

# CFTC'S New Guidance, Recent High-Profile Enforcement Raise the Stakes for Voluntary Carbon Credit Market Participants

Article By:

Richard E. Glaze Jr.

Bruce White

Laurian Cristea

Alexander J. Bandza

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## Highlights

- The Biden administration and the Commodity Futures Trading Commission (CFTC) have recently issued principles and guidance to enhance the credibility of voluntary carbon credits (VCCs) and the integrity of voluntary carbon markets (VCMs)
- The administration underscored the importance of those directives with coordinated parallel civil and criminal proceedings by the CFTC, SEC and DOJ against a high-profile developer and marketer of VCCs
- VCM participants, including developers, issuers, and marketers, need to be mindful of the spotlight that is on the quality of carbon emission projects underlying VCCs and the potential risks posed by any related misconduct

Companies that voluntarily seek to reduce their emissions beyond what they are able to do internally use voluntary carbon credits (VCCs) – emissions reductions or removals by another party, acquired by market participants to supplement emissions reductions or removals achieved from the participant's own operations or activities – to augment their carbon mitigation efforts. VCCs trade bilaterally or on cash exchanges and stand in direct contrast to mandatory markets, such as cap-and-trade, emissions or allowance trading systems established by other governmental markets and initiatives.

The voluntary carbon markets (VCMs) have been [in turmoil recently](#) due to lack of industry conformance, unsubstantiated claims, potential for emission shifting, and instances of outright fraud –

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driving criticism over the quality of the emissions reductions projects supporting VCCs.

In an effort to re-establish trust in the markets and the credibility of VCCs to reduce emissions of greenhouse gases and mitigate climate change, the Biden administration has followed dual complementary tracks. First, it issued a joint statement from multiple agencies followed by recent Commodity Futures Trading Commission (CFTC) guidance that outline principles U.S. voluntary carbon market participants should follow. Second, to reinforce the importance and seriousness of VCM integrity, and to let the public know it has the enforcement tools to compel compliance, the administration has most recently spearheaded coordinated cross-agency parallel civil and criminal proceedings against a high profile developer and marketer of VCCs.

The CFTC guidance and the administration's joint statement establish high expectations for the quality of carbon credits. The high-profile enforcement actions that followed on the heels of those directives represent a significant escalation of efforts to strengthen VCMs in the U.S. VCM participants, including developers, issuers, and marketers, should be mindful of the priority that is being given to the integrity of VCMs and VCCs and the potential risks posed by any misconduct.

## Administration Directives to Facilitate VCM Integrity

Because of the importance of VCCs and other voluntary emissions reductions for meeting emissions reductions targets imposed by state, regional, federal, and even non-U.S. jurisdictions, numerous attempts have been made to rehabilitate the market. Among these, on May 28, 2024, the Biden administration issued a [Voluntary Carbon Markets \(VCMs\) Joint Policy Statement and Principles](#). At the time the joint statement was issued, hopes were high that it would provide a new foundation to [restore trust in the VCMs](#).

On Sept. 20, the CFTC took the further step of [approving its own final guidance](#) for VCC contracts, which the commission identifies as an “emerging class of climate-related derivative contracts” trading on CFTC-regulated exchanges. According to CFTC Chairman Rostin Behnam:

The Commission's final guidance announced today is the product of a strong public-private partnership that I have strived to achieve with both the CFTC's traditional stakeholders as well as a variety of voluntary carbon market stakeholders to support transparency, liquidity, and market integrity in the VCC derivatives markets as well as ultimately drive standardization and efficient capital allocation to scale the underlying cash market for high integrity VCCs.

The guidance applies to designated contract markets (DCMs), which are CFTC-regulated derivatives exchanges for trading specific options or derivatives contracts, and outlines factors for DCMs to consider when addressing certain core principle requirements in the Commodity Exchange Act and other CFTC regulations relevant to the listing for trading of VCC derivative contracts. Specifically, derivatives contracts may only be listed on underlying commodities (VCCs, in this case) that are not readily susceptible to manipulation, and where the terms and conditions related to the underlying commodity can be monitored.

Generally, when a robust market exists in an underlying commodity, the addition of derivatives contracts for risk management can further enhance that underlying market and drive growth in both markets. In this case, the regulated derivatives markets may also drive conformance and stability in the underlying VCC market.

To ensure quality is as expected, encourage accurate pricing, and foster confidence, the CFTC

guidance provides that the terms and conditions of each physically settled derivatives contract must address the attributes of the underlying VCC. DCMs must address these concerns for each contract listed for trading and continually monitor listed contracts for compliance.

## Criminal and Civil Enforcement to Ensure Integrity of VCMs

Less than two weeks after the CFTC guidance was issued, the CFTC, the Securities and Exchange Commission (SEC), and the U.S. Attorney for the Southern District of New York initiated coordinated civil and criminal proceedings against a corporation and three former company officers for allegedly padding emissions data to raise the value of VCCs the company was generating to sell into the market. Specifically, on Oct. 2:

- The [CFTC filed cases](#) naming CQC Impact Investors LLC, CQC's former CEO Kenneth Newcombe, and Jason Steele, former Chief Operating Officer of CQC. The civil complaint against Mr. Newcombe alleges fraud and false, misleading, or inaccurate reports relating to VCCs. The CFTC and the respondents also entered settlement orders that alleged similar misconduct against CQC and Mr. Steele. At the time of filing, CFTC Chairman Rostin Behnam noted that in addition to the guidance just released, "Today's actions show strong enforcement is another critical step in ensuring the integrity of these markets."
- Newcombe and CQC's former head of carbon and sustainability accounting, Tridip Goswami, were [indicted by the U.S. Attorney for the Southern District of New York](#) for fraudulently obtaining carbon credits worth tens of millions of dollars and fraudulently securing an investment of over \$100 million.
- The SEC entered an [administrative cease and desist order](#) settling claims against CQC for perpetrating a scheme to manipulate and misrepresent data and making material misrepresentations to investors about its business, which culminated in a \$250 million offering fraud.

Notably, the U.S. attorneys in New York chose not to charge CQC itself, nor did the SEC impose a penalty against CQC, because the company self-reported the alleged wrongdoing and cooperated in the investigation.

## Takeaways

It remains to be seen whether CFTC's guidance coupled with the administration's joint statement "moves the needle" further toward restoring faith in the integrity of VCMs or whether skeptics who have assailed the value of the instruments will prevail. However, as that story unfolds, all those who participate in the issuance and sale of VCCs should be aware of the growing risk of enforcement over the quality of the underlying carbon emission projects and other misconduct that undermines the integrity and credibility of VCMs.

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