), https://www.gao.gov/assets/670/669721.pdf.
[114] Perez v. Mortgage Bankers Ass'n, 575 U.S. 92, 97 (2015).

agency will implement its statutory power and prompting changes in the behavior of regulated parties.[115] For example, the Food and Drug Administration ("FDA") actively uses guidance to respond quickly and flexibly to the technological and scientific advances in the medicine industry while basing on the existing regulatory framework.[116] Similarly, guidance can help the CFTC cope with climate-related financial risks in a newly developing market by explaining how the CFTC will apply the CEA to this new environment. Giving such notice to regulated entities in advance will allow the entities to *avoid* problematic practices. An additional advantage is that because the guidance does not have a force of law, issuing guidance does not require going through the lengthy formal rulemaking procedure.[117]

The CEA states that the mission of the Commission is to deter and prevent fraudulent and manipulative practices or any other disruptions to market integrity and grants broad enforcement ability to attain this.[118] Therefore, in a guidance document, the CFTC can explain what the *unlawful activities* would look like in the voluntary carbon market. Considering current systematic flaws and problems introduced in Part II.b., crucial components include (1) clear definitions of additionality, permanence, leakage, and double-counting and (2) a certification system that labels high-quality carbon credits as "Certified Carbon Credits."

Clarifying the concepts of additionality, permanence, leakage, and double-counting is important because the terms are interpreted, determined, and weighted differently across market participants.[119] Currently, the FTC's Green Guides provide some guidance as to double-counting

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[115] GUIDANCE DOCUMENTS FROM FEDERAL AGENCIES, *supra* note 113.

[116] Chase Weidner, *The Guidance Document Dilemma: Reforming the FDA's Use of Guidance Documents for the 21st Century*, 75 N.Y.U. ANN. SURV. AM. L. 137, 155 (2019).

[117] OFFICE OF FED. REG., A GUIDE TO THE RULEMAKING PROCESS (2011), https://www.federalregister.gov/uploads/2011/01/the_rulemaking_process.pdf.

[118] 7 U.S.C. § 5(b) (1994).

[119] Congress of the United States, Comment Letter on Request for Information on Climate-Related Financial Risk (Sept. 16, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34724; Carbon Business Council,

and additionality.[120] However, the Green Guides merely state that sellers should "ensure that they do not sell the same reduction more than one time" and that "it is deceptive to claim … that carbon offset represents an emission reduction if the reduction … was required by law."[121] This guidance is so general that it does not give specific guidelines to the market participants, and the Green Guides do not include other concepts. Furthermore, because the FTC aims to protect consumer rights by preventing marketing and advertising fraud, the Green Guides do not fully cover other market practices that exist outside of the marketing and advertising space. Therefore, the CFTC's guidance document should expand on the Green Guides and explicitly explain factors that will be considered for fraud or manipulation determination under the CEA.

The CFTC can provide criteria for measuring the additionality of emissions. The guidance can elaborate that additionality assumes a *but-for* relationship between emissions reductions and carbon credit incentives. More specifically, the Commission should explain that the agency will examine government policies or regulations that could have incentivized offset programs or assess the economic feasibility of the projects in the absence of carbon credits incentive.[122] Furthermore, suggesting utilizing EPA's BAU formula used in the Climate Leaders program as a reference can also inform verifiers and project developers of the CFTC's expectation as for the additionality examination.[123] To address non-permanence, the CFTC can provide that any destruction or removal of projects within a certain period will trigger the Commission's investigation of the projects. Since the United Nations' Intergovernmental Panel on Climate Change provides a 100-

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Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 4, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34726.

[120] FTC Green Guides, 16 C.F.R. § 260.5 (2009).

[121] *Id.*

[122] Environmental Defense Fund, Comment Letter on Request for Information on Climate-Related Financial Risk (Oct. 7, 2022), https://comments.cftc.gov/Handlers/PdfHandler.ashx?id=34768.

