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California Enacts Expansive Climate-Related Disclosure Laws

SB 253, SB 261 and AB 1305 Require Public and Private Companies Doing Business in California to Disclose Greenhouse Gas Emissions (Including Scope 3), Climate Risks and Use of Voluntary Carbon Offsets

SUMMARY

On October 7, 2023, California Governor Gavin Newsom signed into law the Climate Corporate Data Accountability Act (SB 253), the Climate-Related Financial Risk Act (SB 261) and the Voluntary Carbon Market Disclosures Act (AB 1305). Together, these amendments to California's Health and Safety Codes impose new and sweeping climate-related reporting obligations on companies, which are, in many respects, broader and more prescriptive than the climate-related disclosure requirements [proposed by the SEC](#) in 2022. Thousands of companies are expected to fall under the scope of SB 253, SB 261 and AB 1305, including both public and private companies, whether or not they are incorporated in California.

Specifically:

- U.S. companies with total annual revenues in excess of \$1 billion that do business in California will be required to publicly disclose all Scope 1, 2 and 3 greenhouse gas ("GHG") emissions on an annual basis (SB 253)
- U.S. companies (other than insurance companies) with total annual revenues in excess of \$500 million that do business in California will be required to, on a biennial basis, publicly disclose climate-related financial risk in accordance with the Task Force on Climate-Related Financial Disclosures ("TCFD") framework (SB 261)

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- Companies operating in California (U.S. and non-U.S.) that make net zero, carbon neutral or GHG-reduction claims will be required to publicly disclose how they determined the accuracy of those claims, how interim progress is measured, whether third-party verification was obtained, and, if such companies purchase or use voluntary carbon offsets sold within California, information on offsets purchased or used (AB 1305)

CLIMATE CORPORATE DATA ACCOUNTABILITY ACT (SB 253)

SB 253 mandates annual, full-scope GHG emissions data reporting for covered entities. In the preamble to SB 253, the legislature states that such reporting “will inform investors, empower consumers, and activate companies to improve risk management in order to move towards a net-zero carbon economy.”¹ SB 253 requires the California State Air Resources Board (“CARB”) to adopt regulations to implement SB 253’s GHG emissions data reporting requirements on or before January 1, 2025.

Covered Entities. SB 253 applies to any “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 and “that does business in California.” The revenue threshold is not limited to California-based revenue.

Timeline. Beginning in 2026, covered entities will be required to publicly disclose, on an annual basis, all Scope 1 and Scope 2 emissions for the prior fiscal year. Both the initial compliance date and subsequent reporting deadlines are to be determined by CARB. Beginning in 2027, covered entities will also be required to publicly disclose all Scope 3 emissions on an annual basis, with the annual deadline for reporting Scope 3 being 180 days following the reporting deadline for Scope 1 and 2 emissions.

Methodology. At least through 2033, covered entities must measure and report their GHG emissions in conformance with the Greenhouse Gas Protocol (GHG Protocol) standards and guidance. These standards and guidance include the GHG Protocol Corporate Accounting and Reporting Standard and the GHG Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard, which, among other guidance, provide details on when primary or secondary data sources (e.g., industry average data and proxy data) may be used to calculate Scope 3 emissions. Starting in 2033 and every five years thereafter, CARB may survey and assess then-available GHG accounting and reporting standards and adopt a globally recognized alternative accounting and reporting standard if CARB determines that its use would more effectively further the goals of SB 253.

Assurance. Covered entities must obtain an independent third-party assurance of all their Scope 1, 2 and 3 emissions. The assurance for Scope 1 and Scope 2 emissions must be performed at a limited assurance level beginning in 2026 and at a reasonable assurance level beginning in 2030. The assurance for Scope

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3 emissions must be performed at a limited assurance level beginning in 2030, although SB 253 provides CARB with discretion to implement Scope 3 assurance requirements on or before January 1, 2027.

Enforcement. Under 253, CARB will adopt regulations to impose penalties for violation of the statute; however, penalties are capped by statute at \$500,000 per year.

Scope 3 Safe Harbors. For Scope 3 disclosures, a covered entity will not be subject to an administrative penalty for any misstatements in disclosures made with a reasonable basis and disclosed in good faith. In addition, between 2027 and 2030, CARB will only assess penalties with respect to Scope 3 reporting if a covered entity failed to make the filing.

