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The California climate disclosure laws, SEC's proposed climate-related disclosure rule and the CSRD: What U.S. companies need to do now to comply

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Editor's note: Loyti Cheng and David A. Zilberberg are Counsel at Davis Polk & Wardwell LLP. This post was prepared for the Forum by Ms. Cheng and Mr. Zilberberg. Related research from the Program on Corporate Governance includes The Illusory Promise of Stakeholder Governance (discussed on the Forum here) by Lucian A. Bebchuk and Roberto Tallarita; For Whom Corporate Leaders Bargain (discussed on the Forum here) and Stakeholder Capitalism in the Time of COVID (discussed on the Forum here) both by Lucian A. Bebchuk, Kobi Kastiel, and Roberto Tallarita; and Restoration: The Role Stakeholder Governance Must Play in Recreating a Fair and Sustainable American Economy – A Reply to Professor Rock (discussed on the Forum here) by Leo E. Strine, Jr.

Mandatory climate disclosure for U.S. companies is here. In several key jurisdictions, companies will be required to disclose climate-related information within the next few years. Companies need to take action now to (1) determine what disclosure rules will apply to them and (2) put into place the necessary infrastructure to be in a position to develop, collect and report the information called for by applicable requirements. This post will focus on three legal regimes with particular salience for U.S. companies: California's S.B. 253 and 261, the U.S. Securities and Exchange Commission's (SEC) proposed climate-related disclosure rule and the European Union's (EU) Corporate Sustainability Reporting Directive (CSRD).[1]

As discussed below, there is a certain core set of disclosure requirements common to these disclosure regimes, including those relating to the material risks that climate change poses to the company based on the Task Force for Climate Financial Disclosures (TCFD). However, the disclosure burdens posed by the CSRD are significantly greater due to the fundamentally different way it defines materiality and the CSRD's broad coverage of subject areas far beyond climate. Accordingly, a key threshold question facing U.S companies is whether or not they are within the scope of the CSRD.

California's S.B. 253 and S.B. 261

[1] Other countries that have implemented or are in the process of doing so include the United Kingdom, Brazil, Mexico, Hong Kong and Japan. In addition, proposed climate disclosure legislation is currently pending in three states: New York, Illinois and Washington.

- **Scope.** Both laws apply to companies formed in the U.S. that "do business in California" with revenues in excess of $1 billion (for S.B. 253) or $500 million (for S.B. 261). The phrase "do business in California" is not defined in either law. However, the legislative history of both laws refers to the definition in the California Tax Code, which defines "doing business" as "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 (note that such amounts are relatively low – for example, the thresholds for property and payroll were each approximately $71,000 in 2023). The bills' supporters cited estimates that approximately 5,000 companies would be subject to S.B. 253 and 10,000 would be subject to S.B. 261.
- **Disclosure requirements.** S.B. 253 requires disclosure of a company's Scope 1 and 2 greenhouse gas (GHG) emissions beginning in 2026 and Scope 3 GHG emissions beginning in 2027 and directs the California Air Resources Board to develop regulations to establish the disclosure standards by January 1, 2025. S.B. 261 requires disclosure of material climate-related financial risks pursuant to the TCFD recommendations beginning in 2026 and every two years thereafter.
- **Current status.** These laws were enacted in October 2023, though in January 2024 business groups brought litigation challenging these laws on U.S. constitutional grounds. In addition, Governor Gavin Newsom has raised concerns regarding the timing and scope of both laws and indicated that his administration would work with the state legislature to amend them. His latest budget proposal did not include funding for either law. The lack of funding may be particularly problematic for S.B. 253 as it requires rulemaking by the California Air Resources Board to promulgate the substantive disclosure requirements required under that law.

The SEC's proposed climate-related disclosure rule

- **Scope.** The proposed rule would apply to both domestic and foreign private issuers (except Canadian issuers filing on Form 40-F). Note that the SEC had requested comments on how foreign private issuers should be treated under the rule during the comment period.
- **Disclosure requirements.** As proposed, the rule requires disclosures on a number of topics broadly following the structure of the TCFD:
    - Physical and transitional climate-related risks expected to be material to the company, the impact of those risks on the company's strategy, financial planning, capital allocation, business model and outlook as well as the processes for identifying, assessing and managing climate-related risks.

