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Commentary

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California Passes GHG Emissions Reporting and Climate-Related Financial Risk Legislation

Governor Newsom has committed to signing into law two bills that would require certain companies that do business in California to disclose their GHG emissions and climate-related financial risks.

Key Points:

- Starting in 2026 and annually thereafter, SB 253 would require companies doing business in California and with annual revenue of over $1 billion to publicly report to an emissions registry on their Scope 1 and Scope 2 greenhouse gas (GHG) emissions in accordance with the GHG Protocol. Scope 3 emissions would be required starting in 2027 for the prior fiscal year.
- Starting in 2026 and biennially thereafter, SB 261 would require companies doing business in California and with annual revenue of over $500 million to publish a climate-related financial risk report in accordance with the recommended framework and disclosures in the Final Report of Recommendations of the Task Force on Climate-related Financial Disclosures (TCFD Recommendations).

In January 2023, California Senators Scott Wiener, Henry Stern, and Lena Gonzalez reintroduced revised versions of three climate bills that failed to pass the California Legislature last year. On September 17, 2023, California Governor Gavin Newsom committed to signing two of those bills into law: the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261).

SB 253 and SB 261 cement California's role as a US leader in mandating climate-related disclosures. Collectively, SB 253 and SB 261 go further than the Securities and Exchange Commission's (SEC's) proposed climate disclosure rule (the SEC Climate Proposal), as we discuss in more detail below. Significantly, while the SEC modeled the disclosures in the SEC Climate Proposal at least in part on the TCFD Recommendations and the Greenhouse Gas Protocol (GHG Protocol) standards, it did not wholly adopt either standard, arguably in order to afford flexibility for SEC registrants. SB 253 and SB 261, however, feature disclosure requirements that are more rigidly aligned with the GHG Protocol and TCFD Recommendations.

Companies should be aware of similar bills that have been or may be introduced in other US states, such as New York's S897A, and should also be aware of how the requirements of SB 253 and SB 261 compare to other emerging climate disclosure regulations that companies may be subject to, such as the Federal Acquisition Regulation Council's climate-related proposed rule for federal suppliers and the European Union's Corporate Sustainability Reporting Directive (CSRD).

Overview of the Climate Corporate Data Accountability Act (SB 253)

SB 253 would require companies doing business in California and with annual revenue of over $1 billion (Reporting Entities) to publicly report to an emissions registry on their Scope 1 and Scope 2 emissions starting in 2026 and annually thereafter. Reporting on Scope 3 emissions would be required starting in 2027 for the prior fiscal year.

While SB 253 would limit the reporting burden to corporations with revenue exceeding $1 billion, corporations that are subject to the requirement could require smaller businesses in their value chains to align with these requirements in order to facilitate the corporations' compliance with SB 253. At present, Senate Floor Analysis estimates that 5,344 companies would be required to report under SB 253.

Definitions

SB 253 defines Scope 3 emissions as indirect GHG emissions, other than Scope 2 emissions, "from activities of a Reporting Entity that stem from sources that the Reporting Entity does not own or directly control and may include, but are not limited to, emissions associated with the Reporting Entity's supply chain, business travel, employee commutes, procurement, waste, and water usage, regardless of location." This definition substantively aligns with the GHG Protocol's definition of Scope 3 emissions.

SB 253 defines a "Reporting Entity" as a partnership, corporation, limited liability company, or other business entity formed under the laws of California, any other US state, or the District of Columbia, or under an act of Congress, with total annual revenue in excess of $1 billion and that does business in California.

Notably, "doing business" in California utilizes the existing definition in § 23101 of the Revenue and Tax Code, which includes: 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, those amounts are $610,395, $61,040, and $61,040, respectively.

CARB Regulations

Under SB 253, the California Air Resources Board (CARB) would be required to develop and adopt regulations on or before January 1, 2025, to govern the disclosure and assurance of such disclosure. SB 253 would require CARB to contract with an emissions registry to develop a reporting and registry program to receive and make publicly available the required disclosures. The CARB regulations would need to include a requirement that Reporting Entities use the standards and guidance set out under the GHG Protocol. However, in 2033 and every five years thereafter, CARB could survey and assess currently available GHG accounting and reporting standards and thereafter adopt a globally recognized alternative accounting and reporting standard if it determined that the standard would more effectively further the goals of SB 253. Reporting requirements under SB 253 would be separate from, and in addition to, any facility-level GHG reporting requirements under California's Mandatory Greenhouse Gas Emissions Reporting program.

SB 253 would require Reporting Entities to ensure that their disclosures to the emissions registry have been independently verified by the emissions registry or a third-party auditor, approved by CARB, with expertise in GHG emissions accounting. The assurance engagement for Scope 1 and Scope 2 emissions must be conducted with limited assurance beginning in 2026 and at a reasonable level of assurance beginning in 2030. SB 253 would require CARB in 2026 to assess the feasibility of obtaining assurance for Scope 3 emissions; on or before January 1, 2027, CARB could establish an assurance requirement for Scope 3 emissions beginning in 2030, though Reporting Entities would be required to obtain only a limited assurance. While the assurance process lacks further detail, SB 253 would nevertheless require CARB to ensure that the assurance process minimizes the need for Reporting Entities to engage multiple assurance providers and ensures sufficient assurance provider capacity.

