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Insights

DIS-CLOSING TIME: GOLDEN STATE ENACTS GREENHOUSE GAS REPORTING, CLIMATE RISK DISCLOSURE REQUIREMENTS

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Thousands of companies that do business in California will soon face new climate reporting mandates following Governor Gavin Newsom's approval of SB 253 (the "Climate Corporate Data Accountability Act") and SB 261 (the "Climate-Related Financial Risk Act"). Together, the two laws establish a mandatory framework for greenhouse gas ("GHG") emissions reporting (SB 253) and climate risk disclosure (SB 261) that will impact many companies not currently covered by the U.S. Securities & Exchange Commission ("SEC") proposed climate disclosure rule, which applies only to publicly traded companies.

Although California's reporting requirements will not take effect for several years and the California Air Resources Board ("CARB") must first adopt regulations implementing the disclosure framework, companies with annual revenues in excess of the reporting thresholds—$1 billion for SB 253 and $500 million for SB 261—should become familiar with the requirements of these laws and begin developing a reporting strategy now.

SB 253 – CLIMATE CORPORATE DATA ACCOUNTABILITY ACT

WHO IS COVERED?

"Reporting entities" include U.S. public and private companies that do business in the state of California with total annual revenues of more than $1 billion in the prior fiscal year. The $1 billion threshold is not limited to revenues derived from operations in California.

SB 253 does not specifically define what constitutes "doing business" in California, and further clarification may be forthcoming from CARB in its implementing regulations. However, it is likely that most US companies with revenues in excess of $1 billion will have significant economic ties—through incorporation/business organization in California, sales and distribution in California, ownership of property in California, or payment of employees in the state—sufficient to be classified as "doing business" in California.

WHAT IS REQUIRED?

SB 253 requires that CARB develop regulations for the annual disclosure of greenhouse gas emissions by reporting entities no later than January 1, 2025. These regulations must contain the following requirements:

- Starting in 2026, reporting entities must publicly disclose their Scope 1 and Scope 2 emissions for the prior fiscal year on an annual basis.
- Starting in 2027, and no later than 180 days after making its annual Scope 1 and 2 disclosures, a reporting entity must publicly disclose its Scope 3 emissions for the prior fiscal year. Scope 3 emission reports must be published on an annual basis thereafter.

The reporting entity must obtain an “assurance engagement” from an independent third-party assurance provider auditing the entity’s emissions reports.

Reporting entities must also pay an annual fee in conjunction with their annual disclosure to support CARB’s administration of the disclosure mandate. The amount of the fee will be determined by CARB; the total amount of fees collected may not exceed the actual and reasonable costs of program administration.

"SCOPING” OUT COMPLIANCE

The SB 253 reporting regime covers emissions throughout a company’s supply chain and through products’ entire life cycles. Specifically, SB 253 covers:

- Scope 1 emissions – all direct greenhouse gas emissions (such as emissions from fuel combustion) that stem from sources a reporting entity owns or directly controls;
- Scope 2 emissions – indirect greenhouse gas emissions from “consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity”; and
- Scope 3 emissions – indirect upstream and downstream greenhouse gas emissions (other than scope 2 emissions) from sources that the reporting entity does not own or directly control, such as “purchased goods and services, business travel, employee commutes, and processing or use of sold products."

POTENTIAL PENALTIES FOR NON-COMPLIANCE

Entities that fail to report could face steep penalties; SB 253 calls for CARB to adopt regulations authorizing the agency to collect penalties of up to $500,000 per reporting year for inadequate disclosures or failure to report. Good faith compliance efforts will be considered in assessing penalties.

The penalty regime for Scope 3 emissions reporting is somewhat more lenient. Reporting entities will not be subject to penalties for misstatements with regard to Scope 3 emissions where the

misstatements were made with a reasonable basis and disclosed in good faith. Between 2027 and 2030, penalties will only be assessed with respect to Scope 3 emissions if an entity fails to file any disclosure.

SB 261 – CLIMATE-RELATED FINANCIAL RISK ACT

WHO IS COVERED?

SB 261 applies to "covered entities," which include U.S. public and private companies that do business in the state of California with total annual revenues greater than $500 million in the prior fiscal year. (Note that the $500 million threshold is for *total* revenues and is not limited to revenues generated in California.) Subsidiaries that meet this definition of a "covered entity" do not need to report independently if their parent company is also a "covered entity" that reports pursuant to SB 261.

Like SB 253, SB 261 does not specifically define what constitutes "doing business" in California, and further clarification may be needed from CARB as to whether companies with *de minimis* levels of economic activity in the state will be exempt from disclosure. At this point, only insurance companies are exempt from the requirements of SB 261.

WHAT IS REQUIRED?

SB 261 requires "covered entities" to publicly disclose climate-related financial risks by issuing a biennial report that (i) describes relevant risks in accordance with the framework recommended by the Task Force on Climate-Related Financial Disclosures ("TFCD") and (ii) documents measures taken to minimize the business impacts of such risks. If the report contains descriptions of a covered entity's GHG emissions or its voluntary GHG mitigation measures, those statements must be verified by an independent third party.

"Climate-related financial risk" is defined broadly as any "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."

Covered entities must publish their first reports on their public-facing websites no later than January 1, 2026; after that, updated reports must be published on a biennial basis.

Covered entities must also pay an annual fee starting January 1, 2026 to defray the costs of administering and implementing the law; the amount of the fee will be determined by CARB based on anticipated program expenses.

OTHER CONSIDERATIONS

SB 261 also requires CARB to commission a third-party climate reporting organization to publish a comprehensive biennial public report analyzing potential "systemic and sector-wide climate-related financial risks facing the state" based on the information submitted by covered entities.

POTENTIAL PENALTIES FOR NON-COMPLIANCE

SB 261 calls for CARB to adopt regulations authorizing the agency to collect penalties of up to $50,000 per reporting year for inadequate disclosure or failure to report. Good faith compliance measures will be considered in assessing the penalty.

Inadequate reports may be identified in the biennial state climate risk report commissioned by CARB, presenting the potential for public attention and enforcement scrutiny.

CONCLUSION

Even if your business has begun addressing scope 3 emissions, reporting GHG emissions based on data from up and down supply chains and flagging climate change financial risks under California's new laws will present significant challenges for impacted businesses. Evaluating the applicability of these laws and starting to develop a compliance plan sooner rather than later is essential for businesses that may be considered within the scope of the new disclosure regime.

For more information on California's climate disclosure laws and their application to your business, please reach out to a member of BCLP's environmental team.

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