

Major California climate-related disclosure bills poised to become law

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Under a pair of California bills poised to become law, many large U.S. companies will be required to make broad-based climate-related disclosures starting as early as 2026. Once finalized, the laws will have a profound impact on companies doing business in California, with certain disclosure requirements going beyond the requirements of the SEC's proposed climate-related disclosure rule or the current practices of most public companies.

The California legislature passed two climate-related disclosure bills, both of which are expected to be signed by Governor Newsom in the near term:

- [S.B. 253](#), the Climate Corporate Data Accountability Act, which will require certain companies to disclose their direct (scope 1), indirect (scope 2) and value chain (scope 3) greenhouse gas (GHG) emissions, and
- [S.B. 261](#), the Climate-Related Financial Risk Act, which will require certain companies to disclose climate-related financial risks pursuant to the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations.

Both bills lack crucial detail and are unclear in several key respects, and companies will have to await further amendments or implementing regulations to understand their true impact. Ultimately, these laws will require thousands of companies to devote significant resources and incur significant expenses to develop the infrastructure necessary to support these new disclosure requirements, which in certain critical ways go beyond the forthcoming SEC climate-related disclosure rule (applicable to most domestic and foreign private issuer public companies). In addition, some companies that will be subject to the California bills may also be subject to the EU's Corporate Sustainability Reporting Directive (CSRD) (applicable to companies with EU operations meeting certain thresholds). As such, companies will likely need to be prepared to contend with overlapping, yet distinct, climate-related disclosure requirements in multiple jurisdictions.

1. Overview of the bills

The key elements of the bills are set forth below:

	S.B. 253	S.B. 261
Who has to disclose?	<p>“Reporting entity”</p> <p>Annual revenues in excess of \$1 billion</p> <p>Does business in California</p> <p>Formed in the U.S.</p>	<p>“Covered entity”</p> <p>Annual revenues in excess of \$500 million</p> <p>Does business in California</p> <p>Formed in the U.S.</p>
What has to be disclosed?	Scopes 1, 2 and 3 GHG emissions for the prior fiscal year	Climate-related financial risks in accordance with TCFD & measures taken to mitigate/adapt to these risks
How are disclosures made?	Report to an “emissions reporting organization” ¹	Prepare and publish a publicly available report on company’s internet website
Compliance alternatives?	N/A	Provide required disclosures to the best of the entity’s ability and explanations for gaps and steps to be taken to fully comply
When and how often?	<p>2026 (scopes 1 & 2)</p> <p>2027 (scope 3)</p> <p>Annually thereafter</p>	2026 and every two years thereafter
Assurance	<p>Scopes 1 & 2</p> <p>Beginning in 2026: limited assurance</p> <p>Beginning in 2030: reasonable assurance</p> <p>Scope 3</p> <p>Beginning in 2030: limited assurance²</p>	N/A
Implementation	California Air Resources Board (CARB) to issue regulations	Disclosure standards are self-implementing
Interoperability with other reporting standards	Compliance can be achieved via reports under national/international legal regimes that meet the bill’s disclosure standards	Compliance can be achieved via reports under regulatory or voluntary frameworks that meet the bill’s disclosure standards including the IFRS Sustainability Disclosure Standards

Penalties	CARB authorized to seek penalties for nonfiling, late filing or other failure to meet requirements. Penalties not to exceed \$500,000 per year Scope 3 disclosures: (1) no penalties for disclosure made with reasonable basis/good faith (2) before 2030, penalties limited to failure to file	CARB authorized to seek penalties for failure to publish report or inadequate or insufficient reports. Penalties not to exceed \$50,000 per year
Fees	To be determined by CARB	To be determined by CARB

2. Impact of the bills

Once finalized, these laws will have a profound impact, extending well beyond the border of California. Any company that “does business” in California and has revenues above the relevant threshold (regardless of the geographic source of the revenues) is subject to the laws’ requirements, regardless of where its operations are located. As discussed below, “doing business” is a standard that is likely satisfied by fairly minimal interactions with California. It is estimated that S.B. 253 and S.B. 261 will cover over 5,000³ and 10,000⁴ companies, respectively, including many privately-held companies unlikely to have assessed the scope of their GHG emissions or adopted the TCFD recommendations (which are designed for public companies). They also include disclosure requirements that go beyond the far-reaching requirements of the SEC’s proposed climate-related disclosure rule or the current practices of most public companies. For example:

- **Scope 3 disclosure.** S.B. 253’s GHG disclosure requirements extend to scope 3 GHG emissions, which will require companies to collect emissions data from third parties up and down their value chain who themselves may not collect the data. The scope 3 emissions disclosure requirements in the SEC’s proposed climate-related disclosure rule (which are far more modest than S.B. 253 and apply only to scope 3 emissions that are material or the subject of a goal or target) have been consistently one of the most harshly criticized elements of the rule. According to [a study by MSCI, Inc.](#), only 37% of listed companies have disclosed at least some of their scope 3 emissions as of May 31, 2023.
- **Scenario analysis.** S.B. 261 appears to require companies to conduct a scenario analysis (based on the TCFD recommendations), which is an exercise that tests the resilience of a company’s climate-risk strategy, taking into consideration different climate-related scenarios. According to a [recent survey by KPMG](#), only 13% of the world’s largest 250 companies conduct a scenario analysis. By contrast, the proposed SEC climate-related disclosure rule does not mandate one, but merely requires companies to disclose any scenario analysis they choose to conduct.

