WHILE PUBLIC COMPANIES AWAIT SEC CLIMATE-RELATED DISCLOSURE RULES, CALIFORNIA MOVES FORWARD ON ITS OWN

Two very recent developments in California should have caught the attention of ESG practitioners and the broader (and growing) climate-disclosure ecosystem: the passage by the California legislature of first-in-the-nation landmark legislation mandating climate disclosure and the commencement of a lawsuit by the state of California against five major oil companies and the American Petroleum Institute, accusing them of "creating, contributing to, and/or assisting in the creation of state-wide climate change-related harms in California" and deception.

The California climate disclosure requirements are part of a package of legislative initiatives that include: mandated divestment by public retirement funds in fossil fuel companies (SB 252), the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261). SB 252 applies to California pension funds, SB 253 applies to US public and private companies that do business in California with revenue of least $1 billion annually (accompanying legislative analyses estimate that 5,344 companies will be subject to reporting), and SB 261 applies to US public and private companies doing business in California with revenue of at least $500 million annually (accompanying legislative analyses estimate that over 10,000 companies will be subject to reporting, incidentally only 20% of which are public companies). The revenue thresholds are global revenue figures rather than revenue attributable to California, and reporting applies whether or not a company is headquartered in California.

Governor Newsom announced during a moderated conversation at the opening ceremony for Climate Week NYC that he intends to sign SB 253 and SB 261, failing which he has until October 14 to veto the two bills, or the bills become law automatically.

GHG Emissions Disclosure

SB 253's preamble sets forth, as the basis for the legislation, in unambiguous language what is at stake:

- Californians are already facing devastating wildfires, sea level rise, drought and other impacts associated with climate change that threaten the health and safety of Californians, undermines the sustainability of communities, particularly those communities most affected by the negative effects of climate change, and the economic well-being of the state and its residents, including threatening many of the state's largest industries.
- Climate change also poses a significant risk to companies' long-term economic success and disrupts the value chains on which they rely. Managing these risks requires investments in decarbonization strategies that unlock emissions reductions and provide economic benefits for Californians and the state economy.
- Companies can increase California's climate risk through emissions activities that include, but are not limited to, company operations, supply chain activities, employee and consumer transportation, goods production and movement, construction, land use and natural resource extraction.

- The people, communities, and other stakeholders in California, facing the existential threat of climate change, have a right to know about the sources of carbon pollution, as measured by the comprehensive GHG emissions data of those companies benefiting from doing business in the state, in order to make informed decisions.

The preamble continues:

- California investors, consumers and other stakeholders deserve transparency from companies regarding their GHG emissions to inform their decision-making.
- Accurate and comprehensive data subject to an assurance engagement performed by an independent third-party assurance provider is required to determine a company's direct and indirect GHG emissions, also known as its carbon footprint, and to effectively identify the sources of the emissions and develop means to reduce the same.
- The current approach for disclosure of climate emissions from public and private corporate enterprises relies largely on voluntary reporting of GHG inventories, goals, commitments and agreements, and lacks the full transparency and consistency needed by residents and financial markets to fully understand these climate risks.
- The Greenhouse Gas Protocol is the globally recognized GHG emissions accounting and reporting standard and provides the framework for corporate GHG emissions accounting and reporting. Many companies already partially or fully disclose their emissions data.

SB 253 requires covered "reporting entities" to disclose their Scope 1 and Scope 2 GHG emission data, beginning in 2026, and their Scope 3 GHG emission data, beginning in 2027 and within 180 days of the public disclosure of the Scope 1 and Scope 2 GHG emissions data, in each case for the prior fiscal year. Briefly,

- "Scope 1 emissions" means all direct GHG 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 GHG 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 GHG 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.

The legislation requires the State Air Resources Board ("CARB")[1] to adopt implementing regulations by January 1, 2025. Among other things, the regulations are to minimize duplication of reporting that may be required by national (*i.e.,* SEC) or international (*e.g.,* the EU Corporate Sustainability Reporting Directive (the "CSRD")) climate-related disclosure

[1] The California Global Warming Act of 2026 requires the CARB to adopt regulations to require the reporting and verification of GHG emissions and to monitor compliance with the Act.

regimes, and are to take into account corporate transactions, such as acquisitions or dispositions, that bear on GHG emissions of the reporting entity.

