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# California Legislature Passes Far-Reaching Climate Disclosure Bills

September 15, 2023

Earlier this week, the California Legislature passed two broad-reaching bills that would require covered companies doing business in the state to disclose their Scope 1, 2 and 3 greenhouse gas ("GHG") emissions and their climate-related risk management processes.

- Senate Bill 253, the Climate Corporate Data Accountability Act ("SB 253"), will require an estimated 5,300 public and private in-scope companies[1] to disclose the annual GHG emissions from across their operations and value chains in line with the Greenhouse Gas Protocol ("GHG Protocol") standards and related guidance.

- Senate Bill 261, the Climate-related Financial Risk Act ("SB 261"), will apply to a larger universe of companies and require the filing of a biennial climate-related financial risk report in accordance with the framework recommended by the Task Force for Climate-related Financial Disclosures ("TCFD").

The bills are both expected to be signed into law by Governor Gavin Newsom in the coming days or weeks. Assuming they become law, the measures will enter into force on January 1, 2024 (with reporting starting in 2026).[2] The measures require many of the same disclosures set out by the SEC's proposed rule on the Enhancement and Standardization of Climate-Related Disclosures for Investors ("SEC proposed rule"),[3] but with that rule still awaiting finalization, California now stands to precede (and, in some respects, surpass) pending federal requirements.[4]

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1 *See* California Assembly Floor Analysis (9/7/23), available here and referenced Ceres article, available here.

2 The bills were introduced in the California Senate along with another bill, the Fossil Fuel Divestment Act (SB 252), together the Climate Accountability Package, in January. SB 252 would prohibit the boards of the California Public Employees' Retirement System and the California State Teachers' Retirement System from making new investments in fossil fuel companies and require those boards to divest investments in existing fossil fuel companies by July 1, 2031. Though it did not make it to a final vote this year, Senator Lena Gonzalez, the bill's author, released a public statement, stating her intention to have a public hearing on the bill early next year.

3 *See* The Enhancement and Standardization of Climate-Related Disclosures for Investors as well as Enhancement and Standardization of Climate-Related Disclosures Fact Sheet.

4 California is historically an early adopter of sustainability-related requirements. *See, e.g.*, Michael Gerrard and Eric W. Otts, "New California Legislation Would be a Major Step Forward for Climate Disclosure," Climate Law, Sabin Center, Aug. 8, 2023, available here (noting that California passed the nation's first motor vehicle emission standards in 1966, energy efficiency standards for appliances in the 1970s, and the Global Warming Solutions Act of 2006, among others). We also note the California Transparency in Supply Chains Act, which became effective in 2012, and upon which transparency provisions in the U.K. Modern Slavery Act 2015 are partly modeled.

Below, we discuss the bills in further detail, including the application, scope, requirements, implementation timeline, and consequences of noncompliance. Both SB 253 and 261 will be subject to future regulations to be established by the California Air Resources Board (the "State Board") to govern implementation.[5]

# SB 253: Climate Corporate Data Accountability Act

The California legislature passed SB 253 with the goal of informing investors, consumers, communities and other stakeholders in California about the sources of carbon pollution from companies doing business in the state. The development is the latest in a series of measures taken by countries and regions globally to advance climate-related disclosure regulations.[6]

While the prior version of the bill failed to pass by one vote, a revised SB 253 passed following significant pressure from stakeholders seeking standardized and consistent climate-related disclosures and endorsement from some major companies.[7] Compared to its unsuccessful predecessor, SB 253 eases the burden on reporting entities by introducing a phase-in period for verifying GHG emissions data and assists the State Board in enforcing the reporting requirements by introducing an annual filing fee applied to reporting entities and payable to the State Board.[8]

## Covered Companies

SB 253 will apply to public and private companies that:

- Are organized in the United States;
- Reported total annual revenues in excess of $1 billion based on their prior fiscal year; and
- Are "doing business" in California.

