

CLIENT ALERT

# Real Fraud Claims for Fake Carbon Credits

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### **The First of Many?**

For the first time, the U.S. Commodity Futures Trading Commission (the “CFTC”) initiated enforcement actions against a carbon credit project developer and two of its executives for violating the antifraud provisions of the Commodity Exchange Act (the “CEA”) and CFTC regulations.

On October 2, 2024, the CFTC announced that it had issued orders filing and settling charges against CQC Impact Investors LLC (“CQC”) and Jason Steele (CQC’s former chief operating officer (“COO”)), and filed a complaint in the U.S. District Court for the Southern District of New York against Kenneth Newcombe, CQC’s former chief executive officer (“CEO”) and majority shareholder.<sup>1</sup>

The CFTC’s actions, which are the first of their kind, illustrate the agency’s increased focus in recent years on fraud associated with carbon offsets and the environmental claims made by carbon offset projects.

### **The Voluntary Carbon Offset Market**

Carbon offsets are tradable instruments that represent the avoided greenhouse gas (“GHG”) emissions stemming from a project. Typically, one tradable offset represents one metric ton of GHG equivalent that has been reduced or removed from

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<sup>1</sup> See Complaint for Injunctive and Other Equitable Relief and for Civil Monetary Penalties Under the Commodity Exchange Act and Commission Regulations, *Commodity Futures Trading Comm’n v. Kenneth Newcombe*, No. 24-cv-7477 (S.D.N.Y. Oct. 2, 2024) (hereinafter, “Complaint”); *In re CQC Impact Investors LLC*, CFTC No. 24-37 (Sept. 30, 2024) (hereinafter, “CQC Settlement”); *In re Jason Steele*, CFTC No. 24-36 (Sept. 30, 2024) (hereinafter, “Steele Settlement”).

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the atmosphere. For example, carbon offsets may be issued for the preservation of a rainforest in an amount equal to the emissions that were avoided by preventing deforestation. Carbon offsets are also issued for activities like replacing existing appliances (e.g., lightbulbs or stovetops) with more energy-efficient technologies. Carbon offsets may be created and used as a means to comply with mandatory greenhouse gas reduction regimes, such as the California Cap-and-Trade Program administered by the California Air and Resources Board.<sup>2</sup> Alternatively, voluntary carbon credits (“VCCs”) are not subject to any specific compliance or legal obligation pursuant to an environmental regulatory regime, but instead are created, traded, and retired on a voluntary basis. Carbon offsets are commodities traded in both the spot and derivatives markets.<sup>3</sup>

To receive carbon offsets for a project or activity, project developers of carbon offset projects typically work with a carbon crediting program to confirm that the project and the methodology the project uses to quantify its emissions reductions satisfies the crediting program’s standards. Third-party validation and verification bodies (“VVBs”) are also used to validate and verify the project. Generally, crediting programs operate or utilize carbon credit registries that allow market participants to trade and track carbon offsets. Once a project is certified with a crediting program, it will report on the project’s activity and be issued carbon offsets on the carbon credit registry based on the project’s reported GHG reductions.

Once issued, project developers may sell the carbon offsets to market participants. There are several reasons why market participants may wish to purchase carbon offsets. They may purchase carbon offsets in the voluntary market to comply with mandatory compliance standards if permitted by a governing jurisdiction (e.g., to comply with caps on GHG emissions implemented by certain states). Alternatively, some market participants may voluntarily purchase carbon offsets (i.e., VCCs) to meet emissions reduction goals.<sup>4</sup> Other market participants may purchase carbon offsets as marketers to resell to end users.

In recent years, the CFTC has expressed concern about the potential for fraud in the carbon markets and with regard to the environmental claims made by carbon offset projects. On June 29, 2023, the CFTC Division of Enforcement announced that it had created an Environmental Fraud Task Force that “will combat environmental fraud and misconduct in derivatives and relevant spot markets.”<sup>5</sup> The CFTC’s Environmental Fraud Task Force was set up to “examine, among other things, fraud with respect to the purported environmental benefits of purchased carbon credits, as well as registrants’ material misrepresentations regarding ESG products or strategies.”<sup>6</sup>

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<sup>2</sup> Cal. Code Regs., tit. 17, § 95801 *et seq.*

<sup>3</sup> See, e.g., *CFTC Approves Final Guidance Regarding the Listing of Voluntary Carbon Credit Derivative Contracts*, Release No. 8969-24 (Sept. 20, 2024), <https://www.cftc.gov/PressRoom/PressReleases/8969-24>.

