

September 29, 2023

## CALIFORNIA PASSES CLIMATE DISCLOSURE LEGISLATION

To Our Clients and Friends:

The California Legislature recently passed two wide-reaching bills that will impose significant and mandatory climate-related reporting requirements for large public and private companies doing business in the state. Specifically, the bills will ultimately require annual disclosure of audited Scope 1, 2, and 3 greenhouse gas (“GHG”) emissions and biennial disclosure related to certain climate risks. In support of the bills, the California Legislature cited concerns such as the effect of climate change on the state’s economy, companies’ roles in contributing to and addressing climate-related risks to their own businesses and the state’s economy, and the ability of the state to develop emissions reduction requirements, as well as the lack of transparency and consistency resulting from current voluntary emissions disclosure. Both of the bills rely on existing reporting frameworks and standards established by international organizations, and as a result, some companies may find that they already track and report the necessary information, although for many others, these will be costly new undertakings.

These bills will become law, effective on October 14, 2023, unless Governor Gavin Newsom signs the bills at an earlier date or vetoes the bills. Governor Newsom has publicly stated that he plans to sign the bills, subject to minor language changes, although the nature of those changes and the timing of his signature are still uncertain. Once the legislation is final, a litigation challenge is possible.

### **Senate Bill No. 253, Climate Corporate Data Accountability Act (“SB 253”)[1]**

SB 253 creates new GHG emissions reporting requirements for companies[2] that:

- are organized in the United States,
- have total annual revenues in excess of \$1 billion, and
- do business[3] in California (each, a “Reporting Entity”).

According to the September 7, 2023 Assembly Floor Analysis, SB 253 is expected to impact more than 5,300 companies.[4]

If enacted, SB 253 would require all Reporting Entities to publicly and annually report their fiscal year Scope 1, Scope 2, and Scope 3 GHG emissions to a newly established statewide GHG emissions reporting organization. The California Air Resources Board (the “CARB”), which is under the umbrella of the California Environmental Protection Agency, would be required to develop and adopt regulations to implement the reporting program by January 1, 2025, after considering input from various stakeholders, including government stakeholders, climate experts, investors, consumer and

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environmental groups, and “[r]eporting entities that have demonstrated leadership in full-scope greenhouse gas emissions accounting and public disclosure and greenhouse gas emissions reductions.”

Annual Scope 1 and Scope 2 GHG emissions reporting would begin in 2026 for the prior fiscal year, with the specific required date of filing to be determined by CARB. Disclosure of annual Scope 3 GHG emissions would follow in 2027, with CARB to set the deadline no later than 180 days after the deadline for disclosing Scope 1 and Scope 2 GHG emissions. However, on or before January 1, 2030, CARB is required to revisit and potentially update the date of these annual deadlines with the goal that the deadline for disclosure of Scope 3 GHG emissions would fall “as close in time as practicable” to the deadline for disclosure of Scopes 1 and 2 GHG emissions.

SB 253’s definitions of “Scope 1,” “Scope 2,” and “Scope 3” GHG emissions are generally consistent with those established in the Greenhouse Gas Protocol (the “GHG Protocol”)[5] and as subsequently adopted by a variety of international regulatory bodies. The Securities and Exchange Commission’s proposed rules on climate change disclosures (the “SEC’s Proposed Rules”) also rely on the GHG Protocol when defining reportable emissions, although, as discussed below, the Scope 3 requirements in the California law would apply to far more companies. [6] As passed by the legislature, SB 253 includes the following definitions:

- “Scope 1 emissions” means all direct greenhouse gas emissions that stem from sources that a reporting entity owns or directly controls, regardless of location, including, but not limited to, fuel combustion activities.
- “Scope 2 emissions” means indirect greenhouse gas emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity, regardless of location.
- “Scope 3 emissions” means indirect upstream and downstream greenhouse gas emissions, other than scope 2 emissions, from sources that the reporting entity does not own or directly control and may include, but are not limited to, purchased goods and services, business travel, employee commutes, and processing and use of sold products.

Reporting Entities are required to measure and report their emissions in line with the GHG Protocol’s standards and guidance.

When determining the structure for these reports, CARB must minimize duplicative efforts by the Reporting Entities and permit them to submit reports “prepared to meet other national and international reporting requirements, including any reports required by the federal government,” if they meet SB 253’s requirements as well.

SB 253 would also require that each Reporting Entity’s disclosures be independently verified by a third-party assurance provider that is approved by CARB and has expertise in GHG emissions accounting. Assurance of Scope 1 and Scope 2 GHG emissions would be required at a limited assurance level beginning in 2026 and at a reasonable assurance level beginning in 2030.[7] Scope 3 GHG emissions may require assurance at a limited assurance level beginning in 2030.