- The company's Scope 1 and 2 GHG emissions, and, if material or the subject of GHG emissions reduction targets or goals, Scope 3 GHG emissions
- Climate-related targets and goals set by the company, included any GHG emissions reduction targets or goals.
- Climate-specific governance disclosure, including the process by which the board exercises oversight and sets targets and goals, and the role of management in assessing and managing climate-related risks.
- Climate-related financial metrics and supporting footnotes including regarding the financial impact of severe weather events and other natural conditions and transition risks; expenditures to mitigate these risks on business operations; and any impact of such risks on the company's estimates and assumptions.

Aside from certain specific disclosure requirements (such as GHG emissions disclosure requirements), the proposed rule is generally limited to information that is considered material based on whether a reasonable investor is likely to consider the information important in making an investment decision.

- **Timing.** The proposed rule contemplates a phase-in period with the compliance date dependent on the company's filer status and an additional phase-in period for Scope 3 GHG emissions. Assuming this structure is retained in the final rule and it is issued this year, we would expect the following compliance timeline:

Registrant type	**Disclosures other than Scope 3**	**Scope 3**
Large accelerated filers	Fiscal year 2025 (filed in 2026)	Fiscal year 2026 (filed in 2027)
Accelerated and non-accelerated filers	Fiscal year 2026 (filed in 2027)	Fiscal year 2027 (filed in 2028)
Smaller reporting companies	Fiscal year 2027 (filed in 2028)	Not required

Whether the SEC maintains this compliance timeline in the final rule remains to be seen.

- **Current status.** The proposed rule was published in March 2022 but has not yet been issued in final form. After extensive delays – prior SEC regulatory agendas had targeted late 2022 and late 2023 for the final rule – recent reporting indicates that the final rule will

be issued by the end of March. Since the rule was proposed, it has been the subject of controversy, with opponents of the rulemaking focusing their criticism on the proposed rule's requirements relating to Scope 3 GHG disclosures and the thresholds for climate-related financial metrics as well as the authority to regulate in this area at all. While it is impossible to predict what the final rule will look like, expectations are that it may differ significantly from the proposed rule, specifically with respect to disclosure requirements relating to Scope 3 GHG emissions and the thresholds for climate-related financial metrics.

CSRD

- **Scope and timeline.** The CSRD has broad applicability, estimated to cover approximately 50,000 entities when fully implemented. Once implemented, the CSRD will generally apply to any company (1) traded on an EU-regulated exchange (other than "micro-undertakings"[2]), or (2) based in the EU with operations exceeding certain thresholds. The compliance timeline is set forth below:

Entity Type	Criteria	Compliance date
Large EU entities with over 500 employees	Entity must meet the following criteria: • over 500 employees • securities on an EU-regulated exchange ***or*** considered a "public interest" entity in the EU (namely, EU credit institutions, EU insurance entities, or entities designated as such under the law of an EU member state) • over €25 million in total assets or €50 million in net turnover	Fiscal year 2024 (Filed in 2025)

[2] "Micro-undertakings" are companies that meet at least two of the following criteria: (1) no greater than €450,000 balance sheet total assets, (2) no greater than €900,000 net turnover and (3) no greater than 10 employees.

	This category includes parent companies where the company group as a whole meets the above employee and financial criteria.	
Other large EU entities	Other entities incorporated in the EU or with securities on an EU-regulated exchange that are considered “large” under CSRD criteria, namely exceeding two of the following three thresholds: • 250 employees • €25 million in total assets • €50 million in net turnover Similar to the above category, this category also includes parent companies where the company group as a whole meets the criteria for “large” entities.	Fiscal year 2025 (filed in 2026)
Small and medium- sized entities (SMEs)	Other entities on an EU-regulated exchange ***or*** considered a “public interest” entity in the EU (see above) that are not considered “micro-undertakings.”	Fiscal year 2026 (filed in 2027)
Non-EU companies with a substantial EU presence	Non-EU companies where the company group has a net turnover of more than €150 million in the EU for each of the last two consecutive financial years and: • Is a parent of at least one EU subsidiary that is “large” under CSRD criteria or listed on an EU-regulated exchange	Fiscal year 2028 (filed in 2029

	(but not a "micro-undertaking"), *or* • Has a branch in the EU with more than €40 million net turnover	

These criteria could include U.S. (or other non-EU) businesses in a number of scenarios:

- **U.S. companies on EU-regulated exchanges:** CSRD reporting could apply to the entire company group starting with fiscal year 2024, 2025 or 2026 depending on the company's size.
- **U.S. subsidiaries of EU parent companies subject to the CSRD:** CSRD reporting could apply to the entire company group starting with fiscal year 2024, 2025 or 2026 depending on the company's size.
- **U.S. parent corporations with EU subsidiaries meeting CSRD thresholds:** CSRD reporting could apply to the EU subsidiaries (as well as any subsidiaries – based in the EU or otherwise – below those EU subsidiaries) starting with fiscal year 2024, 2025 or 2026 depending on the EU subsidiaries' size.
- **U.S. parent corporations with substantial EU operations:** CSRD reporting could apply to the entire company group starting with fiscal year 2028.

- **Disclosure requirements.** As noted above, the CSRD covers far more than climate risk, including the full range of environmental and other "S" and "G" topics within environmental, social and governance (ESG), and includes European Sustainability Reporting Standards (ESRS) covering each of them as well as two general ESRS. The ESRS for climate broadly matches the contours of TCFD and the SEC's proposed climate-related disclosure rule, containing disclosure requirements regarding climate-related governance and strategy, the management of climate-related risks (as well as opportunities and impacts) and metrics and targets. It is, however, generally more prescriptive and granular than the SEC's proposed rule and includes specific requirements for disclosure of information regarding the company's value chain (though these requirements are subject to a three-year phase-in). The climate ESRS also requires disclosure of Scope 1, 2 and 3 GHG emissions as well as information relating to energy consumption.[3]

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[3] Certain companies subject to the CSRD are also subject to requirements under Article 8 of the EU's Taxonomy Regulation to disclose information regarding their "environmentally sustainable economic activities" (as that

In general, a company's disclosure obligations pursuant to ESRS are limited to information that is material. However, if a company determines that climate change is not a material topic, it must include a detailed explanation of its determination and discuss the conditions that could cause climate change to become material in the future. As discussed further below, however, the CSRD adopts a far broader definition of materiality than the SEC's proposed rule, TCFD and most other climate risk disclosure regimes, encompassing matters that have a material impact not only on the company's own finances but on the environment or society as well.

- **Current status.** The CSRD went into effect on January 5, 2023. As a directive, however, EU member states are required to enact national legislation adopting the CSRD by July 6, 2024 and may include provisions that go beyond the CSRD "baseline." To date, several EU members have enacted such legislation. In addition, development of ESRS is ongoing. In July 2023, the European Commission formally adopted two general ("cross-cutting" in CSRD-parlance) standards as well as standards for the 10 sustainability topics identified in the CSRD, including climate change. Sector-specific standards and standards applicable to non-EU companies with EU footprints are due by June 2026. In addition, the group responsible for developing these standards (European Financial Reporting Advisory Group (EFRAG)) is in the process of developing guidance on a number of important topics, including how to conduct a materiality assessment, and implementing standards with respect to a company's value chain.

What should U.S. companies be doing?

1. **Determine which disclosure regimes apply and when.** Companies first need to determine which disclosure requirements apply to them and the relevant compliance timeline. While at first glance, applying the thresholds under S.B. 253 and 261 or the CSRD are straightforward, they do raise knotty interpretive issues, especially with regard to groups of affiliated entities. For example, S.B. 253 and 261 do not clearly address how the revenue thresholds are assessed with respect to a consolidated group of entities or a corporate structure where only some subsidiaries conduct business in California. While the CSRD, the GHG Protocol and general EU accounting standards provide comparatively more guidance on these matters, similar questions arise under the CSRD in determining how to define a corporate "group" in calculating the relevant thresholds or the circumstances under which a non-EU entity would be considered a "parent undertaking" of an EU subsidiary (e.g., a non-EU private equity general partner or a private equity fund with respect to their EU portfolio company) in determining whether it is in scope under the CSRD for the 2028 reporting period.

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phrase is defined in the Taxonomy Regulation), including how and to what extent their operations are associated with such activities. The general ESRS includes a framework for these disclosures within the CSRD report.

Even if a company is not directly in scope with respect to a mandatory reporting regime, it may nonetheless be the subject of requests by its value chain partners who are in scope. As noted above, the CSRD requires companies to collect information throughout its value chain subject to a phase-in period. Similarly, companies subject to Scope 3 GHG disclosure requirements under S.B. 253 or the SEC's proposed climate-related disclosure rule (assuming these requirements survive in the final version) may request GHG emissions data from their suppliers or customers.