The term "doing business in California" is defined to mean "actively engaging in any transaction for the purpose of financial or pecuniary gain or profit."[9]

An entity is doing business in California for a taxable year if it satisfies any of the following criteria:

- The company is organized or commercially domiciled in California.
- The company's sales (including sales by an agent or independent contractor) in California for the applicable tax year exceed the threshold amount or 25% of the company's total sales. For the 2023 tax year, the threshold amount was $711,538.
- The value of the company's real property and tangible personal property in California for the applicable tax year exceeds the threshold amount or 25% of the company's total real property and tangible personal property. For the 2023 tax year, the threshold amount was $71,154.
- The amount the company pays in California for compensation for the applicable tax year exceeds the threshold amount or 25% of the total compensation paid by the company. For the 2023 tax year, the threshold amount was $71,154.[10]

## Required Disclosure

Reporting entities will be required to disclose Scope 1, 2 and 3 emissions to a nonprofit reporting organization[11] that will be selected by the State Board. Scope 1, 2 and 3 emissions are defined largely in accordance with the GHG Protocol:

- "Scope 1 emissions" mean direct GHG emissions that a reporting entity owns or directly controls,

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[5] The State Board is California's lead agency for climate change programs and oversees all air pollution control efforts in the state to attain and maintain health-based air quality standards.

[6] Countries including the U.K., Singapore, Australia, India and the European Union, have introduced or implemented climate-disclosure related regulations. *See, e.g.* S&P Global, ESG Regulatory Tracker (accessed Sep. 11, 2023), available here.

[7] *See, e.g.*, Apple endorses California bill to oblige companies to report carbon footprint, Reuters, Sept. 8, 2023, available here. *See also* a letter from a group of major companies such as Adobe and Microsoft, expressing support for the bill, available here.

[8] *See* Senate Floor Analysis (5/23/23), available here. Previous drafts of the measure capped the fee at $1,000 but the bill was amended to state that the fee not exceed "the state board's actual and reasonable costs to administer and implement" the regulation.

[9] Cal. Rev. & Tax. Code §23101(a).

[10] Cal. Rev. & Tax. Code § 23101(b)((1) to (4) and (c)(1). The latest amounts set by the Franchise Tax Board available here.

[11] Defined as a nonprofit emissions reporting organization contracted by the State Board that both (i) currently operates a GHG emission reporting organization for organizations operating in the United States; and (ii) has experience with GHG emissions disclosure by entities operating in California.

regardless of location, including, but not limited to, fuel combustion activities;

- "Scope 2 emissions" mean indirect GHG emissions from consumed electricity, steam, heating or cooling purchased or acquired by a reporting entity, regardless of location;
- "Scope 3 emissions" mean indirect upstream or downstream GHG emissions, excluding Scope 2 emissions, from sources that the reporting entity does not directly own or control, and may include, but are not limited to, purchased goods and services, business travel, employee commutes, and processing and use of sold products.

Companies will be required to seek assurance over their emissions disclosures, as detailed in "Timing of Reporting" below.

Emissions must be calculated in accordance with the GHG Protocol standards and related guidance, including the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard and the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard, including guidance for Scope 3 emissions calculations that address acceptable use of primary and secondary data sources (including use of industry average data, and proxy data among others).[12]

The submitted emissions data will then be publicly available via a digital platform to be created and maintained by the selected nonprofit organization. The State Board will also prepare an annual report in conjunction with a specified academic institution in California or an equivalent academic institution.

## Timing of Reporting

The reporting and assurance requirements will apply progressively as follows:

| First Year of Reporting | Disclosure | Assurance Required |
|---|---|---|
| **2026** | Scope 1 and Scope 2 emissions for the prior financial year | Limited third-party assurance over Scope 1 and Scope 2 emissions |
| **2027** | Scope 3 emissions, to be provided no later than 180 days after disclosure of Scope 1 and 2 emissions are publicly disclosed to the emissions reporting organization (covering the prior financial year)[13] | *(No change from prior year)* |
| **2030** | *(No change from prior year)* | Reasonable third-party assurance over Scope 1 and Scope 2 emissions<br>Limited third-party assurance over Scope 3 emissions |

## Assurance Providers

Qualified assurance providers are required to have significant experience in GHG emissions measurement, analysis, reporting or attestations (*i.e.*, SB 253 does not mandate the use of a public accounting firm) and must be independent from the company.