CLIMATE-RELATED FINANCIAL RISK ACT (SB 261)

SB 261 mandates the reporting of climate-related financial risks in accordance with the TCFD framework. In the preamble to SB 261, the California legislature declared that “[i]n order to begin to address the climate crisis, consistent, higher level, and mandatory disclosures are needed from all major economic actors, and California has an opportunity to set mandatory and comprehensive risk disclosure requirements for public and private entities to ensure a sustainable, resilient, and prosperous future for our state.”²

Covered Entities. SB 261 applies to “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 \$500 million and “that does business in California.” Business entities subject to regulation by the California Department of Insurance, or that are in the business of insurance in any other state, are specifically exempted. The California legislature noted that, in April 2022, the National Association of Insurance Commissioners has already adopted a standard for insurance companies to report their climate-related risks in alignment with the TCFD standard.³

Timeline. Beginning on January 1, 2026, covered entities must, on a biennial basis, prepare and make available on their websites a report disclosing (1) their climate-related financial risk and (2) measures adopted to reduce and adapt to such risk.

Methodology. Climate-related financial risk reporting must be prepared in accordance with the TCFD framework. However, SB 261 permits covered entities to take a “comply or explain” approach with respect to any reporting gaps that remain after an entity has made TCFD disclosures “to the best of its ability”. Under those circumstances, the entity must also describe steps it will take to prepare complete disclosures.

Substituted Compliance. A covered entity will be deemed to satisfy the SB 261 reporting requirements if it prepares a publicly accessible biennial report that includes climate-related financial risk disclosure information that (1) pursuant to a law, regulation, or listing requirement issued by any governmental entity,

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incorporates disclosure requirements consistent with the SB 261 requirements, including the International Financial Reporting Standards (“IFRS”) Sustainability Disclosure Standards issued by the International Sustainability Standards Board (“ISSB”), or (2) voluntarily uses a framework that meets the requirements of SB 261 or the ISSB standards.

Consolidation at the Parent / Company Level. Whereas SB 253 is silent on consolidation, SB 261 clarifies that the climate-related financial risk reports “may be consolidated at the parent company level.” If a subsidiary qualifies as a covered entity, the subsidiary is not required to prepare a separate report.

Enforcement. Under 261, CARB will adopt regulations to impose penalties for violation of the statute; however, penalties are capped by statute at \$50,000 per year.

VOLUNTARY CARBON MARKETS DISCLOSURE ACT (AB 1305)

Stemming from a concern about the validity of emission reductions from carbon offsets and the potential for fraud in the voluntary carbon markets,⁴ AB 1305 imposes disclosure requirements on both (1) business entities that market and sell voluntary carbon offsets within California and (2) entities that makes claims regarding the achievement of net zero emissions or “carbon neutrality,” including entities that purchase or use voluntary carbon offsets. This summary focuses on the latter requirements, which are broadly drafted and have the potential to impact many companies within and outside of the United States, even as compared to the sell-side disclosure requirements (added in a new section 44475 to Division 26 of California’s Health and Safety Code).⁵

Covered Entities and Disclosure Requirements. AB 1305 adds a new Section 44475.2 that applies to any “entity that makes claims regarding the achievement of net zero emissions, claims that the entity, a related or affiliated entity, or a product is ‘carbon neutral,’ or makes other claims implying the entity, related or affiliated entity, or a product does not add net carbon dioxide or greenhouse gases [...] to the climate or has made significant reductions to its carbon dioxide or greenhouse gas emissions.” This section does not apply to entities that “do not operate within” California or that “do not make claims within” California. Under Section 44475.2, covered entities must disclose on their websites detailed information on GHG emissions associated with these claims, including:

- All information documenting how, if at all, a “carbon neutral,” “net zero emission,” or other similar claim was determined to be accurate or actually accomplished
- How interim progress towards that goal is being measured (e.g., disclosure relating to any science-based targets used)
- Whether there is independent third-party verification of the company data and claims listed

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In addition, under a new Section 44475.1, any covered entity under Section 44475.2 that purchases or uses voluntary carbon offsets⁶ sold within California must also disclose on its website detailed information with respect to such offsets, including the entity selling the offset and the offset registry, the offset project type (e.g., carbon removal, avoided emission or a combination of both) and site location, the specific protocol used to estimate emissions reductions or removal benefits and whether there is independent third-party verification of company data and claims listed.

Timeline. AB 1305 will be effective on January 1, 2024 and requires relevant disclosures to be updated no less than annually.

Enforcement. Any covered entity that violates AB 1305 will be subject to a civil penalty (capped at \$2,500 per day) for each day that relevant disclosure is not available or is inaccurate on its website. The penalty for each violation will be capped at a total of \$500,000.