<sup>4</sup> See Lola Mendez, *Taylor Swift Claims She Offsets Her Travel Carbon Footprint - How Does That Work?*, BBC (Feb. 13, 2024), <https://www.bbc.com/travel/article/20240213-taylor-swift-private-jet-flight-travel-carbon-footprint>.

<sup>5</sup> CFTC Release No. 8736-23, *CFTC Division of Enforcement Creates Two New Task Forces* (June 29, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8736-23>.

<sup>6</sup> *Id.*

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In addition, the CFTC's Whistleblower Office solicited the public for tips relating to alleged carbon markets misconduct.<sup>7</sup> In its alert for whistleblower tips, the CFTC requested information from the public related to potential fraud in the carbon markets including, but not limited to, manipulative and wash trading, "ghost" credits, double counting, fraudulent statements relating to material terms of the carbon credits, and potential manipulation of tokenized carbon markets.<sup>8</sup>

### **The Complaint Against Newcombe**

In its Complaint against Newcombe, the former CEO of CQC, the CFTC alleges that Newcombe engaged in a fraudulent scheme from at least 2019 to around December 2023 (the "Relevant Period") that involved reporting false information regarding CQC's emissions-reduction projects with the aim of obtaining carbon offsets beyond those that the company was entitled to receive.<sup>9</sup>

As part of its business, CQC developed energy-efficient projects meant to replace more emissions-intensive projects of the same nature. For example, CQC developed more efficient cookstoves that, when installed to replace less efficient household cooking methods, resulted in reduced carbon emissions. During the Relevant Period, CQC managed the installation of millions of cookstoves.<sup>10</sup>

CQC would report information related to its cookstove projects to a carbon credit registry (the "Carbon Credit Registry") and VVBs, pursuant to the approved methodology used to quantify the emissions reductions resulting from the installed cookstoves. Along with this information, CQC made and submitted representations, which in certain instances were signed by Newcombe himself, that stated the information provided to the Carbon Credit Registry was true, accurate, materially complete, and not false, fraudulent, or misleading. The reported information was publicly listed by the Carbon Credit Registry, and was used by the Carbon Credit Registry to issue VCCs to CQC that CQC could, and did, sell to market participants.<sup>11</sup>

In its Complaint, the CFTC alleges that Newcombe, as well as other employees of CQC, repeatedly provided "false, misleading, and inaccurate information to the Carbon Credit Registry and VVBs for the purpose of presenting a misleading impression of the quality and results of the projects, and wrongfully increasing the number of VCCs a project would be issued."<sup>12</sup> The CFTC's Complaint described a fraudulent scheme in which Newcombe and others at CQC would falsify data

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<sup>7</sup> CFTC Release No. 8723-23, *CFTC Whistleblower Office Issues Alert Seeking Tips Relating to Carbon Markets Misconduct* (June 20, 2023), <https://www.cftc.gov/PressRoom/PressReleases/8723-23>.

<sup>8</sup> 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>.

<sup>9</sup> See Complaint at 1.

<sup>10</sup> See Complaint at 8-9.

<sup>11</sup> See *id.* at 10-11.

<sup>12</sup> *Id.* at 11.

