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Demand & Integrity in the Voluntary Carbon Markets – The Publication of the VCMI Claims Code of Practice

The Integrity Dilemma

The voluntary carbon markets (the **VCM**) has faced longstanding criticism on two fronts:

- **On the supply side**, the leading carbon standards bodies, responsible for certifying carbon removal and avoidance projects and issuing carbon credits from those projects, have faced scrutiny on the credibility of the methodologies they use to assess the projects, specifically whether the credits issued in respect of those projects actually represent real carbon reductions; and
- **On the demand side**, companies who buy carbon credits with the intention of making claims about their emissions reduction performance face intense scrutiny from shareholders and third parties alike over the type and accuracy of these claims.

The lingering question marks over integrity have real-world consequences for the viability of VCM projects, with prices of carbon credits falling sharply.

Furthermore, Stephenson Harwood has reported on decarbonisation and litigation risks in the past, which demonstrates that even participating in largely unregulated and voluntary markets like the VCM is not without its risks, both legal and reputational, if the activities in question are perceived to be lacking in integrity.

For example, the once prevalent adverts for companies or their products being "carbon neutral" (or some similar term) have taken a hit with the UK's Advertising Standards Authority's guidance and associated crack down on the risk of greenwashing by requiring companies to prove that their environmental claims are actually effective.

The VCMI's Claims Code of Practice

After two years of development including a public consultation, the Voluntary Carbon Markets Integrity Initiative (the **VCMI**), which is a multi-stakeholder non-profit organisation, published in June its Claims Code of Practice (the **Code**) and Supplementary Guidance, which aims to provide companies with a standardised rulebook for how they should use carbon credits in a way which bolsters demand side integrity.

The starting point for the Code is that, while the VCM can support and accelerate climate policies (and represents a means of mobilising finance to meet the Paris Agreement's ambitious climate finance goals), carbon credits must be used with integrity and not as a substitute for real action. To this end, the VCMI envisages the Code as a means for companies to make credible claims for their carbon credit usage in the form of "**VCMI Claims**".

Making a VCMI Claim entails complying with the 4 step process set out in the Code as summarised below:

Step 1: Complying with the "Foundational Criteria"

Before using carbon credits, a company should be able to demonstrate that its climate strategy complies with the VCMI's Paris Agreement-aligned Foundational Criteria, which are to:

- **Maintain and publicly disclose an annual greenhouse gas emissions inventory.** This inventory should be enterprise-wide, updated annually (such as through the company's annual sustainability report) and in accordance with applicable standards, such as the GHG Protocol Corporate Accounting and Reporting Standard, although the VCMI acknowledges that it is a challenge for some companies to access data on all "Scope 3" (wider supply chain) emissions;

- **Set and publicly disclose validated science-based near-term emissions reduction targets, and publicly commit to reaching net zero emissions no later than 2050.** The Code explains that "science-based" targets should follow the Science Based Target initiative's (**SBTi**) criteria for near-term targets (being targets within 5-10 years), and the VCMI encourages companies to actually validate these targets with the SBTi. Companies should also be clear on how they define "net zero", which should be in line with globally accepted frameworks;
- **Demonstrate that the company is on-track towards meeting a near-term emissions reduction target and minimising cumulative emissions over the target period.** This entails demonstrating year-on-year progress against a set base year for targets. In addition to actually disclosing emissions reductions achieved internally, companies are expected to disclose information about the level of financing they dedicate to their emission mitigation activities, and their governance structures for overseeing their targets; and
- **Demonstrate that the company's public policy advocacy supports the goals of the Paris Agreement and does not represent a barrier to ambitious climate regulation.** The Code expects companies to submit a public statement on how their advocacy is consistent with the principles of the four categories of the Global Standard on Responsible Corporate Lobbying (Policy and Commitment, Governance, Action, and Specific Disclosure).

The VCMI acknowledges that some companies, including SMEs, may struggle to fulfil all the steps necessary for making VCMI Claims, and envisages the development of an "on-ramp" system for less developed companies who struggle to meet the Foundational Criteria.

Step 2: Selecting a VCMI Claim

Once the Foundational Criteria are met, companies can choose from 3 tiers of VCMI Claims to make in connection with the carbon credits they have purchased.

