

Far-reaching California climate disclosure bills signed into law

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On October 7, 2023, California Governor Gavin Newsom signed two broad-reaching bills that will 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.

These landmark measures constitute the most significant emissions- and climate-related disclosure laws enacted in the United States to date.

- California State Senator Scott Wiener's Senate Bill 253,¹ the Climate Corporate Data Accountability Act ("SB 253"), will require an estimated 5,300 public and private in-scope companies 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.
- California State Senator Henry Stern's Senate Bill 261,² the Climate-related Financial Risk Act ("SB 261"), will apply to an estimated 10,000 companies and require the filing of an annual climate-related financial risk report in accordance with the framework recommended by the Task Force for Climate-related Financial Disclosures ("TCFD").

In signing the bills, Governor Newsom noted concerns with respect to implementation deadlines attached to both bills, as well as cost impacts, and is directing his administration to work with the bills' authors and the State Legislature to address these issues in 2024. Nonetheless, companies should continue to operate on the assumption that the reporting timelines written into the legislation (as described below) are ultimately the timelines that will apply.

SB 253 and SB 261 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"), but with that rule still awaiting finalization, California now precedes (and, in some respects, surpass) pending federal requirements.

It is possible that clean-up legislation will align California's requirements to what the SEC ultimately sets forth, if different, and SB 253 in particular could set a new baseline for the SEC, encouraging the federal agency to take stronger action (*i.e.*, by including a Scope 3 emissions reporting requirement in its final rule).

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.

While the prior version of the bill failed to pass by one vote, the revised SB 253 passed following significant pressure from stakeholders seeking standardized and consistent climate-related disclosures and endorsement from some major companies.³ It eased the burden on reporting entities by introducing a phase-in period for verifying GHG emissions data and assists the California Air Resources Board ("CARB") in enforcing the reporting requirements by introducing an annual filing fee applied to reporting entities.

Covered companies

SB 253 will apply to public and private companies that:

- Are organized in the United States;
- Reported total annual revenues⁴ in excess of \$1 billion based on their prior fiscal year; and
- Are "doing business" in California.

"Doing business" in California is not defined in SB 253. While CARB could create a new definition for this purpose, under well-established California law, 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," and an entity meets the test if it satisfies any of the following:⁵

- 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 lesser of five hundred thousand dollars (\$500,000) or 25% of the company's total sales;
- The value of the company's real property and tangible personal property in California exceeds the lesser of fifty thousand dollars (\$50,000) or 25% of the company's total real property and tangible personal property; or
- The amount the company pays in California for compensation exceeds the lesser of fifty thousand dollars (\$50,000) or 25% of the total compensation paid by the company.

Required disclosure

SB 253 requires that CARB, on or before Jan. 1, 2025, develop and adopt regulations to require reporting entities to make annual disclosures of their GHG emissions, and to obtain assurance over those disclosures.

Reporting entities will be required to disclose Scope 1, 2 and 3 emissions to a nonprofit reporting organization. This emissions data will be publicly available via a digital platform, and CARB will also prepare an annual report.

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

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. The GHG Protocol is not static, and is currently undergoing review, with revised texts expected to be released in 2024 and final standards/guidance in 2025.

In his signing message, Governor Newsom described the implementation deadlines in SB 253 as “likely infeasible,” possibly referring to the substantial rulemaking required by CARB during a compressed timeline to meet a Jan. 1, 2025 deadline, and the lack of a clear source of funding for that effort.

Timing of reporting

The reporting and assurance requirements will apply progressively as follows:⁶

First Year of Reporting	Disclosure	Assurance Required
2026	Scope 1 and Scope 2 emissions for the prior financial year (starting on or after January 1, 2025)	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 financial years starting on or after January 1, 2026) ⁷	<i>(No change from prior year)</i>
2030	<i>(No change from prior year)</i>	Reasonable third-party assurance over Scope 1 and Scope 2 emissions 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.

- CARB 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.⁸
- CARB 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, CARB may then establish an assurance 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 CARB 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.”

While SB 253 does not specify a private right of action, it also does not preclude one.

SB 261: Climate-related Financial Risk Act

SB 261 requires in-scope companies to publish biennial TCFD-style climate risk reports. The measure also calls on CARB to issue regulations relating to filing fees and administrative penalties and to contract with a climate reporting organization

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. It 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 risk⁹ and measures adopted to reduce and adapt to those risks.
- Companies may consolidate these reports at the parent level.
- 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 261.¹⁰

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. The climate reporting organization must also prepare its public report on a biennial basis.

Enforcement

SB 261 requires CARB to adopt regulations that authorize it to seek administrative penalties (up to \$50,000) for non-filing, late filing or other reporting-related failures.¹¹

With SB 253 and SB 261, California looks to fundamentally shift the US sustainability reporting landscape.

In his signing statement, Governor Newsom stated that the implementation deadlines in SB 261 “fall short in providing” CARB with sufficient time to adequately carry out the measure’s requirements, likely referring again to the regulatory burden that will fall on CARB during the next fourteen months.

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 requirements in the following table 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

Although no claims have yet been filed, SB 253 and SB 261 are likely to face legal challenges, including potential lawsuits by covered companies or nonprofit organizations against those persons or entities implementing the laws 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.¹²

SB 253 and SB 261 are likely to face legal challenges.

Similarly, in November 2022, a nonprofit organization and others brought suit asking the court to vacate CARB's adoption of a regulation mandating the sale of only new passenger electric vehicles beginning in 2035.¹³ 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.

Key takeaways

With SB 253 and SB 261, California looks to fundamentally shift the US sustainability reporting landscape.

Further, though it is still unclear from an implementation standpoint (i) how the Governor intends to amend SB 253 and SB 261 and (ii) what CARB's final regulations will look like, we note the following:

- 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 measures may offer an alternative template for that information.
- While SB 253 does not require CARB to publicly list noncompliant companies, it is likely that climate advocacy organizations or others, will independently compile a list of companies that are not reporting as required.

Notes

¹ <https://bit.ly/3Q1hafz>

² <https://bit.ly/3M3SAK7>

³ See, e.g., Apple endorses California bill to oblige companies to report carbon footprint, Reuters, Sept. 8, 2023, available here: <https://reut.rs/3FjNzsT>. See also a letter from a group of major companies such as Adobe and Microsoft, expressing support for the bill, available here: <https://bit.ly/3tH1Ayc>.

⁴ Global revenue will be considered in determining whether a company falls into scope. However, SB 253 does not clearly define how revenue will be measured (e.g. gross or net).

⁵ Cal. Rev. & Tax. Code §23101.

⁶ CARB has significant leeway to determine timeframes for reporting, with some restrictions imposed. Other than this, there is no specific indication yet as to when during the year disclosures will be due. Under the SEC's proposed rule, the disclosure would be required in the 10-K (60-90 days following the end of the registrant's fiscal year).

⁷ CARB 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).

⁸ 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."

⁹ 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.

¹⁰ SB 261 states that disclosures using the International Financial Reporting Standards Sustainability Disclosure Standards issued by the International Sustainability Standards Board would meet the SB 261 disclosure requirements.

¹¹ 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.

¹² See *Alliance for Fair Board Recruitment v. Weber*, No. 2:21-cv-01951 (E.D. Cal. May 16, 2023).

¹³ 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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