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reported to the Carbon Credit Registry and VVBs relating to the projects, referring to this falsification internally as “managing the data.”<sup>13</sup>

In one example, the Complaint explained how CQC personnel performed surveys to gather information relevant to the methodology used to calculate the amount of estimated GHG reductions associated with CQC’s cookstove projects, which would determine the amount of VCCs the Carbon Credit Registry would issue. The results of the survey performed indicated a low amount of estimated GHG reductions. Upon hearing of the results, Newcombe allegedly told certain personnel that “he would have liked to see a higher, more favorable output for the project,” and specified a higher target figure he had in mind.<sup>14</sup>

In response, a CQC employee allegedly told Newcombe that “the data would have to be altered to meet that goal.”<sup>15</sup> Then, according to the Complaint, CQC personnel “falsely and misleadingly altered the project’s survey data in order to result in a higher, more-favorable calculation of greenhouse-gas reductions.”<sup>16</sup> This information was submitted to the Carbon Credit Registry, and the Carbon Credit Registry issued VCCs to CQC based upon this information. Newcombe signed a representation attesting to the truth and accuracy of the information submitted.<sup>17</sup> As a result of this fraudulent scheme, the CFTC alleges that CQC was issued “millions more VCCs” than it was entitled to receive.<sup>18</sup>

The Complaint alleges that Newcombe violated Section 6(c)(1) of the CEA and CFTC Regulations 180.1(a)(1)-(3), which “prohibit the use or attempted use of any manipulative or deceptive device, untrue or misleading statements or omissions, or deceptive practice, in connection with any swap or contract of sale of any commodity in interstate commerce, or for future delivery.”<sup>19</sup> The CFTC asserts that Newcombe’s actions violated Section 6(c)(1) of the CEA and CFTC Regulation 180.1(a)(1)-(3) by “directly or indirectly, intentionally or recklessly engaging in fraud in connection with contracts of sale of VCCs, a commodity in interstate commerce,” including by intentionally or recklessly reporting and causing to be reported false or misleading information to the Carbon Credit Registry, VVBs, and others for the purpose of increasing the number of VCCs issued to CQC.<sup>20</sup> The Complaint alleges that CQC “could and did sell deceptively obtained VCCs for revenue.”<sup>21</sup>

The CFTC also alleges that Newcombe’s conduct violated Sections 6(c)(1)(A) and 9(a)(2) of the CEA, as well as CFTC Regulation 180.1(a)(4). Section 9(a)(2) of the CEA makes it unlawful for any person “knowingly to deliver or cause to be

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<sup>13</sup> *Id.* at 12.

<sup>14</sup> *Id.* at 14.

<sup>15</sup> *Id.*

<sup>16</sup> *Id.*

<sup>17</sup> *Id.* at 15.

<sup>18</sup> *Id.* at 16.

<sup>19</sup> *Id.* at 16; 7 U.S.C. § 9(1); 17 C.F.R. § 180.1(a)(1)-(3).

<sup>20</sup> Complaint at 17.

<sup>21</sup> *Id.*

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delivered for transmission through the mails of interstate commerce by . . . telephone, wireless, or other means of communication false or misleading or knowingly inaccurate reports concerning . . . market information or conditions that affect or tend to affect the price of any commodity in interstate commerce.”<sup>22</sup> CEA Section 6(c)(1)(A) and Regulation 180.1(a)(4) similarly prohibit “intentionally or recklessly making false or misleading reports of market information.”<sup>23</sup> The CFTC claims that Newcombe’s conduct violated these sections of the CEA and CFTC Regulations by causing CQC to submit false, misleading, or knowingly inaccurate reports to the Carbon Credit Registry.

For relief, the CFTC requested a permanent injunction enjoining Newcombe and “his affiliates, agents, servants, employees, successors, assigns, attorneys, and all persons in active concert with him,” from engaging in the conduct described in the Complaint, and from generally trading on any registered entity, entering into transactions involving commodity interests, or engaging in activities requiring registration with the CFTC.<sup>24</sup> The CFTC also requested an order directing Newcombe to disgorge all benefits received, “including, but not limited to, salaries, commissions, loans, fees, revenues, and trading profits, derived, directly or indirectly, from acts or practices which constitute violations of the [CEA] and [CFTC Regulations]” described in the Complaint.<sup>25</sup> Finally, the CFTC also requested an order directing Newcombe to make restitution to persons who sustained losses caused by his alleged violations, and pay a civil monetary penalty under the CEA.<sup>26</sup>

