

California's Flurry of ESG Lawmaking

October 31, 2023

Broad new disclosure requirements regarding greenhouse gas emissions and climate risk management, use of voluntary carbon offsets, and the diversity of teams backed by investment funds advance the state's ESG agenda, but raise questions for 2024 and beyond.

While the first half of 2023 was notable for significant anti-ESG state lawmaking activity in the United States, with one-third of states passing laws seeking to limit the impact of ESG-related considerations, the second half of the year has been characterized by a perceptible shift in the regulatory landscape. In July, the SEC finalized new rulemaking relating to public companies' disclosure of cybersecurity incidents and related risk management practices, and in September updated the "Names Rule" to specifically require that registered investment funds with names indicating an ESG-related focus align at least 80% of their underlying assets with that investment focus.¹ And now, with four bills signed into law this month requiring new ESG-related disclosure, California has set first-of-its-kind requirements in the United States impacting a broad swath of companies that have touchpoints with the state.

In brief, these new ESG-related disclosure laws will require:

- Annual reporting of **greenhouse gas emissions** (Scope 1, 2 and 3, including specified assurance, in accordance with the Greenhouse Gas Protocol) for companies with over \$1 billion in annual revenue that are doing business in California, with phased-in requirements beginning in 2026 and covering the prior year.

¹ See our previous client alerts discussing the SEC rules relating to cybersecurity risk management, strategy, governance and incident disclosure ([here](#)) and the SEC's amendments to the fund "Names Rule" ([here](#)).

- Biennial **climate risk reporting** in accordance with the Task Force for Climate-related Financial Disclosure (TCFD) recommendations and framework by companies with over \$500 million in annual revenue that are doing business in California, with first reports published on or before January 1, 2026.
- Annual website disclosure of details relating to **voluntary carbon offsets** (VCOs) marketed, sold, purchased or used to support carbon reduction or net zero claims made within California, beginning as of January 1, 2024.
- Annual reporting of **demographic data and diversity statistics** of the founders and executive team members of companies in which venture capital and other investment firms make investments, beginning in 2025 and covering investments made during the prior year.

Given their scope and novel nature, each of these laws will present new challenges for companies, and raise key questions regarding interpretation, application and compliance, as well as potential legal challenges.

1. Greenhouse Gas Emissions Reporting

SB 253: The Climate Corporate Data Accountability Act

Covered Companies	Public and private companies organized in the U.S. with: <ul style="list-style-type: none"> • Total annual revenues in excess of \$1 billion during prior fiscal year, • That are “doing business” in California
Required Disclosure	Scope 1, 2 and 3 emissions of the company calculated in accordance with the Greenhouse Gas Protocol (GHG Protocol) standards and related guidance, with assurance requirements phased in as provided below
Implementation Timeline	2026: Scope 1 and 2 emissions for the prior year, with <i>limited</i> third-party assurance 2027: Scope 1 and 2 emissions for the prior year, with <i>limited</i> third-party assurance; plus Scope 3 emissions 2030: Scope 1 and 2 emissions for the prior year, with <i>reasonable</i> third-party assurance; plus Scope 3 emissions with <i>limited</i> third-party assurance
Enforcement	Maximum fines of \$500,000 in a reporting year for non-filing, late filing or other failures Prior to 2030 penalties related to Scope 3 reporting limited to failure to file; following 2030 Scope 3 reporting is subject to a safe harbor for good faith reasonable disclosure

Key Questions/Issues	<ul style="list-style-type: none"> • Rules to determine total annual revenue • Consolidation rules for determining scope of emissions reporting • Applicable definition of “doing business” in the state and whether existing standard used for other purposes will be adopted (which would cover a company organized in California; with sales in the state exceeding the threshold amount or 25% of total sales (for the 2023 tax year, the threshold amount was \$711,538); with the value of real or tangible personal property in the state exceeding the threshold amount or 25% of company’s total (for the 2023 tax year, the threshold amount was \$71,154); or with compensation paid in the state exceeding the threshold amount or 25% of the total compensation paid by the company (for the 2023 tax year, the threshold amount was \$71,154)) • Interoperability with other statutory or regulatory regimes (<i>e.g.</i>, the Corporate Sustainability Reporting Directive (CSRD) in Europe and forthcoming SEC disclosure rules) • The extent to which “clean-up” legislation will revise requirements (including timing and the requirement to report Scope 3 emissions and reliance on the GHG Protocol) • Timing of regulations from the California Air Resources Board (CARB)
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2. Climate Risk Reporting

[SB 261](#): *Climate-related Financial Risk Act*²

Covered Companies	Public and private companies (other than insurance providers) organized in the U.S. with: <ul style="list-style-type: none"> • Total annual revenues in excess of \$500 million during prior fiscal year, • That are “doing business” in California
Required Disclosure	Website publication of climate-related financial risk reports created in accordance with TCFD; updated at least biennially
Implementation Timeline	First reports must be available on or before January 1, 2026
Enforcement	Maximum fines of \$50,000 in a reporting year for non-filing, late filing or other failures
Key Questions/Issues	<ul style="list-style-type: none"> • Rules to determine total annual revenue • Applicable definition of “doing business” in the state and whether existing standard used for other purposes will be adopted (see Section 1) • The extent to which “clean-up” legislation will revise the requirements, and timing of regulations from CARB

3. Voluntary Carbon Offset Disclosure

[AB 1305](#): *Voluntary Carbon Market Disclosures Act*

Covered Companies	Entities including public and private companies, that: <ul style="list-style-type: none"> • Market or sell VCOs within California, or
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² For additional detail please see our previous client memo on the climate disclosure bill ([here](#)).