- The State Board must take steps to ensure that the assurance process (i) minimizes the need for reporting entities to engage multiple assurance providers, and (ii) ensures sufficient assurance provider capacity and timely reporting implementation.[14]
- The State Board is required to review and evaluate trends in third-party assurance requirements for Scope 3 emissions during 2026 (presumably, assurance processes that are applied, reporting requirements associated with them, data sample sizes reviewed, etc.). On or before January 1, 2027, the State Board may then establish an assurance

[12] SB 253 provides that every five years, starting in 2033, the State Board may survey and assess current GHG accounting and reporting standards, and may adopt an alternative standard if it would more effectively further the goals of the statute.

[13] The State Board is required to consider updating the reporting deadline for Scope 3 emissions disclosures in 2029 to align with Scope 1 and Scope 2 emissions disclosures (as close in time as practicable).

[14] This provision appears to address a need to ensure that there are sufficient third-party auditors qualified to provide necessary assurance services for companies across their GHG emissions reporting to facilitate compliance with SB 253 and avoid potentially burdensome auditor "shopping." We note that SB 253 as introduced (i) required the State Board to establish auditor qualifications and a process for approving auditors, and (ii) established that disclosures could be verified by a third-party auditor or the emissions registry.

- requirement for third-party assurance engagements of Scope 3 emissions.
- The assurance engagement for Scope 3 emissions must be performed at a limited assurance level beginning in 2030.

### Enforcement

SB 253 requires the State Board to adopt regulations that authorize it to seek administrative penalties for non-filing, late filing or other reporting-related failures. Fines may not exceed $500,000 in a reporting year. Between 2027 and 2030, penalties related to Scope 3 reporting may only be levied for failure to file disclosures. Following 2030, a safe harbor will apply to misstatements with respect to Scope 3 emissions disclosures "made with a reasonable basis and disclosed in good faith."

## SB 261: Climate-related Financial Risk Act

SB 261, which passed one day after SB 253, requires in-scope companies to publish biennial TCFD-style climate risk reports. The measure also calls on the State Board to contract with a climate reporting organization[15] to publish a report that reviews and analyzes these publicly available reports, while also identifying insufficient and/or incomplete reports.

### Covered Companies

SB 261 applies to public and private companies organized in the United States that are "doing business" in California with total annual revenues in excess of $500 million.

The measure does not apply to business entities that are subject to regulation by the California Department of Insurance, or that are in the insurance business in any other state.

### Required Disclosure

Covered entities will need to prepare and publicly share on their websites climate-related financial risk reports created in accordance with the recommended framework in the TCFD.

- The report must include both the company's climate-related financial risk[16] and measures adopted to reduce and adapt to those risks.
- Companies may consolidate these reports at the parent level.[17]
- Covered entities do not need to prepare a separate report pursuant to SB 261 if they make publicly available, on at least a biennial basis, a climate-related financial risk report prepared (i) on a voluntary basis; or (ii) pursuant to a different law or regulation issued by a governmental entity, as long as these reports meet the disclosure requirements of SB 261.[18]

If a company does not complete a report that is consistent with these requirements, it must provide whatever disclosures it can to the best of its ability, while also providing a detailed explanation for any reporting gaps and steps it will take to prepare complete disclosures.

### Timing of Reporting

Covered companies must share their first risk reports on or before January 1, 2026, and at least biennially thereafter.[19] The climate reporting organization must also prepare its public report on a biennial basis.

### Enforcement

SB 261 requires the State Board to adopt regulations that authorize it to seek administrative penalties for non-filing, late filing or other reporting-related failures. Those fines may not exceed $50,000 in a reporting year.[20]

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[15] Defined as a nonprofit climate reporting organization that operates in the United States and has experience with climate-related financial risk disclosures by California companies.

[16] SB 261 defines "climate-related financial risk" as a "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, provisions of goods and services, supply chains, employee health and safety," and more.

[17] Even if a subsidiary company would qualify as a covered entity, it is not required to file a separate climate-related financial risk report.

[18] The bill notes that disclosures using the International Financial Reporting Standards Sustainability Disclosure Standards issued by the International Sustainability Standards Board would meet SB 261 disclosure requirements.

[19] SB 261 initially required covered companies to prepare and publicly publish on an annual basis, but was amended to a biennial basis.

[20] The penalty was previously capped at $500,000 similar to CA SB 253, but the bill was amended to significantly reduce this number to $50,000.

