Change is in the Air: Everything You Need to Know About California's Sweeping New Climate Disclosure Laws

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On October 7, 2023, California Governor Gavin Newsom signed into law two sweeping climate disclosure bills, Senate Bill 253 ("SB 253"), the Climate Corporate Data Accountability Act, and Senate Bill 261 ("SB 261"), the Climate-Related Risk Act. Taken together, SB 253 and SB 261 overlap the U.S. Securities and Exchange Commission's proposed climate disclosure rule (the "SEC Proposed Rule"), and expand upon it in several significant ways. The SEC Proposed Rule addresses both greenhouse gas ("GHG") emissions and climate risk, while the California measures separate the two, with SB 253 addressing GHG emissions, and SB 261 addressing climate risk.

Other important differences include the following:

1. The California laws apply only to companies doing business in California, although all it takes is selling one product in or into California to qualify as "doing business" there *and* California is the world's fifth largest economy by GDP. (Notably, SB 253 includes the Legislature's finding that "California "is on track to be the fourth largest economy in the world [passing Germany], and is a highly desirable market for the globe's most profitable companies.")
2. Unlike the SEC Proposed Rule, which applies only to certain public companies, the California laws apply to private as well as public US companies. The only limitation is annual worldwide revenue, regardless of how much revenue comes from business in California: SB 261 applies to any company with total revenues greater than $500,000, and SB 253 applies to any with total revenues greater than $1 billion. It's estimated that the former will apply to over 10,000 companies and the latter to over 5,400 companies.
3. SB 253 requires disclosure of Scope 3 GHG emissions by *all* covered entities, whereas the current draft of the SEC Proposed Rule requires such disclosures only if "material" or if the covered company has publicly set targets that include Scope 3 emissions.
4. The California laws are *state* laws, not a federal rule. The SEC Rule could be subject to challenge in federal courts under the Major Questions Doctrine recently developed by the US Supreme Court or the federal Administrative Procedure Act. Many have suggested that this may be part of the reason that the SEC is delaying issuing the rule. At a forum hosted by the U.S. Chamber of Commerce on October 26, 2023, SEC Chair Gary Gensler indicated that the SEC Proposed Rule is not likely to be released until 2024, and he cautioned the Chamber against challenging it in court. The California disclosure laws, on the other hand, are immune to such challenges. California state law has no analogue to the Major Questions Doctrine. The California laws may be subject to challenge in federal

court under the Preemption Doctrine or the Commerce Clause, but the federal courts grant the states quite a bit of leeway with their own laws. For example, in its decision last May applying the Dormant Commerce Clause doctrine, *National Pork Producers Council v. Ross*, No. 21-468, the US Supreme Court upheld California's Proposition 21, which prohibits selling pork in California if the pigs were housed in systems that comply with certain specific standards for freedom of movement, even if the pigs were housed out-of-state. An analogous challenge to California's new climate disclosure laws could meet a similar fate.

What do the California climate disclosure laws require?

SB 253 — GHG Emissions

SB 253 requires affected corporations to publicly report their total annual GHG emissions, beginning with Scopes 1 and 2 in 2026, and phasing in Scope 3 emissions in 2027. This is hugely important, as EPA estimates that Scope 3 emissions often account for more than 90% of an organization's total GHG emissions. Scope 3 emissions also are notoriously difficult to quantify. One company's Scope 1 emissions are another's Scope 3, and methodologies for calculating Scope 3 emissions vary from one industrial sector to another. The problem becomes even more challenging when a company's value chain (upstream or downstream) extends outside the United States.

SB 253's definitions of Scopes 1, 2 and 3 GHG Emissions

(SB 253 expressly references and draws upon the Greenhouse Gas Protocol)

- *Scope 1:* "all direct [GHG] 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:* "indirect greenhouse gas emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity, regardless of location."
- *Scope 3:* "indirect upstream and downstream greenhouse gas 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."

Critically, the law delegates to the California Air Resources Board ("CARB") responsibility for developing implementing regulations – not, as one might expect, to an agency such as the Department of Financial Protection and Innovation, which regulates the offer and sale of securities, franchises and off-exchange commodities in California. Since the adoption of Assembly Bill 32 ("AB 32") in 2006, CARB has become the lead agency for climate programs, including the Cap-and-Trade Program and the Low Carbon Fuel Standard. CARB certainly has the expertise to develop these regulations and likely will do so with an eye toward integrating the effort with its other climate programs. As with the model first established by AB 32, SB 253 sets out a series of milestones for CARB to meet – and which reporting entities (*i.e.*, covered companies) will be obligated to meet:

Year	SB 253 Milestones & Requirements
2024	CARB to develop and adopt regulations requiring (a) the reporting of GHG emissions and (b) the assurance requirements for those disclosures (*i.e.*, qualified independent third party verifiers).