Penalties

SB 253 explicitly notes that the Global Warming Solutions Act of 2006 (Section 38580) will not apply, which means CARB would need to adopt regulations to establish a new regime for penalties under SB 253 for companies that fail to file, file late, or otherwise fail to meet the requirements of SB 253. SB 253 would impose a maximum penalty of $500,000 per reporting year for administrative penalties imposed on a Reporting Entity. Further, SB 253 would direct CARB to take into account the following considerations when imposing penalties for violations:

- The violator's past and present compliance.
- Whether the violator took good-faith measures to comply and when those measures were taken.
- With respect to Scope 3 emissions reporting:
  - A Reporting Entity cannot be subject to an administrative penalty under SB 253 for any misstatements with regard to Scope 3 emissions disclosures "made with a reasonable basis and disclosed in good faith."
  - Between 2027 and 2030, penalties assessed on Scope 3 emissions reporting may only occur for failure to report Scope 3 emissions.

Comparison of SB 253 and the SEC Climate Proposal

- *Covered entities.* SB 253 would apply to both private and public companies that meet the $1 billion revenue threshold and conduct business in California, whereas the SEC Climate Proposal would apply only to SEC registrants with reporting obligations pursuant to Section 13(a) or Section 15(d) of the Exchange Act and companies filing a Securities Act or Exchange Act registration statement. Notably, SB 253 would not apply to foreign-incorporated companies doing business in California, whereas the SEC Climate Proposal would apply to foreign private issuers.

- *Scope 3 emissions.* SB 253 would arguably impose stricter requirements than the SEC Climate Proposal by requiring all subject entities to report all Scope 3 emissions in accordance with the GHG Protocol. The SEC Climate Proposal would require registrants to disclose Scope 3 emissions metrics only to the extent that they are material or that the company has established targets covering Scope 3 emissions. If neither of these criteria is met, then Scope 3 emissions metrics disclosure arguably would not be required under the SEC Climate Proposal.

- *GHG emissions calculation methodology.* SB 253 would require companies to report GHG emissions using the standards and guidance set out under the GHG Protocol. The SEC Climate Proposal cites the GHG Protocol as the prevailing standard but would not mandate registrants to abide by that framework for determining their GHG emissions.

- *Verification vs. assurance.* SB 253 would require immediate independent verification of the Reporting Entity's Scope 1 and Scope 2 emissions disclosure by the emissions registry or a third-party auditor approved by CARB and with expertise in GHG emissions accounting. In contrast, the SEC Climate Proposal would mandate only large accelerated filers and accelerated filers to include in the relevant filing an attestation report covering the disclosure of Scope 1 and Scope 2 emissions only and to provide certain related disclosures about the service provider used.

Overview of the Climate-Related Financial Risk Act (SB 261)

SB 261 would require entities formed under US law that do business in California and have total annual revenue in excess of $500 million (Subject Entities) to prepare and submit to CARB a climate-related financial risk report every two years beginning in 2026. Entities subject to regulation by the California Department of Insurance or that are in the business of insurance in any other state would be excluded. Thus, entities that are not required to report on GHG emissions under SB 253 could still have reporting obligations under SB 261. The first report would be required to be prepared and made publicly available by January 1, 2026.[1]

SB 261 defines "climate-related financial risk" to mean 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."

Report Requirements

A Subject Entity's report would need to identify climate-related financial risks in accordance with the recommended framework and disclosures in the TCFD Recommendations. SB 261 would also allow reports to be prepared pursuant to any "equivalent reporting requirement," which it defines to include:

- climate-related financial risk disclosure reports prepared pursuant to any "law, regulation, or listing requirement issued by any regulated exchange, national government, including the US, as well as the International Financial Reporting Standards Sustainability Disclosure standards, issued by the International Sustainability Standards Board (ISSB)" as well as reports provided voluntarily using the TCFD Recommendations or voluntarily using the ISSB standards.[2]

Finally, SB 261 would require a Subject Entity to report on measures it has adopted to reduce and adapt to the climate-related financial risks described in its report.

In addition to providing reports to CARB, Subject Entities would be required to make such reports available on their website. SB 261 does not prescribe where these disclosures should feature or the form they should take (e.g., in a company's Form 10-K, a stand-alone TCFD report, or elsewhere). Notably, SB 261 would allow a Subject Entity's subsidiary company to meet its reporting obligations under SB 261 through its parent's climate-related financial risk report. Thus, multiple subsidiaries would not necessarily need to file separate reports as long as the parent company met its own reporting obligations and included information concerning such subsidiaries.

Each Subject Entity would need to submit a statement to the California Secretary of State affirming that its report disclosed climate-related financial risk in accordance with the requirements of SB 261.

Subject Entities that fail to publish a compliant report (including if such report is "inadequate or insufficient") could be subject to penalties of up to $50,000 in a reporting year.[3]

Comparison of SB 261 and the SEC Climate Proposal

In general, the risk disclosure requirements of SB 261 are similar but narrower than those of the SEC Climate Proposal as well as the ISSB's climate disclosure standard and the CSRD's climate disclosure requirements.

Fees Under SB 253 and SB 261

Each Reporting Entity and Subject Entity would be required to pay an annual fee to CARB upon filing their annual disclosures. CARB would use these fees to fund oversight of the programs.

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Endnotes

[1] A prior version of the bill would have required first reports to be published on or before December 31, 2024.

[2] A prior version of the bill did not include explicit safe harbors for entity's that already provide TCFD disclosures in voluntary filings.

[3] A prior version of the bill would have authorized the California Attorney General to bring a civil action against a covered entity for civil penalties of up to $500,000 per violation, if the Attorney General were to find that a covered entity has violated or is violating the bill or receives a complaint from the state board.