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New California laws mandate climate-related disclosures

Expansive requirements will apply to large public and private companies doing business in California and indirectly impact businesses in their value chain

On October 7, 2023, California Governor Gavin Newsom signed two climate-related disclosure laws intended to significantly increase public information available regarding businesses' greenhouse gas emissions and climate-related risks. These are groundbreaking laws in the United States as the expansive disclosure requirements broadly apply to both public and private business entities that do business in California and meet specified annual revenue thresholds.

Climate Corporate Data Accountability Act (SB 253)

The Climate Corporate Data Accountability Act (Climate Data Act) requires all US-organized partnerships, corporations, limited liability companies or other business entities that "do business" in California and have total annual revenues of over $1 billion to report their Scope 1, Scope 2 and Scope 3 greenhouse gas emissions. Reporting entities must also engage an independent third-party to provide an assurance report to be filed with the emissions disclosure.

The Climate Data Act requires the California Air Resources Board (CARB) to develop and adopt the implementing regulations by January 1, 2025. This legislation builds on the Greenhouse Gas Protocol and is intended to provide a standardized and broadly referenced reporting framework.

As a refresher:

- **Scope 1** emissions include all direct greenhouse gas emissions from sources an entity owns or directly controls.
- **Scope 2** emissions include indirect greenhouse gas emissions from consumed electricity, steam, heating or cooling purchased or acquired.
- **Scope 3** emissions include indirect upstream and downstream greenhouse gas emissions, other than Scope 2 emissions, from sources that the entity does not own or directly control.

Scope 3 emissions, which reach from the beginning of the supply chain to the customer's disposal of the product, are intended to encompass the greenhouse gas emissions of the full value chain of a company's activities. The Scope 3 requirement will indirectly expand the law's impact to many smaller businesses (for example suppliers, distributors or retailers) that do not do business in California or meet the applicable revenue thresholds.

Annual reporting for Scope 1 and Scope 2 emissions begins in 2026 (measuring 2025 greenhouse gas emissions) and reporting for Scope 3 emissions begins in 2027 (measuring 2026 greenhouse gas emissions). Beginning in 2026, the report must include an independent third-party report on a "limited assurance" basis for the Scope 1 and Scope 2 emissions and on a "reasonable assurance" basis beginning in 2030. CARB will evaluate the feasibility of obtaining assurance for Scope 3 emissions and, on or before January 1, 2027, establish an assurance requirement for Scope 3 emissions which, at minimum, will require an independent third-party-report on a "limited assurance" basis beginning in 2030 (measuring 2029 emissions). These assurance reports are work-intensive endeavors and are roughly analogous to a financial audit.

The reports will be publicly available, although where remains to be determined. CARB must select an emissions reporting organization to provide the reporting platform.

CARB may seek administrative penalties up to $500,000 per year for violations of the Climate Data Act. However, recognizing the inherent difficulty in determining Scope 3 emissions, no administrative penalties will be assessed for any misstatements with respect to Scope 3 emissions disclosure made with a reasonable basis and disclosed in good faith and, until 2030, Scope 3 reporting penalties will only be assessed for non-filing. CARB will also collect an annual filing fee to cover California's costs of administering the new reporting program.

The scope of CARB's mandate is broad and ambiguous and the implementing regulations will be important in clarifying the specifics of the law. One area of particular interest is that the threshold for "doing business" in California is not defined – although it likely will be fairly broad and will presumably leverage existing thresholds similar to those California utilizes in the state tax and business registration contexts. Another question is whether affiliated entities would need to be consolidated. These two questions, among many others, are areas where businesses will look to the implementing regulations for clarity.

Greenhouse Gases: Climate-Related Financial Risk (SB 261)

An accompanying law, Greenhouse Gases: Climate Related Financial Risk (Financial Risk Act) requires companies that do business in California with annual revenues over $500 million to prepare a report disclosing the company's climate-related financial risks as well as measures adopted to reduce and adapt to such risks, on a biennial basis.[1] The lower annual revenue threshold means that the Financial Risk Act will apply to many more companies than the Climate Data Act. As with the Climate Data Act, the Financial Risk Act builds on a broadly accepted framework – in this case, the Task Force on Climate-related Financial Disclosures (TCFD) – to guide the content of the reports.