	<ul style="list-style-type: none"> Operate in California and either make claims within California regarding net zero emissions, “carbon neutral” products or any other similar claims, or purchase VCOs sold in the state to support such claims
Required Disclosure	<p>For entities that market or sell VCOs in the state, website disclosure of information including:</p> <ul style="list-style-type: none"> Protocol used to estimate benefits, details about the project including type, location, start date and timeline, whether it meets any external standards, durability period, and any external validation, emissions reduced or carbon removed; Accountability measures taken if a project is not completed or the project does not meet emissions reduction/removal goals; and Data and calculation methods needed to verify reduction/removal credits <p>For entities that operate in California and purchase or use VCOs sold in the state to support carbon-related claims, website disclosure of information including:</p> <ul style="list-style-type: none"> Details regarding the offset including the seller, project type, identification number, protocol used to estimate impact, and any independent third-party verification of data or claims <p>For entities that operate in California and make claims in the state regarding the carbon impact of VCOs, website disclosure of:</p> <ul style="list-style-type: none"> Process for determining the accuracy or accomplishment of such claims, and how interim progress towards goals are being measured; and Any independent third-party verification of data and claims listed
Implementation Timeline	January 1, 2024 with annual updates required
Enforcement	Fines of \$2,500 per day up to a maximum of \$500,000 per year
Key Questions/Issues	<ul style="list-style-type: none"> Applicable definitions of “operate within the state” and “make claims within the state,” and whether the law essentially applies to any company with covered language on its website Whether covered claims include historical achievements and future targets Timing requirements for initial website disclosures and frequency of subsequent updates Whether penalty cap is one-time or annual <p><i>Note: No clean-up legislation is contemplated at this time</i></p>

4. Venture Capital Diversity Disclosure

SB 54: Investing in Equity

Covered Companies	<p>“Venture capital companies” (defined below) that:</p> <ul style="list-style-type: none"> (1) Either (i) primarily invest or provide financing to startup, early state or emerging growth companies, or (ii) manage assets on behalf of third-party investors, <u>and</u> (2) Either: (i) are headquartered in California, (ii) have significant presence or operational office in the state, (iii) make venture capital investments in businesses located in, or with significant operations in the state, or (iv) solicit or receive investments from a California resident <p>“Venture capital company” means an entity that either (i) on at least one occasion during the first year of its initial capitalization, and on at least one occasion during each annual period thereafter, has invested at least fifty percent (50%) of its assets in securities in an operating company as to which the entity has or obtains management rights, (ii) is a “venture capital fund” as defined in the Investment Advisers Act, or (iii) is a “venture capital operating company” as defined in ERISA</p>
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Required Disclosure	<p>Covered entities making qualifying investments must conduct a survey to seek demographic data about the founding and executive team members of businesses in which they invest, using a standardized template. To the extent such information is provided, the entity must report information to the California Civil Rights Department (CRD) including:</p> <ul style="list-style-type: none"> • Aggregate demographic information for the founding and executive teams, including gender, race, ethnicity, disability status, LGBTQ+, veteran status and residence in California • The number of qualifying investments in which more than one-half of the team members responding to the survey are “diverse team members” (someone who self-identifies as a woman, nonbinary, Black, African American, Hispanic, Latino-Latina, Asian, Pacific Islander, Native American, Native Hawaiian, Alaskan Native, disabled, veteran or disabled veteran, lesbian, gay, bisexual, transgender, or queer) and the percentage of investments that so qualify • The total amount of money in venture capital investments invested during the prior calendar year, and the principal place of business of each investee company
Implementation Timeline	Annual reports must be submitted by March 1, 2025 covering the period beginning January 1, 2024, and annually thereafter
Enforcement	Failure to comply may result in a court action to compel performance, a monetary penalty, or other court-ordered relief
Key Questions/Issues	<ul style="list-style-type: none"> • How broadly the definition of VCC will be applied (<i>i.e.</i>, to private equity firms or other investment vehicles not traditionally considered venture capital firms) • Specificity with which covered entities must report names of investee businesses • Consolidation rules for reporting affiliated VCC information • How revisions will be addressed in the 2024-2025 Governor’s Budget <p><i>Note:</i> CRD expected to issue guidelines/FAQ</p>

Conclusion

With this host of broadly-applicable new laws, California is making a significant impact on the sustainability reporting requirements applicable to companies with a nexus to the state.

Implementing these laws will require further action from the Governor’s office, as well as the legislature and applicable regulators, as interpretive questions remain. Meanwhile, New York has introduced legislation almost identical to the greenhouse gas reporting requirements, and other states are advancing other types of ESG-related disclosure requirements that could go beyond rulemaking yet to be finalized by the SEC.

While California’s new laws may be subject to legal challenges that could impact implementation timelines, in the meantime, companies are wise to evaluate whether they are in scope of these laws and to begin to prepare. Most urgent are determining whether disclosure will relate to VCO use, which must be posted on websites by January 1, 2024, and assessing whether SB 54 will require them to gather demographic data from investments closed as of the same date.

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