CARB would also be subject to its own reporting requirements and would be required to contract with an academic institution to prepare a report on disclosures made by Reporting Entities by July 1, 2027, taking into account “the context of state greenhouse gas emissions reduction and climate goals.” Reporting Entities’ emissions disclosures and the CARB’s report are required to be made available to the public via a digital platform created by the new emissions reporting organization. Upon filing, Reporting Entities will annually pay a filing fee in an amount to be established by CARB to cover the costs of administration and implementation of the law. Finally, SB 253 authorizes administrative penalties up to \$500,000 for noncompliance, including reporting late or not at all, but includes a safe harbor for Scope 3 GHG emissions such that (i) penalties will not apply to any misstatements regarding Scope 3 GHG emissions that were “made with a reasonable basis and disclosed in good faith,” and (ii) until 2030, penalties will only be assessed on Scope 3 reporting for failures to disclose.

## **Senate Bill No. 261, Greenhouse Gases: Climate-Related Financial Risk (“SB 261”)[8]**

SB 261 imposes new reporting requirements on companies,[9] other than insurance companies, that:

- are organized in the United States,
- have total revenues greater than \$500 million, and
- do business in California (each a “Covered Entity”).

This risk reporting can be provided at the consolidated parent company level, and a separate report is not required for subsidiaries that independently qualify as a Covered Entity. According to the September 12, 2023 Senate Floor Analysis,[10] SB 261 is expected to impact more than 10,000 companies.

If enacted, SB 261 would require each Covered Entity to prepare a biennial report disclosing its climate-related financial risks and the measures it has adopted to reduce and adapt to those disclosed climate-related financial risks. A Covered Entity would make this report publicly available on its own website, and the first report must be published on or before January 1, 2026. Unlike SB 253, the reporting requirements do not depend on CARB adopting additional regulations to implement the reporting program, and no submission to CARB is required.

The bill 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.”

SB 261 requires that Covered Entities report their financial risks in accordance with the recommended frameworks found in the Final Report of Recommendations of the Task Force on Climate-related Financial Disclosures (“TCFD”).[11] TCFD is a widely used reporting framework that helps companies assess and report their exposure to climate-related risks. TCFD’s recommendations outline disclosure of climate-related risks in four areas: governance, strategy, risk management, and metrics and targets. TCFD also provides specific guidance for companies in the financial sector, as well as those in the

energy, transportation, materials and buildings, and agriculture, food, and forest products industries. Covered Entities may also comply by preparing a publicly accessible report that includes climate-related financial risk disclosure if made either voluntarily or pursuant to a law, regulation, or listing requirement issued by a government entity or regulated exchange. Any such alternative report must use a framework consistent with SB 261’s requirements or the International Financial Reporting Standards Sustainability Disclosure Standards, as issued by the International Sustainability Standards Board (the “ISSB”). Where a Covered Entity’s report fails to fully comply with TCFD or ISSB standards, the entity will need to explain any gaps and describe how it take steps to provide complete disclosure.

Similar to SB 253, SB 261 requires CARB to contract with a climate reporting organization to prepare a biennial report on Covered Entities’ disclosures, which would include an “[a]nalysis of the systemic and sectorwide climate-related financial risks facing the state based on the contents of climate-related financial risk reports, including, but not limited to, potential impacts on economically vulnerable communities.” The climate reporting organization would also be responsible for gathering input on required disclosure from “representatives of sectors responsible for reporting climate-related financial risks, state agencies responsible for oversight of reporting sectors, investment managers, academic experts, standard-setting organizations, climate and corporate sustainability organizations, labor union representatives whose members work in impacted sectors, and other stakeholders.” Covered Entities could be subject to a fine of up to \$50,000 per reporting year for violation of the statute and will be required to pay an annual fee to cover CARB’s costs in administering and implementing the law.

## **Key Takeaways**

Unlike the SEC’s Proposed Rules, which apply only to public companies and investment firms, these two bills would impose reporting requirements for both public and private companies. And while both the SEC’s Proposed Rules and SB 253 reference the GHG Protocol when defining reportable emissions, SB 253’s Scope 3 GHG emissions reporting requirements are more onerous: specifically, while the SEC’s Proposed Rules would only require Scope 3 reporting by public companies where such emissions are material or part of a reduction target, SB 253 would require Scope 3 GHG emissions reporting for all Reporting Entities, regardless of whether Scope 3 emissions are material to the entity. Additionally, SB 253 authorizes (but does not require) CARB to establish a third-party assurance requirement for Scope 3 GHG emissions (in addition to the required assurance for Scope 1 and Scope 2 GHG emission disclosures) beginning in 2027, with assurance at a limited assurance level beginning in 2030. The SEC’s Proposed Rules, by comparison, only require third-party assurance for Scope 1 and Scope 2 GHG emissions.