The Financial Risk Act defines climate-related financial risk 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, consumer demand, and financial markets and economic health."[2] Again, the reporting mandate is broad and ambiguous and the scope of the disclosure is unclear. That said, many international reporting regimes and voluntary reports are based on the TCFD and market practices are already being developed with regards to these disclosures. In an effort to reduce duplicative efforts for companies subject to this law, reports prepared pursuant to another law or regulation that incorporate standards consistent with the requirements of the Financial Risk Act may satisfy the report requirements.

The biennial reporting requirement will begin on or before January 1, 2026, and the report must be posted on the company's own website. Subsidiary companies that are subject to the rule may comply by posting an equivalent report prepared by their parent company, if available. If a company cannot complete the report, it must provide the recommended disclosures to the best of its ability, provide a detailed explanation for any reporting gaps, and describe steps it will take to complete disclosures.

As with the Climate Data Act, the law requires CARB to charge a filing fee that will fund the operations of administering and implementing the Financial Risk Act. CARB may also seek administrative penalties up to $50,000 per year for failure to comply with the act.

Compared to the Proposed SEC Rules

With these laws, California has jumped ahead of the Securities and Exchange Commission (SEC) in the race to require certain climate-related disclosures. When released in March 2022, the SEC's proposed rules attracted significant attention, including our legal alert, but have taken longer than anticipated to finalize given the scope and volume of comments received by the SEC. There are substantial areas of overlap and both the new California laws and the proposed SEC rules build on the TCFD and Greenhouse Gas Protocol and are intended to better standardize disclosures and reference frameworks with which many affected companies would be familiar.

The most notable difference between the two reporting regimes is the entities within the scope of the reporting obligations. The Climate Data Act applies to both public and private companies that meet the jurisdictional and revenue thresholds, whereas the SEC's rule would only directly apply to SEC-reporting entities. Further, the Climate Data Act requires Scope 3 emissions reporting for all reporting entities while the proposed SEC rule only requires reporting for entities for whom Scope 3 emissions are material or who included Scope 3 emissions in a public greenhouse gas reduction target. Even with more limited applicability, the SEC's inclusion of Scope 3 emissions was one of the most controversial aspects of the proposed rule and was rumored to be on the chopping block for the final rule. However, the Climate Data Act's required disclosure of Scope 3 emissions reduces the incremental compliance cost for entities subject to both sets of regulations and may influence the SEC's ultimate decision.

1 The Financial Risk Act recognized the existing risk reporting obligations promulgated by the National Association of Insurance Commissioners and does not apply to business entities that are subject to regulation by the California Department of Insurance or that are in the business of insurance in any other state.

2 SB 261

Another key difference is that new California mandates are laws passed by the legislature and signed by the governor. The SEC is acting without a specific legislative remit, which has led to a number of concerns regarding the scope of the rule as well as promised challenges to the final rule that the SEC is exceeding its authority, particularly following the Supreme Court's West Virginia v. EPA decision in June 2022.

One last difference to note is that unlike the SEC's proposed rules, which specifically require registrants to report their gross greenhouse gas emissions, without regard to any carbon offsets, the Climate Data Act law does not specifically address the role carbon offsets may make in a company's emissions profile. Hopefully, CARB will also clarify this in the implementing regulations.

What's Next?

These reporting obligations begin in 2026, just over two years away. And the greenhouse gas emission reports will cover the 2025 fiscal year, which for calendar reporting entities, begins in less than 15 months. This is fast. Governor Newsom even acknowledged issues with the aggressive schedule and potential costs of the new laws and announced that he would work with the legislature to address potential issues with the new laws.

Companies subject to the Climate Data Act will need to evaluate their existing climate-related disclosure infrastructure and ensure or develop the infrastructure necessary to gather and report emissions data as well as find a suitable assurance provider to attest to the emissions disclosure. Companies subject to the Financial Risk Act must thoroughly evaluate their climate-related business risks. Failure to accurately comply with reporting obligations could create significant legal exposure for companies. Plaintiffs will be waiting and ready to scrutinize the reported emissions data for any inconsistencies with a company's prior public statements.

Lastly, it is likely that some companies or industry groups will challenge the laws on various grounds, including compelled speech, federalism and state overreach into areas of federal concern. Regardless of the success of any challenges, as the trend of increased climate-related disclosure continues to grow, companies are coming under increasing pressure or mandates to disclose greenhouse gas emissions and climate-related risks, and should prepare accordingly.

If you have any questions about this Legal Alert, please feel free to contact the attorney listed or the Eversheds Sutherland attorney with whom you regularly work.

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