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Alert | Environmental, Social & Governance (ESG)/ California Government Law & Policy

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California Enacts First-of-Their-Kind Laws Requiring Corporate Climate Disclosures

On Oct. 7, 2023, California Governor Gavin Newsom signed into law Senate Bill (SB) 253 and SB 261, both of which dramatically expand corporate climate disclosures for both private and public companies doing business in California. This development comes as the United States Securities and Exchange Commission (SEC) is finalizing new rules that would mandate public companies to make climate-related disclosures in their annual reports and registration statements.[1] California's new laws require disclosures beyond what the SEC has proposed. This GT Alert summarizes the two laws.

SB 253: Climate Corporate Data Accountability Act

SB 253 by Senator Scott Wiener (D-San Francisco) requires affected companies to annually disclose their emissions at certain levels.

Affected Entities

Companies that fall under the purview of SB 253 are (i) partnerships, corporations, limited liability companies, or other business entities formed under the laws of California or any other U.S. state or

[1] SEC press release, March 21, 2022; SEC, 17 CFR 210, 229, 232, 239, and 249, Release Nos. 33-11042; 34-94478; File No. S7-10-22, RIN 3235-AM87, The Enhancement and Standardization of Climate-Related Disclosures for Investors (2022).

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District of Columbia, or under an act of the U.S. Congress, (ii) with total annual revenues in excess of $1 billion (based on revenue for the prior fiscal year), and (iii) that do business in California.[2] The law refers to these companies as "reporting entities."

Required Disclosures

Beginning in 2026, reporting entities must annually disclose publicly each year to an "emissions reporting organization," contracted by the California Air Resources Board (CARB), the Scope 1 and Scope 2 Greenhouse Gas Emissions (GHG) for the prior fiscal year. Scope 1 emissions consist of all direct GHG emissions that stem from sources that a reporting entity owns or directly controls, regardless of location, including, but not limited to, fuel combustion activities. Scope 2 emissions consist of all indirect GHG emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity, regardless of location, including emissions outside of the United States.

Beginning in 2027, reporting entities must annually disclose the Scope 3 emissions no later than 180 days after its Scope 1 and Scope 2 disclosures. Scope 3 emissions consist of indirect upstream and downstream GHG emissions, other than Scope 2 emissions, from sources that the reporting entity does not own or directly control and may include, but are not limited to, purchased goods and services, business travel, employee commutes, and processing and use of sold products.

As part of these disclosures, reporting entities must engage with independent third parties to provide assurance engagements on all of the reporting entity's Scope 1, Scope 2, and Scope 3 emissions. SB 253 requires that these third-party auditors have significant experience measuring the emission of greenhouse gases and be sufficiently competent to perform assurance engagements in accordance with applicable legal and professional standards.

Penalties for Noncompliance

SB 253 directs CARB to adopt regulations authorizing it to seek administrative penalties for non-filing, late filing, or other failure to meet the law's requirements. The administrative penalties imposed on a reporting entity may not exceed $500,000 in a reporting year. However, reporting entities will not be subject to an administrative penalty for any misstatements regarding Scope 3 emissions disclosures made with a reasonable basis and disclosed in good faith. Further, any penalties assessed on Scope 3 reporting between 2027 and 2030 will only be for non-filing. While proponents of SB 253 estimate that the cost of compliance for affected businesses should not exceed $300,000 per year, others estimate that the cost to comply with the bill's requirements will likely exceed the potential $500,000 administrative penalty.[3]

SB 261: Greenhouse gases: climate-related financial risk

Similar to SB 253, SB 261 by Senator Henry Stern (D-Calabasas) would require affected companies to biannually prepare and disclose a climate-related financial risk report.

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[2] Doing Business in California, STATE OF CA. FRANCHISE TAX BD. (last updated June 29, 2023) (defining "doing business in California" as "engaging in any transaction for the purpose of financial gain within California, [being] organized or commercially domiciled in California," or having California property, payroll, or sales exceeding certain amounts).
[3] Nidhi Sharma, California Bill Would Force Large Companies to Disclose Greenhouse Gas Emissions, NBC NEWS (Sept. 14, 2023); *see also* Daniela Pardo, Jackson Ellison, Senate Bill 253 Supported by the Governor, Mandates Corporate Climate Accountability, SPECTRUM NEWS 1 (Oct. 5, 2023).