3. Key open issues

- **Doing business in California.** Both bills apply only to entities that “[do] business in California.” While the phrase is not defined in the bills, it is defined in other California statutes:
 - Cal. Rev. and Tax Code § 23101, which defines the phrase expansively to include “actively engaging in any transaction for the purpose of financial or pecuniary gain or profit” in California; being “organized or commercially domiciled” in California; or having California sales, property or payroll exceeding specified amounts.
 - Cal. Corp. Code § 191(a), which provides a somewhat narrower definition: “entering into repeated and successive transactions of its business in [the] state, other than interstate or foreign commerce.”

In the absence of regulation providing a definition, the prudent course would be to assume the broader formulation in the Cal. Rev. and Tax Code. Notably, this definition is referenced in the [Senate Floor Analysis](#) memo for SB 253.

- **Treatment of affiliated corporate entities.** Read literally, both bills assess applicability based on the revenues and business activities of a discrete legal entity (“...a partnership, corporation, limited liability company, or other business entity...with total annual revenues...”). It is unclear whether the bills treat affiliated corporate entities as a consolidated unit and determine applicability on an aggregate basis or whether applicability is determined on an entity-by-entity

basis. Without clarification as to how to determine whether the thresholds have been met under both bills, it will be difficult for companies to determine their obligations. For example, what if an entity is below the relevant threshold on an individual basis but is above the threshold when consolidated with its affiliates? Or, what if a company with revenues that exceed the threshold has corporate affiliates below the threshold? How should private equity funds and their portfolio companies be treated?

Aside from being consistent with a plain reading of the text, the entity-by-entity approach has support in the California Consumer Privacy Act,⁵ which includes very similar language defining which entities are subject to the law but adds a separate provision defining the circumstances under which an affiliate of an in-scope entity (i.e., an “entity that controls or is controlled by a business [subject to the law]”) would also be covered. This language would be unnecessary if affiliates in a single corporate family were considered on a consolidated basis.

On the other hand, the legislative histories of the bills provide some support for a reading that treats corporate affiliates on a consolidated basis. The [Senate Floor Analysis](#) memo for S.B. 253 states that “an estimated 5,344 companies... would be required to report under this bill,” which is based on an analysis that appears to consider entities on a consolidated basis.⁶ This number was also cited by Governor Newsom in public remarks confirming his intention to sign the bills.⁷

A further complicating factor is that S.B. 253 calls on CARB to issue disclosure requirements based on the GHG Protocol Corporate Accounting and Reporting Standard and the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard, which establish rules for how companies should set their “organizational boundaries” in determining what parts of a Company’s business operations should be included in GHG reporting⁸. These rules often require companies to include subsidiaries or affiliates under certain circumstances, which may be at odds with a narrow entity-specific reading of the bills. How the regulations will ultimately address this issue remains to be seen.

– **Reporting requirements under S.B. 261.** S.B. 261 requires companies to publish a report disclosing (1) a company’s climate-related financial risks in accordance with the TCFD recommendations, and (2) the measures adopted by a company to reduce and adapt to these risks. However, because these disclosure requirements don’t neatly align with the TCFD recommendations, it is difficult to determine which elements of the TCFD recommendations are mandated under S.B. 261. At the very least, the Strategy section of the TCFD recommendations, which calls for the disclosure of “the actual and potential impacts of climate-related risks and opportunities on the organization’s businesses, strategy, and financial planning where such information is material,” would appear to be responsive to S.B. 261’s disclosure requirements. However, there are many other elements of the TCFD recommendations that arguably relate to disclosure of climate-related financial risk or mitigation, as well as the processes employed by a company to identify them, and the bill provides little useful direction as to whether those elements are required.

Also unclear is whether the bill requires companies to comply with the parts of the TCFD recommendations labeled as “guidance,” which consists of more granular implementation instructions as well as disclosure guidelines for the financial sector and certain industries. Notably, unlike S.B. 253, S.B. 261 does not delegate any rulemaking authority to CARB or other agencies (other than for the limited purposes of setting of fees and penalties and working with companies to prepare reports). As such, it is unclear whether these uncertainties will be clarified through a rulemaking process.

4. Next steps

– **Rulemaking and possible amendments.** S.B. 253 directs CARB to adopt regulations implementing the bill’s reporting requirements by January 1, 2025. Given the breadth and scope of the bill, we expect the notice and comment process to attract significant attention much like the proposed SEC climate-related disclosure rule. In addition, Governor Newsom stated that he wanted “some cleanup on some little language” in the bills, suggesting that he might work with the state legislature to amend the bills in a future legislative session.⁹ Whether those amendments address some of the issues identified in this Client Update remains to be seen, but any amendment could potentially result in a delay in the effective dates of the bills.