In a parallel action, on October 2, 2024, the U.S. Attorney’s Office for the Southern District of New York announced the unsealing of criminal charges against Newcombe and another employee, the Head of CQC’s Carbon & Sustainability Accounting Team, in connection with the fraudulent scheme described above.<sup>27</sup>

### **The CQC and Steele Settlements**

In connection with allegations of fraud committed by CQC and Steele, as COO of CQC, each separately submitted offers of settlement that the CFTC accepted, in which CQC and Steele, respectively, each admitted the facts alleged by the CFTC and acknowledged that their conduct violated Sections 6(c)(1), 6(c)(1)(A), and 9(a)(2) of the CEA, as well as CFTC Regulations 180.1(a)(1)-(4).<sup>28</sup>

Like the conduct described above, the CQC Settlement explained that, during the Relevant Period, CQC engaged in a fraudulent scheme related to the carbon offset projects it was developing—namely, cookstove and energy-efficient lightbulb projects. According to the CQC Settlement, CQC repeatedly intentionally provided false and misleading information to the

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<sup>22</sup> 7 U.S.C. § 13(a)(2).

<sup>23</sup> Complaint at 19; 7 U.S.C. § 9(1)(A); 17 C.F.R. § 180.1(a)(4).

<sup>24</sup> Complaint at 22.

<sup>25</sup> Complaint at 23.

<sup>26</sup> Complaint at 23-24.

<sup>27</sup> Sealed Indictment, *United States v. Kenneth Newcombe and Tridip Goswami*, 24-crm-567 (S.D.N.Y. Oct. 2, 2024).

<sup>28</sup> CQC Settlement at 1; Steele Settlement at 1.

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Carbon Credit Registry and VVBs, including from the United States, for the purpose of presenting a misleading impression of the quality of the [cookstove and lightbulb projects], wrongfully increasing the number of carbon credits a project would produce . . . . At the time, certain CQC executives, supervisors, and compliance personnel knew of, oversaw, and participated in these efforts.<sup>29</sup>

Similarly, the Steele Settlement explained that, during the Relevant Period, Steele engaged in a fraudulent scheme as COO of CQC that involved causing CQC to report false and misleading information to the Carbon Credit Registry, VVBs, and others about the carbon offset projects so that “millions more VCCs were issued for those projects and listed on the public registry than was warranted.”<sup>30</sup>

In each settlement, the CFTC found that CQC and Steele violated Section 6(c)(1) of the CEA and Regulation 180.1 “by intentionally and recklessly engaging in fraud in connection with contracts of sale of VCCs, a commodity in interstate commerce.”<sup>31</sup> Furthermore, the CFTC concluded that CQC and Steele violated Sections 9(a)(2) and 6(c)(1)(A) of the CEA, as well as CFTC Regulation 180.1(a)(4), by “knowingly, and intentionally or recklessly, delivering or causing to be delivered, for transmission through the mails or interstate commerce, false or misleading or inaccurate reports concerning the relevant projects’ performance and compliance with the purported methodologies, validation processes, and verification processes relating to the quality and supply of the VCCs relating to those projects,” to the Carbon Registry, to VVBS, and to market participants.<sup>32</sup>

As part of the settlement, CQC must pay a \$1 million civil monetary penalty and undertake a process of canceling all of the carbon credits that resulted from the violative conduct.<sup>33</sup> CQC represented as part of the settlement that it has undertaken a program of remediation, including terminating individuals responsible for the violative conduct, appointing new senior executives (including a new CEO), implementing additional compliance policies and improvements related to verification and reporting of VCCs, and conducting relevant trainings.<sup>34</sup> Finally, CQC agreed to cooperate with the CFTC in any current or future investigation or action related to the violative conduct.<sup>35</sup>

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<sup>29</sup> CQC Settlement at 5.

<sup>30</sup> Steele Settlement at 5. As was set forth in the Newcombe Complaint and the CQC Settlement, the Steele Settlement described Steele as referring internally to the fraudulent falsification of data as “managing the data.” *Id.*

<sup>31</sup> CQC Settlement at 6-7; Steele Settlement at 6.

<sup>32</sup> CQC Settlement at 8; Steele Settlement at 7.

