California Legislature Passes and Governor Newsom Signs Landmark California Climate Bills

OVERVIEW

In September 2023, the California legislature passed two seminal climate disclosure bills by a significant majority:

- Climate Corporate Data Accountability Act[1] ("SB 253") – Any partnerships, corporations, limited liability companies, and other business entities formed in the U.S. and "doing business in California" with total annual revenues from operations globally in the prior fiscal year in excess of $1 billion (a "Reporting Entity") must disclose Scope 1 and 2 greenhouse gas ("GHG") emissions (starting in 2026) and Scope 3 GHG emissions (starting in 2027), in each case for the prior fiscal year and in accordance with the Greenhouse Gas Reporting Protocol (the "GHG Protocol"). SB 253 directs the California Air Resources Board ("CARB") to adopt implementing regulations by January 1, 2025 that will provide additional detailed compliance requirements, potentially including with respect to the important open questions highlighted below.[2]
- Greenhouse Gases: Climate-Related Financial Risk[3] ("SB 261") – Any partnerships, corporations, limited liability companies, and other business entities formed in the U.S. and "doing business in California" with total annual revenues from operations globally in excess of $500 million, except insurance companies (a "Covered Entity"), must disclose climate-related financial risk, consistent with the Recommendations of the Task Force on Climate-Related Financial Disclosures (the "TCFD Recommendations"), starting in 2026.

Governor Gavin Newsom signed the bills into law on October 7, 2023, at which point they became the most extensive set of mandatory climate disclosures in the United States. In his signing statements, however, Governor Newsom expressed concerns that the bills' timelines may be too abridged and directed his administration to work with the bills' authors and the legislature on such issues. He also separately expressed concerns about the costs of administering the legislation and directed CARB to monitor the financial impacts of the bills.[4] While these bills mandate public disclosures broadly similar to the SEC's proposed climate rule[5], there are important differences, both in the breadth of application and disclosure obligations. In addition, the bills are relatively brief and certain details remain undefined or otherwise uncertain, and may be subject to clarification in future amendments, implementing regulations or legal challenges.

Key additional considerations related to these bills include:

- Unlike the SEC's proposed climate rule, the California bills cover both private and public companies, and are estimated to cover more than 5,000 companies (in the case of SB 253) and 10,000 companies (in the case of SB 261). It is likely that many private companies within the bills' scope have not previously and/or sufficiently measured their GHG emissions or made disclosures in alignment with the TCFD Recommendations.
- Both bills apply only to U.S. entities (including U.S. subsidiaries of non-U.S. companies) – there is no direct extraterritorial applicability. It is currently unclear how the bills will extend to non-U.S. affiliates of U.S. entities.

- The "doing business in California" requirement is undefined in the text of the bills but is likely to be interpreted broadly in any implementing regulations and/or practice. In particular, the California legislature commentary recognizes the existing California tax code, which defines "doing business in California" as, among other things, "engaging in any transaction for the purpose of financial gain within California...".
- The bills do not (although implementing regulations and/or practice may) clarify whether "total annual revenues" must (i) include gross or net revenues, (ii) include global or solely U.S. revenues, (iii) be calculated on a consolidated basis (*e.g.*, treating corporate affiliates as one entity for monetary threshold purposes) or (iv) be calculated under a specified accounting standard.
- We expect these requirements to impact indirectly many non-subject entities that operate within the value chain or corporate structure of a Reporting or Covered Entity.
    - For example, to comply with the SB 253 Scope 3 disclosure requirement, Reporting Entities will need to estimate and/or collect data on GHG emissions by any non-reporting affiliates and other entities (*e.g.*, suppliers) in their value chain – there is no materiality threshold or exception.
    - Additionally, Covered Entities will need to include in their SB 261 report any climate-related financial risk to non-reporting affiliates and other entities (*e.g.*, suppliers) in their value chain, but only to the extent those risks present a material climate-related financial risk to a Covered Entity.
- Unlike the SEC's proposed climate rule, SB 253 requires all Reporting Entities to report their Scope 3 GHG emissions – there is also no materiality threshold or exception.
- Both bills permit subject entities to satisfy their disclosure obligations with reports prepared in order to meet other national and international reporting requirements (including reports filed with the SEC), so long as those reports satisfy all the relevant California requirements.
- SB 253 requires that Reporting Entities obtain independent third-party assurance for their Scope 1 and 2 GHG emissions reporting (limited assurance in 2026 and reasonable assurance from 2030 onwards). Unlike the SEC's proposed climate rule, SB 253 also appears to require independent third-party assurance for Scope 3 GHG emissions reporting (limited assurance from 2030 onwards) – although the bill is somewhat unclear on this point and seems to suggest that CARB may also establish an assurance requirement for Scope 3 GHG emissions on or before January 1, 2027.