The prospect of SB 253 and SB 261 becoming law seems almost a certainty since Governor Newsom has indicated he will sign these bills—although, as noted, a litigation challenge to the requirements is possible. Based on their statutory language, the risk report required by SB 261 would need to be filed in 2025, and the Scope 1 and Scope 2 GHG emissions disclosures required by SB 253 would need to be filed in 2026. As California has the largest economy of any state in the United States, this legislation would fundamentally alter the regulatory landscape for climate change disclosures in the United States. In the event the legislation becomes law without significant change and survives any litigation challenge, companies doing business in California will very soon have to begin to prepare for reporting

these emissions and climate risk disclosures. Companies that qualify as either Reporting Entities or Covered Entities should start by taking stock of their existing climate-related disclosures—including in their SEC filings and on their websites (e.g., on an ESG webpage or stand-alone ESG report), as applicable—and assessing what additional disclosures, if any, would be needed to comply with SB 253 and SB 261. Those companies that are privately held and that have not to date provided any public climate-related disclosures likely will have the most work to do.

SB 253 would be the first widely-applicable law in the United States to require the assurance of Scope 1 and Scope 2 emissions reporting. As a result, companies will need to consider potential options for conducting the required GHG emissions attestation—e.g., whether the outside auditor or a different service provider. Note that CARB must approve the third-party assurance provider, which must be able to demonstrate that it has expertise in GHG emissions accounting. Companies may also need to implement, enhance, or alter their processes for collecting and measuring GHG emissions data, including, in the case of Scope 3 emissions data, by working with industry resources and partners in their value chains. This may also require updating any existing GHG emissions collection and reporting cadence, if needed, to align with reporting based on the fiscal year (rather than the calendar year).

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[1] *Available at* [https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill\\_id=202320240SB253](https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB253).

[2] This includes corporations, partnerships, limited liability companies, and “other business entit[ies] formed under” the laws of California, any state of the United States, the District of Columbia, or an act of Congress.

[3] The September 11, 2023 Senate Floor Analysis (the “SB 253 Analysis”) notes that existing tax code provisions define “doing business” in the state as “engaging in any transaction for the purpose of financial gain within California, being organized or commercially domiciled in California, or having California sales, property or payroll exceed specified amounts: as of 2020 being \$610,395, \$61,040, and \$61,040, respectively.” Senate Rules Committee, Office of Senate Floor Analyses, SB 253, 2023-2024 Reg. Sess., at 2 (September 11, 2023), [https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill\\_id=202320240SB253](https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240SB253).

[4] Assembly Floor Analyses, SB 253, 2023-2024 Reg. Sess. (September 7, 2023), [https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill\\_id=202320240SB253](https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240SB253).

[5] *See* The Greenhouse Gas Protocol: A Corporate Accounting and Reporting Standard, Revised Edition (2004), at 25, <https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf>.

[6] For more information on the SEC’s proposed rules on climate-related disclosures, see Summary of and Considerations Regarding the SEC’s Proposed Rules on Climate Change Disclosure, Gibson Dunn (April 2022), <https://www.gibsondunn.com/summary-of-and-considerations-regarding-the-sec-proposed-rules-on-climate-change-disclosure/>.

[7] “Reasonable assurance” is the same level of assurance provided for a company’s audited financial statements in the Form 10-K. It is an affirmative assurance that the GHG emissions disclosure is measured in accordance with the attestation provider’s standards. “Limited assurance” is a form of negative assurance commonly referred to as “review,” and it is the same level of assurance provided to a company’s unaudited financial statements in a Form 10-Q.

[8] *Available at* [https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill\\_id=202320240SB261](https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB261).

[9] This includes corporations, partnerships, limited liability companies, and “other business entit[ies] formed under” the laws of California, any state of the United States, the District of Columbia, or an act of Congress.

[10] Senate Rules Committee, Office of Senate Floor Analyses, SB 261, 2023-2024 Reg. Sess. (September 12, 2023), [https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill\\_id=202320240SB261](https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240SB261).

[11] *Available at* <https://www.fsb-tcf.d.org/publications/>.



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