[123] EPA, THE EPA CORPORATE GHG GOAL EVALUATION MODEL USER'S MANUAL (2014), https://www.epa.gov/sites/default/files/2015-07/documents/epa_ghg_goal_model_users_guide_8.14_final.pdf.

year timeframe to monitor permanence, the CFTC may refer to this timeframe.[124] For leakage, appropriately defining a "leakage area" can help project developers understand the boundary of their accountability for increased emissions around or within that area. Lastly, in terms of double counting, although the concept itself is unequivocal, the guidance may provide that any cross-country trading or transactions involving intermediaries such as brokers/retail providers, where the potential for double counting is relatively high, are subject to vigilant monitoring by the CFTC.

One caveat in issuing a guidance document separate from the FTC's Green Guides is that this creates a risk of double enforcement by the FTC and the CFTC. Fraudulent activities that are enforceable under the CFTC's guidance could also fall within the scope of deceptive marketing or advertising under the FTC's Green Guides. To prevent double enforcement and confusion in the market, the two agencies should collaborate to either divide the scope of oversight or consider an interagency approach through which the agencies work like a single entity.

Secondly, as the Center for American Progress suggested in its comment, the Guidance can notify what constitutes a good quality carbon credit by introducing a labeling scheme.[125] Labeling has been a useful tool to encourage sellers to produce products that meet certain standards set by the government and assist in making informed decisions by customers. For example, EPA's ENERGY STAR label is granted to products "meeting the energy efficiency requirements set forth in ENERGY STAR product specifications."[126] Another example is the United States Department of Agriculture's ("USDA") Organic Certification for products "grown and processed according to federal guidelines addressing, among many factors, soil quality, animal raising practices, pest and

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[124] *IPCC Updates to Methodology for Greenhouse Gas Inventories*, IPCC (May 13, 2019), https://www.ipcc.ch/2019/05/13/ipcc-2019-refinement/.
[125] Center for American Progress, *supra* note 19.
[126] *How a Product Earns the ENERGY STAR Label*, ENERGY STAR, https://www.energystar.gov/products/how-product-earns-energy-star-label (last visited Nov. 22, 2023).

weed control, and use of additives."[127] The Organic Certification program is particularly noteworthy because it reduced ten different certification protocols to one standard.[128] Thus, introducing a label system to the voluntary carbon market can similarly bring uniformity to the verification standards. Also, in creating the certification program, the USDA created a National Organics Standards Board ("NOSB") which is comprised of industry representatives to incorporate their market expertise.[129] A comparable group already exists in the voluntary carbon market—the Integrity Council for the Voluntary Carbon Market ("ICVCM"), an independent governance body for the voluntary market.[130] The ICVCM consists of key stakeholders in the market and released in 2023 the Core Carbon Principles "to establish a consistent and standardized guide to assess the quality of high-quality carbon credits".[131] Since the ICVCM has special expertise in the voluntary market, the CFTC may collaborate with the ICVCM to devise specifications for the carbon credit certification. Once a labeling system is in place in the market, consumers can readily estimate the quality of products they pay for, verifiers with below-average standards will improve their standards, and project developers will redesign offset projects to receive the certification. The labeling system creates an inherent incentive to improve the quality of carbon credits because doing otherwise would establish a rebuttable presumption that carbon credits without the label are susceptible to fraud and manipulation.

[127] Miles McEvoy, *Organic 101: What the USDA Organic Label Means*, U.S. DEPARTMENT OF AGRICULTURE (Mar. 22, 2012), https://www.usda.gov/media/blog/2012/03/22/organic-101-what-usda-organic-label-means.
[128] Maria Savasta-Kennedy, *The Newest Hybrid: Notes Toward Standardized Certification of Carbon Offsets*, 34 N.C.J. INT'L. L & COM. REG. 851, 875–76 (2009).
[129] *Id*. at 879–80.
[130] *About the Integrity Council for the Voluntary Carbon Market*, INTEGRITY COUNCIL FOR THE VOLUNTARY CARBON MARKET, https://icvcm.org/about-the-integrity-council/ (last visited Nov. 22, 2023).
[131] *Core Carbon Principles provide guidance around global thresholds for a high-integrity voluntary carbon market*, ENVIRONMENTAL DEFENSE FUND (July 28, 2023), https://www.edf.org/media/core-carbon-principles-provide-guidance-around-global-thresholds-high-integrity-voluntary.

b. Be-brave option: Establish a regulatory framework but collaborate with Federal Energy Regulatory Commission

The second recommendation is to regulate the global voluntary market but in coordination with the Federal Energy Regulatory Commission ("FERC"). Regulations are more effective than prosecution in that they mandate compliance with substantive and procedural standards, thereby preventing fraudulent and manipulative practices from the earlier stage of the lifecycle of carbon credits. However, given the jurisdictional criticisms that may arise from the CFTC's independent rulemaking, the Article proposes establishing a regulatory framework with the FERC, the agency vested with regulatory authority over the carbon credit *spot* market.