The legislation specifies that no disclosure will be required beyond that which is covered by the Greenhouse Gas Protocol. (For more information about Scope 1, Scope 2 and Scope 3 emissions and the Protocol, *see* my January 20, 2022 briefing note.)

GHG emissions disclosure will be subject to independent verification and will be posted on a publicly available digital platform. The third-party verification will be scaled: the assurance engagement for Scope 1 and Scope 2 emissions will be performed at a "limited" assurance level beginning in 2026 and at a higher "reasonable" assurance level beginning in 2030. During 2026, the CARB is to review and evaluate trends in third-party assurance requirements for Scope 3 emissions. On or before January 1, 2027, the CARB may establish an assurance requirement for third-party assurance engagements of Scope 3 emissions. The assurance engagement for Scope 3 emissions is to be performed at a "limited" assurance level beginning in 2030.

Climate-Related Financial Risk Disclosure

SB 261 requires covered companies to prepare and submit climate-related financial risk reports, on a bi-annual basis, based on the TCFD framework. (For more information about the TCFD framework, see my Climate Lexicon.) SB 261 does not apply to insurance companies, because the National Association of Insurance Commissioners has adopted its own new standards for regulated insurances companies to report their climate-related risks, in alignment with TCFD recommendations.

Reports, which are to be made available on company websites, will be required beginning in 2026, and bi-annually thereafter. Specifically, reports are to cover climate-related financial risk in accordance with the TCFD recommendations and the measures adopted to reduce and adapt to the identified climate-related financial risk.

If a company is unable to provide the required disclosure, it is directed to do so to the "best of its ability," and provide a detailed explanation of any reporting gaps and describe the steps it will take to provide compliant disclosure. Disclosure can be consolidated at a parent company level, obviating any covered subsidiary to provide separate reports.

A reporting entity will be deemed to satisfy the reporting obligation if it provides disclosure "[p]ursuant to a law, regulation, or listing requirement issued by any regulated exchange, national government, or other governmental entity, including a law or regulation issued by the US government, incorporating disclosure requirements consistent with [SB 261 requirements], including the International Financial Reporting Standards Sustainability Disclosure Standards, as issued by the International Sustainability Standards Board" or alternatively voluntarily provides International Financial Reporting Standards Sustainability Disclosure Standards. (For a discussion of the ISSB standards, *see* my June 28, 2023 briefing note.)

Concluding Thoughts

While the pending SEC climate-related disclosure obligations would apply only to public companies (domestic and foreign private issuer reporting companies), SB 253 and 261 will apply to both public and private companies. Similarly, the CSRD applies to both public and private companies meeting the EU-market access thresholds and, incidentally, will cover a far broader scope of sustainability themes than either the SEC or the California disclosure regimes. If the SEC does adopt its disclosure rules this year, it is possible that large accelerated filers will be required to report before the California reporting obligations apply. SB 253 is stricter than the proposed SEC rules when it comes to disclosure of Scope 3 emissions data, as the proposed SEC rules mandate disclosure of Scope 3 emissions data only if they are material or if the registrant has set GHG emissions targets or goals that include Scope 3 emissions. (*See* my November 5, 2022 and March 22, 2022 briefing notes on the scope of the proposed SEC rules.)

While there are vocal opponents of mandatory climate-related disclosure (and, in fact, vocal opponents of any climate disclosure), as I have highlighted before, many companies are voluntarily embracing climate-related and broader sustainability disclosure and many are supportive of providing/benefitting from the disclosure.[2] For some reporting companies, providing climate disclosure is viewed as the right thing to do, for others their institutional investors, their lenders and/or their insurers are demanding consistent, comprehensive, comparable and decision-useful climate disclosure. Yet other companies will be covered by the scope, including the extra-territorial coverage, of the CSRD, and so will be obligated to provide disclosure. Finally, a growing number of companies will find themselves caught up in the ripple effect of disclosure, for one company's Scope 3 emissions will be another company's Scope 1 and Scope 2 emissions, and increasingly companies in supply chains will also find that they must provide GHG emissions data to allow those further up the chain to meet their own disclosure obligations.

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[2] A group of companies, which included Microsoft, IKEA and Adobe, wrote in support of SB 253. Also, as I have highlighted frequently before, the direction travel for mandatory climate disclosure is clear.