Year	SB 253 Milestones & Requirements
2025	With the regulations in place, companies must collect Scopes 1 and 2 emissions data so as to be able to files reports in 2026.
2026	Companies must submit disclosure reports re 2025 Scopes 1 and 2 emissions on a digital platform established by CARB, and will be obligated to do so annually thereafter. Companies also must collect Scope 3 emissions data in addition to Scopes 1 and 2 data for reporting in 2027. CARB to develop assurance requirements for Scope 3 reporting, and also to contract with an academic institution to prepare an evaluation of the program and to establish a digital platform for the reports (by July 1, 2027).
2027	Companies must submit disclosure reports re 2026 Scope 3 emissions as well as Scopes 1 and 2 emissions. The Scope 3 report must be prepared in accordance with the Greenhouse Gas Protocol standards and guidance, "including guidance for scope 3 emissions calculations that detail acceptable use of both primary and secondary data sources, including the use of industry average data, proxy data, and other generic data in its scope 3 emissions calculations."
2029	CARB shall review and update the disclosure deadlines and the requirements for third-party assurance providers.
2030	Companies must submit Scopes 1 and 2 emissions reports that are independently verified at a reasonable assurance level, and must submit Scope 3 emissions reports independently verified at a limited assurance level.

Potential Schedule Slippage: SB 253 provides that CARB can extend the first reporting requirements for Scopes 1 and 2 such that they start at some point *after* 2026. However, it's not clear that if CARB does extend those deadlines, that it also would push-out the start date for Scope 3 emissions. The provisions re Scope 3 reporting does not contain parallel language allowing CARB to set a later start date, providing instead that Scope 3 reporting must begin in 2027 *and* no later than when Scopes 1 and 2 emissions are reported. A conflict thus could arise if CARB delays the start date for Scopes 1 and 2 emissions reporting.

Fees & Penalties: SB 253 directs CARB to establish filing fees for those submitting disclosure reports, with the fees set at levels sufficient to fund its administration of the program. SB 253 also directs CARB to establish administrative penalties for noncompliance. The penalties may not exceed $500,000, and with respect to Scope 3 emissions reports shall be limited to non-filing prior to 2030.

SB 253 Assurance Requirements

- *Scopes 1 and 2 emissions reports* must be verified by an independent third-party assurance provider at a "limited assurance" level for reports submitted 2026-2029. Beginning in 2030 they must be verified at a "reasonable assurance level."
- *Scope 3 emissions reports may* have independent third-party assurance requirements for reports submitted 2027-2029 if CARB establishes such requirements. Beginning in 2030, they must be verified at a "limited assurance level."
- SB 253 does not define limited and reasonable assurance levels. However, the SEC Proposed Rule defines them as follows: "Reasonable assurance is equivalent to the level of assurance provided in an audit of a registrant's consolidated financial statements included in a Form 10-K. Limited assurance is equivalent to the level of assurance (commonly referred to as a "review") provided over a registrant's interim financial statements included in a Form 10-Q." SEC Proposed Rule at fn. 564.

SB 261 — Climate Risk

Whereas SB 253 is quantitative — *i.e.*, measuring and reporting GHG emissions — SB 261 is qualitative. It obligates companies doing business in California with over $500,000 in worldwide revenue to report (a) their climate-related financial risk based on the recommendations of the Task Force on Climate-related Financial Disclosure (the "TCFD"), and (b) the measures that they have adopted to mitigate and adapt to the disclosed risks. "Climate-related financial risk" is defined as "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." Rather than filing a report with CARB, a company must post the required disclosures report to its public website every two years starting in 2026.

SB 261 directs CARB to contract with a "nonprofit climate reporting organization" by January 1, 2026. The reporting organization will be charged with preparing a biennial report that includes (a) a review all of the disclosure reports posted by the covered companies, (b) an analysis of "the systemic and sector-wide climate-related financial risks facing the state based on the contents of climate-related financial risk reports, including, but not limited to, potential impacts on economically vulnerable communities," and (c) the identification of inadequate or insufficient reports.

Fees & Penalties: As with SB 253, SB 261 directs CARB to establish filing fees for companies posting climate risk disclosure reports, with the fees set at levels sufficient to fund its administration of the program. SB 261 also directs CARB to establish administrative penalties for noncompliance – *i.e.*, failing to post disclosure reports or posting inadequate or insufficient reports. The penalties may not exceed $500,000.

What's next?