Through Section 341 of the American Clean Energy and Security Act of 2009, Congress amended the Federal Power Act, conferring regulatory authority over the carbon credits spot market to the FERC.[132] Under the amended Federal Power Act, the FERC has the authority to promulgate regulations for the establishment, operation, and oversight of spot markets for carbon credits.[133] The underlying regulatory and enforcement authorities are similar to those granted to the CFTC by the CEA—the FERC's regulations must provide comprehensive market oversight and prohibit fraud and market manipulation, and if the agency determines any entity has violated the regulations or made any misleading statements, the FERC may issue an order prohibiting the entity from trading carbon credits or impose fines.[134] Thus, while the CFTC's regulatory jurisdiction alone does not cover both spot and derivative markets, collaborative efforts with the FERC can effectively govern the entire voluntary market. This interagency approach can also

[132] H.R. REP. NO. 111-137, at 208–14, 420 (2009) ("The Federal Energy Regulatory Commission is charged with regulating the cash market in allowances, offset [credits], and RECs.").
[133] *Id.*
[134] *Id.*

prevent the creation of duplicative regulatory frameworks by each agency, thereby avoiding market confusion and minimizing unnecessary administrative costs.

However, it's essential to note that the FERC lacks substantive expertise in the voluntary carbon market and carbon credits. Despite the grant of power under the American Clean Energy and Security Act of 2009, the FERC has not played any role in the voluntary carbon market. In 2021, the FERC issued a policy statement contemplating the integration of state-determined carbon prices into the organized wholesale electricity market.[135] However, carbon pricing mechanisms in the wholesale electricity market are distinct from those in the voluntary carbon market, and the market ecosystem of the wholesale electricity market and voluntary carbon market are different. Nevertheless, this underscores the FERC's effort to address GHG emissions through a market-based tool, which could be expanded to carbon emissions in the voluntary market.

An effective governance over the voluntary market must incorporate the MRV mechanism targeting stakeholders that are sources of problems in Part II.b. Challenges associated with non-additionality primarily stem from project developers who often provide incomplete or inaccurate information about offset projects and verifiers/registries, some of which employ questionable verification standards. The double-counting is typically related to brokers/retail providers who sometimes claim carbon credits themselves and let subsequent claiming by consumers and verifiers/registries responsible for tracking title changes and retirement of carbon credits. Non-permanence and leakage are associated with project developers, who operate offset projects, and verifiers/registries, tasked with monitoring project status. In addition to the identified problems, price manipulation by brokers/retail providers should be addressed. In fact, many of them sell

[135] *FERC Issues Policy Statement on Carbon Pricing in Organized Wholesale Markets*, FERC (Apr. 15, 2021), https://www.ferc.gov/news-events/news/ferc-issues-policy-statement-carbon-pricing-organized-wholesale-markets.

carbon credits at a significant, unreasonable markup.[136] Price variations of each carbon credit and fluctuations of prices in the marketplace make it harder for consumers to detect such manipulative practices.

The following sections suggest contents for the CFTC's regulation and examine California's "cap-and-trade" program ("California's Program") as a benchmark. Administered by the California Air Resources Board ("CARB"), California's Program necessitates that carbon credits "represent a GHG emission reduction or GHG removal enhancement that is real, additional, quantifiable, permanent, verifiable, and enforceable." [137] Given that its regulatory framework delineates requirements per key stakeholders,[138] California's Program serves as a valuable and instructive resource.

i. Governing project developers

In ensuring the complete and accurate provision of data regarding offset projects, the regulatory framework must explicitly prohibit project developers from engaging in the falsification, concealment, or omission of material facts related to offset projects. This prohibition should apply both when submitting required information to verifiers/registries for the verification of offset projects and selling carbon credits to consumers. Violations of these provisions should result in injunctions or fines.