<sup>33</sup> CQC Settlement at 10.

<sup>34</sup> *Id.*

<sup>35</sup> *Id.* at 12.

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In a parallel matter, the Securities and Exchange Commission (the “SEC”) entered into a settlement order with CQC in connection with the fraudulent scheme described above.<sup>36</sup> According to the SEC’s settlement order, CQC violated Section 17(a) of the Securities Act and Section 10(b) of the Exchange Act, and Rule 10b-5 thereunder, by disseminating information to potential investors that contained the manipulated project data and other misleading statements concerning the cookstove projects and VCCs. CQC agreed to the entry of a cease-and-desist order, but no civil monetary penalties were imposed.

Separately, the U.S. Attorney’s Office for the Southern District of New York announced it was declining to prosecute CQC for the described conduct.<sup>37</sup>

Steele was not assessed a civil penalty as part of the settlement, but agreed to cooperate with the CFTC in accordance with the terms of a formal Cooperation Agreement entered into with the Division of Enforcement. Steele also must cooperate with any other government agency with respect to any current or future action related to the subject matter of violative conduct.

Separately, the U.S. Attorney’s Office for the Southern District of New York announced that Steele had pled guilty pursuant to an Information before U.S. District Judge Margaret M. Garnett and was cooperating with the Government.<sup>38</sup>

### **Key Takeaways**

The CFTC’s actions against Newcombe, CQC, and Steele confirm that the CFTC is serious about pursuing claims of fraud in the carbon markets, and likely mark only the beginning of the CFTC’s enforcement activity in the rapidly expanding carbon and other environmental commodity and derivatives markets.

The CFTC does not explain how it became aware of the fraudulent scheme conducted by CQC, Newcombe, and Steele. The CFTC may have received a referral from the Carbon Credit Registry. Alternatively, it may have received a complaint from a party who purchased a fake VCC from CQC. Or, the CFTC may have received a whistleblower tip. Suffice it to say that the CFTC has a number of ways to find out about fraudulent schemes in the carbon market.

Because VCCs are not futures, swap or option contracts, market participants who purchased VCCs from CQC that were issued pursuant to the fraudulent scheme described by the CFTC do not have a private right of action against CQC under

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<sup>36</sup> *In re CQC Impact Investors LLC*, Order Instituting Cease-and-Desist Proceedings, Securities Act Release No. 11315, Exchange Act Release No. 101232, Administrative Proceeding File No. 3-22224 (Oct. 2, 2024), <https://www.sec.gov/files/litigation/admin/2024/33-11315.pdf>.

<sup>37</sup> *U.S. Attorney Announced Criminal Charges in Multi-Year Fraud Scheme in the Market for Carbon Credits*, U.S. Attorney’s Office, Southern District of New York (Oct. 2, 2024), <https://www.justice.gov/usao-sdny/pr/us-attorney-announces-criminal-charges-multi-year-fraud-scheme-market-carbon-credits>.

<sup>38</sup> *U.S. Attorney Announced Criminal Charges in Multi-Year Fraud Scheme in the Market for Carbon Credits*, U.S. Attorney’s Office, Southern District of New York (Oct. 2, 2024), <https://www.justice.gov/usao-sdny/pr/us-attorney-announces-criminal-charges-multi-year-fraud-scheme-market-carbon-credits>.

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the CEA.<sup>39</sup> Consequently, if they do not receive restitution payments as requested by the CFTC in its Complaint against Newcombe, market participants that suffered damages as a result of purchasing the fake or invalidated VCCs would have to bring a civil action in federal or state court alleging common law fraud.<sup>40</sup>

Given the increased attention directed by the CFTC—as well as the Department of Justice and the SEC—toward the carbon markets, it is important for participants trading voluntary carbon offsets to exercise increased diligence when purchasing credits, and when claiming, or evaluating claims of, GHG emission reductions.

If you have any questions regarding this client alert, please contact the following attorneys or the Willkie attorney with whom you regularly work.

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<sup>39</sup> CEA § 22(a); 7 U.S.C. § 25(a).

<sup>40</sup> Complaint at 23-24.