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ALERT

California Moves Ahead on ESG Reporting

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On October 7, 2023, California Governor Gavin Newsom signed two new climate reporting bills into law: Senate Bill (SB) 261, Greenhouse gases: climate-related financial risk and SB 253, the Climate Corporate Data Accountability Act. The new disclosure laws reach public as well as private companies above a certain size located in and well outside of California. Thousands of companies doing business in California will be subject to these reporting requirements that become effective in 2026. While a legal challenge is likely, companies subject to these rules will need to analyze and assess the timing and interplay of these new laws with the federal reporting requirements that are planned in this area.

SB 261 – Greenhouse gases: climate-related financial risk

SB 261 requires any company with an annual revenue of more than $500 million that does business in California to report on climate-related financial risk and disclose measures to reduce such risk. The report will need to be prepared in accordance with the framework and disclosures identified by the Final Report of Recommendations of the Task Force on Climate-related Financial Disclosures (June 2017). Reporting must describe any measures to reduce climate-related financial risk or adapt to the disclosed risk. Failing to publish a report or providing an inadequate report may result in a $50,000 penalty per reporting year.

SB253 – Climate Corporate Data Accountability Act

Any U.S. company doing business in California with total annual revenues greater than $1 billion will need to report on direct and indirect greenhouse gas (GHG) emissions under the new Climate Corporate Accountability Act. Starting in 2026, and annually thereafter, companies would evaluate, inventory, and report Scope 1

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emissions (direct) and Scope 2 emissions (indirect) in accordance with the Greenhouse Gas Protocol standards and guidance. Ultimately, this law will require even broader reporting than last year's controversial proposal by the U.S. Securities and Exchange Commission (SEC). Beginning in 2027, all reports must include Scope 3 emissions ("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 . . . purchased goods and services, business travel, employee commutes, and processing and use of sold products,") from the prior fiscal year. In contrast, fewer companies would be subject to Scope 3 reporting under the SEC's proposal (only public companies with an emissions reduction goal or for whom such emissions are material to their operations). Data related to the GHG emissions inventory of reporting companies shall be subject to verification through an assurance engagement performed by an independent third-party assurance provider. Companies making scope 1 and 2 emissions require limited assurance, and then reasonable assurance in 2030. Scope 3 disclosures will begin at limited assurances starting in 2030. Failure to file may result in penalties up to $500,000 in a reporting year; however, businesses will not be subject to penalty for misstatements related to scope 3 emissions made with a reasonable basis.

Implications and Concerns

The California Air Resources Board (CARB) is charged with issuing implementing regulations in advance of the scheduled reporting periods for these laws.

Governor Newsom has instructed CARB to lessen potential financial impacts. For instance, the need to report upstream and downstream emissions (scope 3) will likely result in non-regulated companies analyzing their emissions to help affected companies ensure that their scope 3 reports are founded on a "reasonable basis."

Both laws require CARB to contract with third-party organizations to review and analyze the reported data. For example, under SB 261, CARB will contract with a climate reporting organization to prepare a public report that reviews a subset of these disclosures to analyze "the systemic and sectorwide climate-related financial risks facing the state."

Keep your eyes on California. The impact of these laws on public financial disclosures by private companies is unprecedented. Their long reach, timing, and standard of reporting could be challenged in court or renegotiated in future sessions by California's legislature. However, a final federal rule is unlikely to preempt state laws in this area. As it stands today, these new California laws are set to become the nation's standard for climate reporting.

The full text of the new state laws is provided below:

SB261

SB253