Social Sector Hotline

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CALIFORNIA LEADS THE WAY IN CLIMATE DISCLOSURE LEGISLATIONS

- California's transformative bills require climate transparency from large companies operating within the State.
- SB 253 mandates companies generating over $1 billion annual revenue to disclose Scope 1, Scope 2 and Scope 3 greenhouse gas emissions.
- SB 261 mandates companies generating over $500 million annual revenue to report climate-related financial risks and strategies to mitigate these risks.
- These legislations set a global example for corporate climate responsibility.
- Success hinges on regulatory execution and may catalyze global sustainability efforts.

In a seminal and exemplary move, California has once again emerged as a pioneer in environmental responsibility with the recent passing of two imperative bills i.e., the Climate Corporate Data Accountability Act ("**CCDAA**") (**SB 253**)[1] and the Climate-Related Financial Risk Act ("**CFRA**") (**SB 261**)[2] setting forth higher corporate responsibility and disclosure obligations on companies operating in California. The transformative bills contain broad climate-related disclosure obligations targeted towards certain large companies doing business in California.If signed into law, these measures will position California as a global leader in climate-related corporate disclosures and environmental accountability.[3]

This article explores the key provisions and implications of these pioneering legislative measures, which not only have significant ramifications for companies operating within California but also set a potential precedent for climate-related disclosures on a global scale.

I. CCDAA – SB 253

The CCDAA, encapsulated in SB 253, represents a historic leap forward by making it mandatory for large companies referred to a "reporting entities"[4] to publicly disclose their greenhouse gas ("**GHG**") emissions.

A. Reporting requirements

SB 253 necessitates that reporting entities with over $1 billion of annual revenue conducting business in California to comply with annual disclosure requirements. These entities must disclose their Scope 1, Scope 2 and Scope 3 GHG emissions. The reporting requirements will commence in a phased manner from 2026, following the adoption of implementing regulations by the State Board of California ("**board**") in 2025.

The distinctive feature of the legislation lies in its comprehensive approach, encompassing not only direct GHG emissions from sources owned or controlled by the reporting entity ("**Scope 1**")[5] and indirect emissions from purchased or acquired electricity, steam, heating, or cooling, ("**Scope 2**")[6] but also the often-overlooked indirect upstream and downstream GHG emissions from the supply chains ("**Scope 3**")[7].

These disclosure have to be made in conformity with the Greenhouse Gas Protocol reporting standards.[8] SB 253 mandates the creation of a publicly accessible digital platform for GHG emissions data by the emissions reporting organization designated by the state. Further, independent third-party assurance providers appointed by the board will be responsible for auditing emissions data, ensuring transparency and credibility.

SB 253's proactive approach includes periodic reviews, beginning in 2033, to assess and potentially update reporting standards and collaboration with academic institutions demonstrating California's commitment to aligning with evolving global norms.

B. Assurance Engagement

Reporting entities must obtain an assurance engagement performed by an independent third-party assurance provider to validate their public disclosures. The complete assurance provider's report, including the provider's name, must be provided to the emissions reporting organization as part of or in connection with the reporting entity's public disclosure.

The bill mandates the board to review and update the eligibility criteria and qualifications for third-party assurance providers in 2029, with any changes taking effect by January, 2030. The board shall take into consideration the provider's experience in GHG emissions measurement, analysis, reporting and attestation, as well as their competence and capabilities in alignment with professional standards and legal requirements. For ensuring efficiency, the board must minimize the need for reporting entities to engage multiple assurance providers and ensure timely reporting implementation.

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C. Administrative penalty

Non-compliance with reporting deadlines may result in administrative penalties of up to $500,000 per reporting year. However, the board must take into account the past compliance history and good faith efforts of the reporting entity before imposing penalties. This provision reinforces the importance of timely and accurate reporting while acknowledging genuine attempts to comply.

D. Annual Fee

The legislature has gone a step further in supporting the administrative aspect of the bill by setting up a Climate Accountability and Emissions Disclosure Funds, wherein the reporting entities are obligated to pay an annual fee into the fund, the amount of which shall be determined by the board.

II. CFRA – SB 261

Complementing the CCDAA, the SB 261 specifically targets "climate-related financial risks".[9] Companies with annual revenues exceeding $500 million operating in California, referred to as "covered entities,"[10] will be required to prepare biennial climate-related financial risk reports. These reports will detail the entity's exposure to climate-related financial risks and strategies to mitigate and adapt to these risks.

A. Regulatory requirements:

The companies along with displaying the reports on their official website will be mandated to forward them to the climate reporting organizations appointed by the board. These organizations will be responsible for producing periodic public reports of the companies.

Furthermore, the CFRA emphasizes transparency and accountability. Therefore, the reports submitted by the companies must adhere to the disclosure framework recommended by the Task Force on Climate-related Financial Disclosures[11] ("TCFD"), aligning California's standards with international best practices. Companies already complying with International Financial Reporting Standards Sustainability Disclosure Standards[12] can leverage their existing reports to fulfill CFRA requirements, streamlining compliance.

B. Duties of climate reporting organizations

The board is tasked with contracting climate reporting organization to produce periodic public reports. The climate reporting organizations will evaluate climate-related financial risk disclosures, analyze sector-wide risks, convene stakeholders for input on best practices and monitor federal regulatory actions related to financial stability.