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Affected Entities

SB 261's climate-related financial risk disclosure requirements apply only to "covered entities," which are (i) partnerships, corporations, limited liability companies, or other business entities formed under the laws of California or any other U.S. state or District of Columbia, or under an act of the U.S. Congress, (ii) with total annual revenues in excess of $500 million (based on revenue for the prior fiscal year, including revenues generated outside of California), and (iii) that do business in California.

Required Disclosures

Beginning Jan. 1, 2026, and once every two years afterwards, covered entities must publish on their websites a climate-related financial risk report. These reports must disclose the following:

- Its climate-related financial risk, in accordance with the recommended framework and disclosures contained in the Final Report of Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017) published by the Task Force on Climate-related Financial Disclosures (TCFD)[4] or pursuant to an equivalent reporting requirement; and
- The measures it has adopted to reduce and adapt to the disclosed climate-related financial risk.

The law defines "climate-related financial risk" as the "material risk of harm to immediate and long-term financial outcomes due to physical and transition risks, including, but not limited to, risks to corporate operations, provision of goods and services, supply chains, employee health and safety, capital and financial investments, institutional investments, financial standing of loan recipients and borrowers, shareholder value, consumer demand, and financial markets and economic health." Ultimately, SB 261's reporting requirements, according to the law's text, are meant to ensure that covered entities are aware of and can prepare for any economic risks they might face as a result of climate events such as "wildfires, sea level rise, extreme weather events, extreme droughts, and associated impacts to the global economy," and that awareness of these climate-related financial risks will avoid significant harm to California and its residents.

If a covered entity cannot provide a complete report that contains the required disclosures, it must provide disclosures to the best of its ability, explain any reporting gaps, and describe steps it will take to prepare complete disclosures in the future.

CARB Reporting

The disclosures will be consolidated in a biennial public report from a nonprofit climate organization yet to be determined that will work with CARB. This public report will (i) review the disclosure contained in a subset of publicly available climate-related financial risk reports by industry; (ii) analyze the systemic and sector-wide climate-related financial risks facing the state based on the contents of climate-related financial risk reports; and (iii) identify inadequate or insufficient reports.

Penalties for Noncompliance

SB 261 directs CARB to adopt regulations authorizing it to seek administrative penalties from a covered entity that fails to publish the required climate-related financial risk report or publishes an inadequate or

[4] Final Recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD) Help Companies Disclose Climate-Related Risks and Opportunities Efficiently and Effectively, TASK FORCE ON CLIMATE-RELATED FIN. DISCLOSURES (June 29, 2017).

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insufficient report. The civil, administrative penalties imposed on a reporting entity may not exceed $50,000 in a reporting year.

Key Takeaways

These two laws significantly expand California's reach in the climate-change policy arena and call into question how the state will implement them. Governor Newsom included a signing message with both bills. In response to SB 253, the Governor said that "the implementation deadlines in this bill are likely infeasible, and the reporting protocol specified could result in inconsistent reporting across businesses subject to the measure." Similarly, in the signing message to SB 261 the Governor noted that the "deadlines fall short in providing [CARB] with sufficient time to adequately carry out the requirements in this bill." Both senators also indicated that next year's legislative session will include attempts to clarify and address the issues both SB 253 and SB 261 present.

Outside of the concerns regarding implementation within California's borders, given the new laws' broad scope, they may face significant legal challenges, including potential questions about the constitutionality of one state regulating both private and public business practices that occur outside of its state boundaries; potential federal preemption; and the potential implications of several states enacting similar, but different regulations on the same subject in the future. Whether the laws will withstand these challenges remains to be seen. Likewise, how the laws' requirements might evolve through the administrative rulemaking process—which could be both time-consuming and controversial—is still unclear. But given the push on both a state and federal level to increase transparency and reporting into GHG emissions, all companies doing business in California, including those that sell products to entities subject to these requirements and which may be required to provide information to customers so they can calculate their Scope 3 emissions, are encouraged to monitor these developments and consider creating action plans to comply with California and federal requirements if and when they are implemented.

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