Once offset projects are listed, project developers must bear the responsibility of maintaining project integrity to deliver high-quality carbon credits. California's Program stipulates that project developers monitor measurements and project performance[139] and report the result in

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[136] Center for American Progress, *supra* note 19.
[137] CAL. CODE REGS. tit. 17, § 95970 (2019).
[138] *Id.*
[139] tit. 17, § 95976(d).

compliance with designated schedules.[140] In addition, project developers are obligated to retain records pertaining to their offset projects for a minimum duration of 15 years post-carbon credit issuance.[141] These records must contain comprehensive, essential information verifying the legitimacy of offset projects, such as project boundaries, BAU baseline calculations, GHG emission reductions, data supporting additionality calculations' accuracy, and quality assurance and control information.[142] The CFTC can adopt such reporting and record retention requirements, which will serve as an effective deterrent against fraudulent activities by project developers. Through these requirements, verifiers/registries can conveniently review project history to examine potential overestimation of carbon credits and prevent project developers from intentionally hiding or destroying important data for investigation in the event of suspicious withdrawals or destruction of offset projects.[143]

ii. Governing verifiers/registries

One notable difference between the current voluntary market and California's compliance market is the requisite separation of verifiers and registries in the latter,[144] whereas the same entities usually serve both functions in the former. The rationale behind the separation is to prevent conflict of interests and preserve neutrality. Verifiers in California's Program assess offset projects and share verification report with the CARB or registries following the verification standards.[145] In contrast, registries determine the eligibility of offset projects for carbon credit issuance based on verification reports submitted by the verifiers.[146] While the identical structural model is not

[140] tit. 17, § 95976(d).
[141] tit. 17, § 95976(e).
[142] *Id.*
[143] tit. 17, § 95976.
[144] tit. 17, § 95979.
[145] *Id.*
[146] tit. 17, § 95802.

obligatory, regulations governing the voluntary market must ensure to avoid the conflict of interest between these functions.

Moreover, to ensure the robustness of verifiers/registries in the voluntary market, the regulatory frameworks may stipulate accreditation requirements so that entities possess the requisite expertise in carbon credits and offset projects. In California's Program, verifiers are mandated to meet accreditation standards outlined by the CARB[147], while registries must acquire approval from the executive officer of the CARB[148]. Registry approval is conditioned upon the independence of the registry from project developers and verifiers, coupled with proficiency in an environmentally-focused market where carbon-emission-based commodities are traded.[149]

Next, verifiers/registries in the voluntary market must assess offset projects using their verification standards and periodically monitor the project status, adjusting classifications from "active" to "inactive," "terminated," "completed," or "monitored." Similar to California's Program, verifiers/registries should be obligated to maintain a log detailing all issues raised and their subsequent resolutions and submit verification and monitoring reports to the CFTC and the FERC for review.[150]

iii. Standardizing verification metrics

Standardizing verification metrics employed by verifiers/registries is crucial to minimize the risk of introducing low-quality credits and enhance credibility in the market. Additionally, standardization will contribute to reducing transaction costs for consumers by eliminating the need for individual research to verify carbon credit quality.

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[147] tit. 17, § 95978.
[148] tit. 17, § 95987.
[149] *Id.*
[150] tit. 17, § 95987(f).

In California's Program, the CARB has instituted Compliance Offset Protocols ("Protocols") for each project type, tailoring them to characteristics unique to each project type.[151] Regulations for the voluntary market can model after these Protocols and establish tailored criteria and minimum requirements for calculating business-as-usual scenarios and monitoring and collecting data about emission reductions and enhancement of offset projects.