2. **Develop and obtain the necessary infrastructure and resources for compliance.** Depending on where a company is with respect to sustainability reporting, it will need to make sure that it has the necessary internal and external tools to assess what information it will be required to collect, organize and report. Companies will need to take a number of steps to accomplish this, including:

- Assemble an interdisciplinary team across legal, accounting, ESG, operations, human resources and marketing that can coordinate the collection of relevant data from all parts of the company, both domestic and international, engagement with value chain partners as necessary, identification of any key data gaps and development of a roadmap for compliance.
- Implement effective management systems so that a company is more prepared to respond to evolving regulations, analyze long-range data, assess impacts of a company's operations on the environment, and execute programs and processes more efficiently and consistently.
- Invest in better data to provide a company with greater information to more accurately calculate GHG emissions, particularly Scope 3 GHG emissions.
- Engage third-party experts as necessary, including carbon accounting consultants and third parties who can provide verification and assurances with respect to a company's GHG emissions and other reporting.
- Ensure appropriate governance is in place, including board level committees, to provide oversight with respect climate-related risks, accounting and disclosure.

The scope of these efforts will be fundamentally more extensive for companies subject to CSRD. As noted above, the California laws and the SEC's proposed rule (as well as most other regulatory climate disclosure regimes) focus mainly on disclosure of information that is material to the company. As such, climate-related disclosure is an outgrowth of what companies are already doing. Public companies – as well as any well-run company – will generally already have the appropriate infrastructure in place to identify, monitor and manage issues that pose a material risk to their financial outlook. Most climate-related disclosure rules call on companies to ensure that climate-related risks are included in that purview and are appropriately disclosed. In contrast, the CSRD

asks companies to shift their focus to the "material" impacts of their operations – whether those impacts are direct or associated with their value chains, comply with applicable laws or are likely to give rise to legal liability – on the full range of sustainability matters covered by CSRD. This will require a company to conduct wide-ranging and extensive assessments – and very likely engagement with value chain partners and other stakeholders – to fully understand the range of impacts of its operations on the CSRD's sustainability topics, e.g., the environment, and assess their materiality.

3. **Beware the potential "negative feedback loop" of CSRD reporting.** While many matters considered material from an "impact" perspective could also be considered material from a company's financial perspective, CSRD reporting is likely to require companies to disclose negative material impacts associated with its operations which wouldn't otherwise be disclosed. Companies need to be prepared for any potential reputational impacts, potential litigation in plaintiff-friendly jurisdictions and other negative public scrutiny that may result from such disclosures. In addition, companies may ultimately be obligated to mitigate or remediate these impacts under corporate "due diligence" legislation such as the EU's Corporate Sustainability Due Diligence Directive and similar laws in certain EU member countries.

4. **Greenwashing concerns.** Companies need to be aware that in disclosing climate-related information pursuant to the various climate-disclosure regimes that such disclosure may be considered greenwashing. In disclosing such information, a company should avoid claiming it or its products are environmentally friendly or sustainable without any factual backup. This is particularly true with respect to claims relating to net-zero ambitions and carbon neutrality. There has been increasingly more focus on greenwashing by regulators and activists in numerous jurisdictions. For example, California passed an anti-greenwashing law (on the same day it passed S.B. 253 and 261), called the Voluntary Carbon Market Disclosures Act (A.B. 1305), which requires applicable entities to disclose certain information regarding climate-related claims and the purchase or use of voluntary carbon offsets. We expect this focus on greenwashing, including related enforcement actions, to continue in 2024.

5. **Monitor relevant legal developments.** Climate disclosure is a quickly evolving regulatory area throughout the world and companies need to keep abreast of developments in the jurisdictions relevant to them. Over the next several months alone, we expect the final version of the SEC's climate-related disclosure rule (which is expected to differ significantly from the proposed rule), potential amendments to S.B. 253 and 261, continued adoption of the CSRD by EU members and guidance from EFRAG regarding assessment of double materiality and implementation of ESRS with respect to a company's value chain. Implementation of climate-related disclosure requirements in other jurisdictions is likely to continue as well. Tracking these developments will require significant attention from companies' legal departments and outside counsel.