– **Potential legal challenges.** Given the broad scope of the bills, we expect that legal challenges will be brought on a number of fronts:

- **Dormant Commerce Clause.** This doctrine, based on the Commerce Clause of the U.S. Constitution, generally prohibits state legislation that unduly burdens interstate commerce. As one opponent of the bills put it, the state has “no authority to regulate emissions beyond the California border,”¹⁰ and there is case law suggesting that state laws violate this doctrine when they regulate conduct that takes place entirely out of state.¹¹ However, the contours of this doctrine are unclear, and a recent plurality opinion in a U.S. Supreme Court decision rejecting a dormant Commerce Clause challenge to another California law suggested that the doctrine is limited to laws that

discriminate against other states,¹² which is not a feature of either of these two bills.

- **First Amendment.** Challengers may also argue that by compelling speech, the bills violate the First Amendment of the U.S. Constitution. Recent SEC rules regarding conflict minerals were successfully challenged on this basis¹³ and several critics of the SEC's proposed climate-related disclosure rule ([including one of the commissioners](#)) objected to the proposed climate rule on First Amendment grounds. The case law in this area is unsettled and whether such a challenge will succeed remains to be seen.
- **Development and implementation of other disclosure regimes.** Other disclosure regimes will continue to develop in the coming months and years. The proposed SEC climate-related disclosure rule remains mired in a seemingly endless rulemaking process. It remains to be seen what, if any, impact the passage of the California legislation will have on the final SEC climate-related disclosure rule (and what impact, if any, the final SEC climate-related disclosure rule might have on the implementation of the California bills). The CSRD, which is already effective, incorporates the European Sustainability Reporting Standards E1 – Climate Change, which in many ways goes far beyond the California bills and the proposed SEC climate-related rule, including in its embrace of the “double materiality” disclosure philosophy, and may satisfy the “interoperability” provisions of the California bills. Finally, other states may follow California's lead. Bills similar to the California legislation are pending in the New York State legislature and other states that have supported climate change policies may pass such laws as well.

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- ¹ A nonprofit emissions reporting organization contracted by the California Air Resources Board (CARB) to develop a reporting program to receive and make publicly available disclosures that has experience with GHG emissions disclosure.
- ² Bill is somewhat unclear on this point as it also provides for CARB to establish, on or before January 1, 2027, an assurance requirement for third-party assurance engagements for scope 3 emissions.
- ³ State of California, Assembly Floor Analysis, SB-253 Climate Corporate Data Accountability Act, at 2 (September 7, 2023), https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240SB253.
- ⁴ State of California, Assembly Floor Analysis, SB-261 Greenhouse gases: climate-related financial risk, at 2 (September 8, 2023), https://leginfo.legislature.ca.gov/faces/billAnalysisClient.xhtml?bill_id=202320240SB261.
- ⁵ California Consumer Privacy Act 1.81.5 CIV § 1798.140 (2018).
- ⁶ We understand that the analysis was conducted by Ceres based on the D&B Hoovers database, which generally includes company data on a consolidated basis.
- ⁷ Sharon Udasin, *Newsom declares intention to sign landmark climate disclosure bill*, The Hill (September 18, 2023), <https://thehill.com/homenews/state-watch/4209917-newsom-declares-intention-to-sign-landmark-climate-disclosure-bill/>.
- ⁸ *A Corporate Accounting and Reporting Standard*, Greenhouse Gas Protocol, 16-22, <https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf> and *Corporate Value Chain (Scope 3) Accounting and Reporting Standard*, Greenhouse Gas Protocol, 28-29, https://ghgprotocol.org/sites/default/files/standards/Corporate-Value-Chain-Accounting-Reporting-Standard_041613_2.pdf.
- ⁹ *California governor says he will sign climate bill on companies and carbon footprints*, Reuters (September 18, 2023), <https://www.reuters.com/sustainability/california-governor-says-he-will-sign-climate-bill-2023-09-18/>.

- ¹⁰ *New California Legislation Would Be a Major Step Forward for Climate Disclosure*, Columbia Climate School Sabin Center for Climate Change Law, (August 8, 2023) (quoting the California Chamber of Commerce), <https://blogs.law.columbia.edu/climatechange/2023/08/08/new-california-legislation-would-be-a-major-step-forward-for-climate-disclosure/>.
- ¹¹ *Healy v. Beer Inst.*, 491 U.S. 324, 336 (1989) (quoting *Edgar v. MITE Corp.*, 457 U.S. 624, 642-43 (1982) (plurality opinion)).
- ¹² *National Pork Producers Council v. Ross*, 59 U.S. 356 (2023).
- ¹³ *National Association of Manufacturers v. SEC*, 800 F.3d 518 (D.C. Cir. 2015).