Furthermore, the Protocols account for key considerations such as leakage, permanence, and additionality of offset projects. For instance, the additionality requires that GHG reductions and removal enhancements are not required by law, regulation, or any legally binding mandate applicable in the offset project's jurisdiction and would not otherwise occur in a conservative business-as-usual scenario.[152] To address the particularly high non-permanence risk in forest projects, the Protocols incorporate distinct procedures to handle intentional and unintentional reversals.[153] Likewise, verification standards for the voluntary carbon market should clearly address how additionality, permanence, leakage, and double counting will be managed.

iv. Governing brokers/retail providers

While California's Program effectively addresses a majority of key stakeholders, it lacks governing mechanisms for brokers/retail providers primarily because California's Program doesn't rely on these intermediaries. As mentioned earlier, regulations for brokers/retail providers in the voluntary market are imperative due to their potential to compromise market integrity through price manipulation and double counting.

[151] California runs (1) livestock projects, (2) mine methane capture projects, (3) ozone depleting substances projects, (4) rice cultivation projects, (5) U.S. Forest Projects, and (6) Urban Forest Projects. Therefore, there exists separate protocol governing each project type. *Compliance Offset Program*, CALIFORNIA AIR RESOURCES BOARD, https://ww2.arb.ca.gov/our-work/programs/compliance-offset-program (last visited Nov. 22, 2023).
[152] tit. 17, § 95973(a)(2)(A).
[153] tit. 17, § 95983.

The inherent information asymmetry between brokers/retail providers and consumers is a primary driver of price manipulation. To empower consumers to make informed purchasing decisions, the CFTC and FERC should mandate the provision of key information influencing carbon credit pricing to consumers throughout the transactions. This information, including project type, vintage, and the reputation of the project developer, will enable consumers to independently and easily assess the reasonableness of the price.

To prevent double counting by brokers/retail providers, the CFTC can require registries to establish a distinct categorization system for carbon credits sold to brokers/retail providers. Registries can label such credits as "sold, unclaimed" and restrict brokers/retail providers from retiring these carbon credits unless they are claiming emissions reductions to meet their net-zero goals. Throughout transactions between consumers and brokers/retail providers, the latter must transparently convey the fact that the carbon credits being traded are unclaimed. Regulations should further stipulate that consumers personally claim and retire these credits from registries, rather than relying on brokers/retail providers to do so. Such a system will promote transparency in carbon credit transactions, thereby enhancing market credibility.

VI. CONCLUSION

The global voluntary carbon market has evolved significantly, relying solely on market mechanisms. While this free-market system has fostered private sector engagement and shown promise as a bridge toward achieving global net zero by 2050, it is becoming evident that some form of government intervention is necessary to avert potential market failure. Failure to curb fraudulent and manipulative practices, including non-additionality, non-permanence, double counting, leakage, and price manipulation, poses a threat to market trust and growth. Moreover,

permitting transactions of illegitimate carbon credits may inadvertently contribute to increased greenhouse gas emissions.

Thus, this Article contends that the Commodity Futures Trading Commission possesses sufficient authority to enhance the integrity of the voluntary market. As the primary regulator of the United States derivatives market, the CFTC wields broad enforcement power to combat fraud and manipulation in the voluntary carbon market and holds regulatory authority to formulate rules governing carbon credit derivatives. The Article further concludes that the CFTC's future rulemaking is unlikely to encounter significant challenges under the major questions doctrine providing that the CFTC adheres to the jurisdictional boundaries.

Accordingly, two recommendations are proposed, offering distinct approaches. The first option centers on leveraging enforcement power through active prosecution. For optimal effectiveness, it is further recommended to utilize a guidance document explaining the agency's definition of fraud and manipulation as well as introducing the "Certified Carbon Credits" labeling system. The second option advocates for a regulatory framework based on the CFTC's rulemaking authority, employing the MRV system to enhance transparency and credibility. Given potential jurisdictional concerns, the Article suggests collaboration with the FERC, which oversees the carbon credit spot market.

Such analyses on statutory authority and viable solutions are particularly timely and meaningful because the agency is pondering the kinds of efforts it can make to address the climate-related financial risks in the voluntary carbon market. The comment period of the RFI ended in October 2022, and a lot of commentators agreed upon some sort of CFTC's intervention in the market while having different opinions as to the level of intervention. That is why the Article suggested two options although the Commission can utilize both powers at the same time.

Irrespective of the path chosen by the agency, centralized governance by the CFTC is posited as crucial for fostering confidence, encouraging market growth, and driving innovations because only through the transactions of quality carbon credits will the voluntary market confer the meaningful climate benefits.