C. Administrative penalties

Similar to the CCDAA, SB 261 introduces administrative penalties for non-compliance not exceeding $50,000 per reporting year. The board must consider past compliance and good faith efforts of the covered entity before imposing penalties, emphasizing the importance of accurate and timely reporting.

D. Payment of annual fee to the board

The legislature again taking into consideration the financial aspects of implementing the bill, has mandated the covered entities to deposit an annual fee to the Climate-Related Financial Risk Disclosure Fund, for supporting administrative costs. The amount of fee to be paid shall be determined by the board and may be adjusted based on the Consumer Price Index.

ANALYSIS

With California being the fifth-largest economy globally, the impact of these bills extends far beyond its borders. The advocates of the bills hope that this legislation will encourage other states and countries to adopt similar climate-related disclosure laws. California's history of enacting policies that become templates for the nation highlights its leadership in environmental stewardship.

These bills by focusing not only on Scope 1 and Scope 2 emissions but also on Scope 3 emissions have marked a significant shift in the regulatory landscape for large companies operating in California.While some industry stakeholders may raise concerns about the burden of reporting Scope 3 emissions, it is crucial to recognize that these emissions constitute a substantial part of a company's carbon footprint and are essential to address in the fight against climate change.

In 2022, the U.S. Securities and Exchange Commission proposed similar federal regulations[13] regarding reporting of Scope 3 emissions. However, they have faced delays and opposition from companies resistant to disclosing these emissions, deeming them as burdensome and beyond their control.[14]

In California, although these measures are being backed by major large corporation including Microsoft, Apple[15] etc. operating in the state, who have recognized the importance of acknowledging and mitigating harmful GHG emissions.[16] The bills have received notable opposition from certain industry stakeholder including California Chamber of Commerce citing the legislations to be overly burdensome, costly and restrictive.[17] They have also raised concerns with respect to the authority of the board to regulate out-of-state companies operating in California.

In the given scenario, while the Governor of California has stated his desire to approve the measures,[18] their impact and success will depend on the board's regulations and execution.

CONCLUSION

In a broader context, these bills align with global trends, emphasizing the importance of environmental, social and governance factors in corporate responsibility and risk management. By requiring companies to provide mandatory disclosures, California aims to empower investors and stakeholders to make informed decisions while holding the companies accountable.

California's visionary approach to climate disclosure legislation sets a precedent for a new era of environmental transparency and responsibility within the corporate sector. By means of these legislations, they send a clear message to

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companies that environmental transparency is not just a social responsibility but a legal imperative deserving strict adherence. If signed into law, the CCDAA and CFRA will not only impact large companies operating in California but also inspire a global shift towards greater sustainability and climate accountability.

– Sehar Sharma & Rahul Rishi

You can direct your queries or comments to the authors.

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[1]https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB253

[2]https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB261

[3]https://sd11.senate.ca.gov/news/20230917-governor-newsom-announces-intention-sign-senator-wiener%E2%80%99s-landmark-climate-bill

[4]Section 2 of the SB 253 – "Reporting entity" means a partnership, corporation, limited liability company, or other business entity formed under the laws of this state, the laws of any other state of the United States or the District of Columbia, or under an act of the Congress of the United States with total annual revenues in excess of 1 billion dollars ($1,000,000,000) and that does business in California. The applicability shall be determined based on the reporting entity's revenue for the prior fiscal year. [5]https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB253

[6]https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB253

[7]https://leginfo.legislature.ca.gov/faces/billTextClient.xhtml?bill_id=202320240SB253

[8]https://ghgprotocol.org/sites/default/files/standards/ghg-protocol-revised.pdf, https://ghgprotocol.org/corporate-standard

[9]SB 261 broadly 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."

[10]SB 261-"Covered entity" means a corporation, partnership, limited liability company, or other business entity formed under the laws of the state, the laws of any other state of the United States or the District of Columbia, or under an act of the Congress of the United States with total annual revenues in excess of five hundred million United States dollars ($500,000,000) and that does business in California. Applicability shall be determined based on the business entity's revenue for the prior fiscal year. "Covered entity" does not include a business entity that is subject to regulation by the Department of Insurance in this state, or that is in the business of insurance in any other state.

[11]https://assets.bbhub.io/company/sites/60/2021/10/FINAL-2017-TCFD-Report.pdf , https://www.fsb-tcfd.org/about/#:~:text=In%202017%2C%20the%20TCFD%20released,to%20support%20informed%20capital%20allocation.

[12]https://www.ifrs.org/supporting-implementation/supporting-materials-for-ifrs-sustainability-disclosure-standards/

[13]https://corpgov.law.harvard.edu/2022/05/10/secs-climate-risk-disclosure-proposal-likely-to-face-legal-challenges/

[14]https://news.bloomberglaw.com/ip-law/california-emissions-reporting-bill-would-go-further-than-sec

[15]https://appleinsider.com/articles/23/09/08/apple-officially-endorses-californias-climate-corporate-data-accountability-act

[16]https://www.ceres.org/sites/default/files/Asm%20Approps%20Major%20Companies%20and%20Institutions%20Support%20SB%20253.pdf

[17]https://advocacy.calchamber.com/wp-content/uploads/2023/08/Alert-9-1-23.pdf

[18]https://sd11.senate.ca.gov/news/20230917-governor-newsom-announces-intention-sign-senator-wiener%E2%80%99s-landmark-climate-bill

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