All VCMI Claims are intended to represent action above and beyond that company's own internal decarbonisation efforts, also referred to as "beyond-value-chain mitigation" or "BVCM". The SBTi has recently published a report on BVCM, which explains that within its recommended hierarchy of mitigation activities companies should focus on near and long-term targets to reduce emissions within their own value chains but alongside this they are encouraged to mitigate emissions beyond their own value chains, i.e. BVCM. The Code explains that: "Carbon credits underpinning VCMI Claims are not counted as internal emission reductions that a company undertakes to meet decarbonization targets. Rather, these purchases represent a contribution to both the company's climate goals and to the collective global mitigation effort to reach net zero emissions". The VCMI defines such carbon credit claims as "contribution claims".

In other words, companies must set and meet targets within their own value chains not based on the use of carbon credits, and only use carbon credits in addition to the (internal) action needed to meet these targets. This adds to the trend of independent bodies and regulators pressuring companies to move away from potentially misleading claims of being "carbon neutral" through the use of just carbon credits.

The current tiers of VCMI Claims are:

- **VCMI Silver** – As the entry level tier, a company can make a VCMI Silver claim if it purchases and retires carbon credits in an amount equal to or greater than 20%, and less than 60%, of its remaining emissions <u>once</u> it has demonstrated its own internal progress towards its near-term emissions targets.
- **VCMI Gold** – As the intermediate tier, a company can make a VCMI Gold claim if it purchases and retires carbon credits in an amount equal to or greater than 60%, and less than 100%, of a company's remaining emissions <u>once</u> it has demonstrated progress towards its near-term emissions targets.
- **VCMI Platinum** – As the "most aspirational" tier, a company can make a VCMI Gold claim if it purchases and retires carbon credits in an amount equal to or greater than 100% of remaining emissions <u>once</u> it has demonstrated its own internal progress towards its near-term emissions targets.

Making a VCMI Claim requires the company in question to measure its performance against a base year and, in respect of VCMI Silver or Gold claim, to increase the percentage of carbon credits purchased and retired year-on-year after making the relevant VCMI Claim.

The names and variety of VCMI Claims is subject to further revision by the VCMI.

Step 3: Meeting Carbon Credit Use and Quality Thresholds

The Code requires companies to only make VCMI Claims using "high quality" carbon credits, which it defines as those credits which will meet the Integrity Council for the Voluntary Carbon Market's (the **ICVCM**) Core Carbon Principles (**CCPs**) and qualify under its Assessment Framework once this ICVCM labelling system is in operation for specific activity types. In the interim, companies may use certain CORSIA eligible carbon credits. Therefore, the VCMI is linking integrity on the demand side of the VCM with the ICVCM's complementary multi-stakeholder initiative designed to ensure integrity on the supply side of the VCM.

Ensuring compliance with the ICVCM's requirements will be the responsibility of the relevant standards bodies but, going forward, corporate buyers will need to ensure that the carbon credits which they buy, either directly from project developers or through brokers or platforms, have the required labels demonstrating their provenance and credentials.

Step 4: Obtaining Third-Party Assurance of Reported Information

Finally, the Code requires companies to be transparent and disclose key information regarding their purchase and use of carbon credits in order to prove their compliance with the Foundational Criteria and VCMI Claims they allege to make, which information must be assured by an independent third party.

The scope of this assurance will be further set out by the VCMI in November when it publishes its "Monitoring, Reporting and Assurance (MRA) Framework". If companies have already undergone an independent third-party assurance process this documentation may be provided as part of the VCMI assurance process.

Going Forward

The VCMI envisages the Code as an evolving rulebook, and plans to supplement it with additional guidance and features, including the addition of new tiers of VCMI Claims and, in November, the MRA Framework, which will provide further guidance on how companies can obtain VCMI Claims. As a result, companies can begin to familiarise themselves with the Code and use it to assess their existing carbon credit strategies, including considering whether any lingering claims related to carbon neutrality are potentially misleading. However, they will need to wait for further updates this year from the VCMI before they can truly start preparing to make VCMI Claims.

In addition, the implementation of the Code will be linked to the ICVCM's development of CCP-eligible carbon crediting programmes later this year, under which "CCP-approved" carbon credits may be issued.

Once fully in action, the Code should not only help companies manage how they use carbon credits but also provide other actors, such as investors and financiers, with an effective means of assessing those companies' environmental claims and performance.

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We hope that you find this update both useful and interesting. If you have any comments or would like to learn more about this topic, please get in touch with either your usual SH contact or any member of our commodities team by clicking here.

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