SUMMARY OF REQUIREMENTS

	SB 253	SB 261
Companies in Scope	Public and private U.S. companies, with total annual revenues exceeding $1 billion	Public and private U.S. companies, with total annual revenues exceeding $500 million
Primary Framework	GHG Protocol[6]	TCFD (or IFRS Sustainability Disclosure Standards, as issued by ISSB)
Primary Disclosure Obligation	Reporting Entities must publicly disclose, on an annual basis and in conformance with the GHG Protocol: • all of their Scope 1 and Scope 2 emissions for the prior fiscal year starting in 2026	(i) Climate-related financial risk[7] (ii) Measures adopted to reduce and adapt to identified Climate-Related Financial Risk

	SB 253	SB 261
	• all of their Scope 3 GHG emissions for the prior fiscal year starting in 2027	(iii) Does not specify the "look-back" period for each report, although we expect the reports will need to cover the prior two-year period
Reporting Period	Annual	Biennial
Exemptions	None	(i) Insurance companies are fully exempted (ii) Subsidiaries of parent companies that prepare consolidated reports are exempted from preparing their own reports (iii) All companies may submit incomplete reports so long as they include the TCFD-recommended disclosures to the best of their ability, provide a detailed explanation for any reporting gaps, and describe steps they will take to prepare complete disclosures[8] (iv) All companies may comply with SB 261 with any public report that complies with the IFRS Sustainability Disclosure Standards, as issued by ISSB
Publication	On a digital platform operated by a nonprofit "emissions reporting organization" (to be contracted by CARB)	On the Covered Entity's website
Assurance	Required on the following timeline: (i) Phased assurance for Scope 1 and Scope 2 GHG emissions disclosures (from limited assurance in 2026 to reasonable assurance from 2030 onwards) (ii) Limited assurance for Scope 3 GHG emissions disclosures from 2030 onwards (iii) Detailed requirements for qualifications of third-party assurance providers[9]	None is required
Penalties	(i) Administrative penalties not to exceed $500,000 per company per reporting year (ii) Safe harbor for good faith Scope 3 GHG emissions disclosures (and, until 2030, no penalties for Scope 3 disclosures may be imposed, other than for failure to report)	(i) Administrative penalties not to exceed $50,000 per company per reporting year (ii) Criminal and civil penalties for violations of the California Global Warming Solutions Act of 2006 will not apply

	SB 253	SB 261
	(iii) Criminal and civil penalties for violations of the California Global Warming Solutions Act of 2006 will not apply (iv) Although not filed with the SEC, these disclosures will be subject to anti-fraud provisions and related liabilities under U.S. securities laws[10]	(iii) Although not filed with the SEC, these disclosures will be subject to anti-fraud provisions and related liabilities under U.S. securities laws
Fees	Reporting Entities must pay an annual fee to CARB upon filing their disclosures. The amount of the fee will be determined by CARB and will be based on the "actual and reasonable costs" to administer and implement SB 253	Covered Entities must pay an annual fee to CARB upon filing their disclosures. The amount of the fee will be determined by CARB and will be based on the "actual and reasonable costs" to administer and implement SB 261
Monitoring / Enforcement	(i) Academic institution to prepare annual public reports on disclosures (ii) CARB to seek and enforce administrative penalties[11] (iii) SEC and investors may seek and enforce anti-fraud liability	(i) Nonprofit climate reporting organization to prepare biennial public reports on disclosures (ii) CARB to seek and enforce administrative penalties (iii) SEC and investors may seek and enforce anti-fraud liability
Compliance Timeline	(i) Scope 1 and Scope 2 GHG emissions disclosures in 2026 for the prior fiscal year (ii) Scope 3 GHG emissions disclosure in 2027 for the prior fiscal year (iii) Exact reporting dates will be determined in the implementing regulations, and Scope 3 GHG emissions may be reported up to 180 days after reporting Scope 1 and Scope 2 GHG emissions.	First reports by January 1, 2026