# Comparison of SB 253 and 261 to SEC's Proposed Climate-Related Disclosure Rule

While SB 253 and 261 cover many of the same topics as the SEC's proposed rule on the Enhancement and Standardization of Climate-Related Disclosures for Investors, the rules contain some important differences. Since the SEC rule remains in proposed form, any of the following could be revised in the final rulemaking.

| Topic | Requirement under SB 253 or 261 | Requirement under SEC Rule (as proposed) |
|---|---|---|
| **Covered Companies** | Public or private entities doing business in California, with revenue above a minimum threshold | Public registrants that are large accelerated filers, accelerated filer/non-accelerated filers or smaller reporting companies |
| **GHG Emissions Disclosure** | Scope 1, 2 and 3 for all covered companies | Scope 1 and 2 emissions and GHG intensity for all covered companies; Scope 3 emissions and Scope 3 intensity required if material, or if the registrant has set a reduction target or goal that relates to Scope 3 emissions |
| **Climate-Related Risk Disclosure** | TCFD Report | Generally based on TCFD requirements, but rules set out additional factors, details and considerations to be incorporated |
| **Reporting Standard** | Prepare reports in accordance with the GHG Protocol and TCFD | In many respects incorporates standards of the GHG Protocol and TCFD but differs in key areas, including the scope of entities within a registrant's consolidated group for which reporting is required |
| **Assurance Requirement** | Limited assurance over Scope 1 and 2 until 2030 when reasonable assurance is required; limited assurance over Scope 3 starting in 2030 | Limited assurance over Scope 1 and 2 for the 2nd and 3rd filing years following implementation, with reasonable assurance required beginning in the 4th year; no assurance required over Scope 3 emissions or from smaller reporting companies |
| **Location of Disclosure** | Submitted for inclusion in publicly-available database | Included in 10-K filings |

# Potential Litigation

SB 253 and SB 261 could face legal challenges, including lawsuits by covered companies or nonprofit organizations against those persons or entities implementing the bills or regulations issued with respect to them. We anticipate such challenges to focus on the constitutionality of the laws (the U.S. Constitution and/or the California State Constitution). For example, a California federal court recently held that a California statute requiring California-based corporations to have a minimum number of directors from certain under-represented groups violated the U.S. Constitution's Equal Protection Clause.[21] Similarly, in November 2022, a nonprofit organization and others brought suit against the State Board and others, asking the court to vacate the State Board's adoption of a regulation mandating the sale of only new passenger electric vehicles beginning in 2035.[22] The lawsuit alleges violations of both the U.S. and California Constitutions. We may see similar constitutional challenges with respect to SB 253 and/or SB 261. Absent a court order otherwise, and assuming SB 253 and SB 261 become law, we expect companies to remain subject to the measures while any such potential lawsuits are pending.

[21] See *Alliance for Fair Board Recruitment v. Weber*, No. 2:21-cv-01951 (E.D. Cal. May 16, 2023).

[22] See *The Two Hundred For Homeownership et al. v. California Air Resources Board et al.*, (E.D. Cal. Nov. 14, 2022).

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# Key Takeaways

With SB 253 and SB 261, assuming they are signed into law, California looks to fundamentally shift the US sustainability reporting landscape.

- While a growing number of companies already voluntarily report their GHG emissions and/or climate-related risks and opportunities using the TCFD framework, for companies covered by the new measures that are not doing so, the reporting obligations are significant. They could lead to a dramatic increase in substantive disclosures (and attendant costs).
- Companies that are subject to SB 253 and/or 261 will want to begin preparing now, using the GHG Protocol and TCFD framework to inform their strategies for preparing and producing emissions and climate-related disclosures.
- Public companies subject to SB 253 and/or 261 that will also be subject to the forthcoming SEC proposed rule (and/or other global climate reporting regulations) should give strategic consideration as to their GHG emissions tracking and reporting approach, given differences between standards and reporting timelines.
- Given many covered companies will be subject to increased disclosure under one or both measures, the implementation of the measures could have the effect of partially reversing the "greenhushing" trend—whereby a company purposely opts not to disclose its sustainability efforts in an effort to mitigate "greenwashing" claims or to avoid unwanted attention from stakeholders.
- For companies that are not within scope of SB 253 and SB 261 but are considering voluntary GHG emissions-related disclosure, these bills may offer an alternative template for that information.

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