In the Executive Branch

CARB likely will begin developing regulations to implement the two laws early in 2024. Normally, CARB's rulemaking process takes at least a year; indeed, the regulations for the Cap-and-Trade Program took several years and multiple rounds of both standard and expedited rulemakings. CARB has developed a rulemaking process that includes a remarkably robust public participation component with discussion drafts and stakeholder workshops that are in addition to and precede the exacting requirements of the California Administrative Procedure Act. In addition, SB 253 expressly directs CARB to consult with a wide variety of stakeholders. Thus, *there will be plenty of opportunities for the regulated community to be heard*. Likely hot topics include:

- Which companies are covered? That is, what does it mean to be doing business in California? SB 253 does not define the term and so CARB likely will. The California Franchise Tax Board has defined what "doing business" in the state means (which includes "[engaging] in any transaction for the purpose of financial gain within California"), but CARB could adopt a more restrictive definition.
- If CARB's definition of "doing business in California" is based on revenue as the statutes specify, how will revenue be defined? Gross vs. net? Consolidated for all affiliates or just the entity(ies) doing business in California? Will it include a *de minimis* exception for companies that meet the revenue requirement but do very little business in the state.
- How are Scope 3 emissions to be measured, calculated and reported? To what degree may companies rely on averages and estimates? As many have noted, the available standards vary widely.

- Will the reporting schedules be modified and extended? As noted above, SB 253 contains ambiguous language regarding CARB's ability to extend-out the deadlines for Scopes 1 and 2 vs. Scope 3. In addition, some have argued that it's impracticable if not impossible to calculate Scope 3 emissions within 180 days of reporting Scopes 1 and 2 emissions.
- Will CARB include regulations setting forth what it views as acceptable carbon credits that provide guidance to those companies that wish to include voluntary carbon offsets as part of their plans for mitigating their climate-related financial risks under SB 261?

In the Legislative Branch

At same time, it's quite possible that the Legislature will take-up the issue again and amend one or both of the two laws. In his SB 253 Signing Statement, Gov. Newsom stated that the "the implementation deadlines in this bill are likely infeasible," and that the Scope 3 disclosure requirements "could result in inconsistent reporting across businesses subject to the measure." He expressed similar concerns about SB 261's implementation deadlines. He directed his Administration to work with the bills' sponsors to amend these laws in 2024. As noted above, the governor is not alone in expressing these concerns. Thus, it's quite possible that both CARB and the Legislature will be addressing the same issues at the same time. Of course, any changes to the statutes would override any conflicting regulations that CARB may develop.

In the Courts

There is always the possibility of a legal challenge in the courts, though as noted above, it seems unlikely that a court would enjoin the statutes' before any requirements go into effect, which won't occur until 2026 or perhaps later. By that time, the SEC may have adopted its Climate Disclosure Rule; if the SEC Proposed Rule is adopted in 2024, as appears likely, then reporting requirements won't kick-in until 2026. During the same October 26, 2023 forum noted above, SEC Chair Gary Gensler said that the California laws may be preempted by an SEC regulation under the National Securities Markets Improvement Act of 1996. That too is possible, although even then it would not be clear that such preemption extends to the California laws' applicability to private corporations, which would not be subject to the SEC Rule. Any one of these issues could give rise to litigation.

Lastly, it's worth noting the synchronicity of the various climate disclosure laws. As discussed above, it appears likely that the reporting requirements under the California climate laws and the SEC Proposed Rule all will begin in 2026. In addition, on July 31, 2023, the European Commission adopted the European Sustainability Reporting Standards ("ESRS"). For most US companies that fall under the ESRS, the reporting obligations also will begin in 2026 (for those that are currently obligated to report under the EU's Non-Financial Reporting Directive, the ESRS reporting will begin in 2025). Companies will have to determine which reporting requirements apply to them, and whether the different regimes impose different obligations.

What can companies do to prepare?

2025 will be an important year for companies to establish data collection systems, and 2026 is shaping up to be the year of climate disclosures on a large scale (and/or of related law suits; time will tell). The takeaway for 2024 is that companies should begin preparing. Here are a few things to consider.

- *Monitor and consider participating in CARB's rulemaking process.* There will be many opportunities to be heard and CARB has a reputation for working with diverse stakeholders, including the regulated community. Lobbying around the legislative process also may be possible if the sponsors of SB 253 and SB 261 work with the Governor to consider amending the laws. Senators Scott Wiener (SB 253) and Henry Stern (SB 261) are well-respected leaders in the State Senate and have reputations for being cooperative.

- *Develop a thorough understanding of your company's climate-related risks and its carbon footprint.* These are not small undertakings. The guidance provided by the Greenhouse Gas Protocol and TCFD is robust and detailed – and there are other resources available as well. For many companies it will be appropriate to engage outside carbon accounting professionals.
- *Develop a plan for addressing your company's climate-related risks and disclosing its GHG emissions.* In doing so, it will be critical to avoid potential greenwashing claims: disclosures and other public statements about GHG emissions and climate risk and other climate-related claims — *e.g.*, statements regarding Net Zero plans — must be carefully considered and properly supported. In doing this work, it also will be key to consider the G in ESG – governance. Ideally, these tasks would be handled by a well-qualified and well-supported team within the company, and that team's work will be vetted at the C-suite level. It also will be important for Boards of Directors to be mindful of their corporate oversight responsibilities as companies navigate the new regulatory climate.

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