NEXT STEPS

Legal Challenges

As in the case of the SEC's proposed climate rule, these bills are expected to face legal challenges. Similar to the SEC's proposed climate rule, it is possible the bills may face challenges to CARB's authority to regulate climate change. However, unlike the SEC's proposed climate rule, both bills rely on specific statutory authority (namely, the California Global Warming Solutions Act of 2006). Plaintiffs may also seek to bring federal or state constitutional challenges premised on grounds, such as the U.S. Constitution's dormant commerce clause or on grounds of compelled speech. Finally, it is also possible for opponents to overturn the bills by way of referendum in California.

Similar Developments

Other U.S. states have undertaken, or may undertake, similar efforts. For example, New York's Climate Corporate Accountability Act, which (as currently drafted) would require reporting entities to disclose publicly their Scope 1, Scope 2 and Scope 3 GHG emissions, consistent with the GHG Protocol, is currently moving through the New York legislature. Passage of SB 253 and SB 261 may also inspire Republican-led states to pass bills of similar scope but advancing an agenda consistent with the broader recent backlash to ESG.

Recommendations

As a practical matter, potentially subject entities should begin preparing for these disclosure obligations, particularly those entities which may be subject to climate-related reporting requirements or undertakings for the first time. This includes assessing the bills' requirements and implementing or updating controls and procedures to collect and maintain relevant data. Relatedly, other businesses, even if outside the scope of the bills, should anticipate an increased number of inquiries and heightened scrutiny with respect to their own controls and procedures and data points from their clients, suppliers or affiliates.

In addition, potentially subject entities that also may be subject to the SEC's proposed climate rule, the EU's Corporate Sustainability Reporting Directive and/or other climate-related reporting requirements will need to reconcile and determine how best to address potentially varying obligations (both in terms of the scope and timing of disclosure) and identify gaps in their current practices and disclosures.

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1 S. 253, 2023-2024 Leg., Reg. Sess. (Cal. 2023), Bill Text - SB-253 Climate Corporate Data Accountability Act. (ca.gov).

2 The implementing regulations may receive significant public comments pursuant to the legally required notice and comment procedures (under California law, the comment period must remain open for a minimum of 45 days), which could delay or substantially alter the posture of SB 253.

3 S. 261, 2023-2024 Leg., Reg. Sess. (Cal. 2023), Bill Text - SB-261 Greenhouse gases: climate-related financial risk. (ca.gov).

4 SB 253 Signing Statement from Gavin Newsom, Cal. Governor, to Cal. S. (Oct. 7, 2023), SFresno_Biz23100709400 (ca.gov); SB 261 Signing Statement from Gavin Newsom, Cal. Governor, to Cal. S. (Oct. 7, 2023), SFresno_Biz23100709400 (ca.gov).

5 The Enhancement and Standardization of Climate-Related Disclosures for Investors, 87 Fed. Reg. 21334 (Apr. 11, 2022).

6 Including the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard and the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard. Beginning in 2033, and every five years thereafter, CARB may survey and assess the then-available global GHG accounting and reporting standards and adopt an alternative standard to the GHG Protocol that they determine would "more effectively further the goals of the bill".

7 SB 261 defines "Climate-Related Financial Risk" as any "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".

8 There is no such relief for the requirement to disclose any measures the Covered Entity has adopted to reduce and adapt to the identified climate-related financial risk.

9 Requirements include that assurance providers must be independent and have significant experience in measuring, analyzing, reporting or attesting to GHG emissions and sufficient competence to perform the engagement in accordance with legal and regulatory requirements. CARB may update these qualifications, consistent with trends, in 2029.

10 Rule 10b-5 under the United States Securities and Exchange Act of 1934, as amended (the "Exchange Act"), prohibits a company from making "any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading … in connection with the purchase or sale of any security".

11 Such penalties shall be sought and recovered by way of administrative hearings. In imposing any penalties, CARB shall consider all relevant circumstances, including (i) the Reporting Entity's past and present compliance with SB 253 and (ii) any good-faith compliance measures undertaken by the Reporting Entity. SB 261 includes an analogous provision.

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