IMPLICATIONS

The California Laws Will Apply To Many Non-California Companies. The California legislature, which has enacted SB 263, SB 261 and AB 1305 as demonstrations of “California’s leadership in the battle against climate change,” has indicated their intention for the state’s climate-related laws to impact companies beyond its borders. For example, the preamble to SB 253 states that “the climate actions of [California] have inspired and contributed to bold actions in other states and across the globe” and that “United States companies that have access to California’s tremendously valuable consumer market by virtue of exercising their corporate franchise in the state also share responsibility for disclosing their contributions to global GHG emissions.” The legislative materials cite an estimate by Ceres, one of the sponsors of SB 253, that 5,300 United States companies will be subject to the new law’s GHG reporting requirements.⁷ The legislature also estimated that over 10,000 companies “do business” in California and exceed the \$500 million revenue threshold for reporting under SB 261.⁸ It is difficult to accurately estimate the volume of companies that may fall under AB 1305, given the large and continually growing number of companies that make some type of claim about achieving net zero, carbon neutrality or GHG reduction.

The Laws Overlap With, And May Be Broader Than, Proposed SEC Rules. SB 253, SB 261 and AB 1305 all cover areas that are addressed in the climate-related disclosure requirements proposed by the SEC in 2022. For example, the SEC’s proposed rules would also require (1) disclosure and attestation of GHG emissions, (2) reporting on material climate-related risks based on the TCFD framework, and (3) if a company sets a climate related target or goal or uses carbon offsets as part of its net emissions reduction strategy, detailed disclosure about how the company uses such targets, goals or carbon offsets. However, the requirements under the California laws are significantly more broadly drafted than those proposed by

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the SEC. The new California laws generally do not specify any materiality threshold for the required disclosures. For example, although some aspects of the proposed SEC rules also do not reference a traditional materiality threshold, the proposed SEC rules only mandate Scope 3 emissions reporting if the emissions are material or if the company has set targets or goals that include Scope 3 emissions. In contrast, as drafted, SB 253 requires reporting of Scope 3 emissions without referencing any materiality or other disclosure trigger. In addition, certain elements of the California laws are more prescriptive than the proposed SEC rules. For example, the proposed SEC rules do not mandate any particular protocol for GHG emissions reporting, but SB 253 requires that the Scope 1, 2 and 3 reporting be made in conformance with the GHG Protocol's standards and guidance.

The extent to which the California laws will actually differ from the federal rules will depend on further rulemaking from California regulators and the SEC. CARB is required to fill gaps in SB 253 and SB 261 through regulations to implement each law. SB 253 specifies that CARB must ensure that it adopts implementing regulations that are "structured in a way that minimizes duplication of effort and allows a reporting entity to submit to the emissions reporting organization reports prepared to meet other national and international reporting requirements, including any reports required by the federal government, as long as those reports satisfy all of the requirements of this section." SB 261 expressly permits substituted compliance with its requirements if a company already makes TCFD-consistent disclosures pursuant to "a law or regulation issued by the United States government." The SEC is likewise monitoring the developments in California. On September 27, 2023, SEC Chair Gary Gensler stated that the enactment of SB 253 and SB 261 may "change the baseline" for the SEC's rulemaking, thereby potentially impacting how federal regulators weigh the costs of the proposed SEC rule.⁹

One key difference between the California laws and any SEC rulemaking is that the proposed SEC rules would only apply to SEC registrants subject to reporting requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934 (i.e., public companies). In contrast, any company meeting the applicable annual revenue thresholds in SB 253 and SB 261 and doing business in California, whether private or public (including a company held by one shareholder), will need to comply with the reporting requirements of the new laws. The California legislature estimates that 73% and 80% of the covered companies under SB 253 and SB 261, respectively, will be private companies.¹⁰

Potential for Additional Legislation and Litigation Add to Uncertainty. On October 7, 2023, in the signing statements to SB 253 and SB 261, Governor Newsom opined that the implementation deadlines are likely infeasible and expressed concerns about potential financial impact on businesses. Specifically for SB 253, Governor Newsom also expressed concern that the reporting protocol specified could result in inconsistent reporting across businesses subject to the measure. As a result, Governor Newsom is directing his administration to work with the bill's author and the California legislature next year to address these

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issues. He is also instructing CARB to closely monitor the cost impact on businesses and to make recommendations to streamline reporting.¹¹

In addition to further legislative developments, there may also be legal challenges to the new laws, and various trade organizations have already voiced their opposition.

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ENDNOTES

¹ SB 253, 2023 Leg. § 1(l) (Cal.2023).

² SB 261, 2023 Leg. § 1(j) (Cal.2023).

³ Assembly Committee on Appropriations, SB 261, 2023 Leg., at 3 (Cal. Aug. 16, 2023)

⁴ Assembly Floor Analysis, AB 1305, 2023 Leg., at 1 (Cal. Sep. 8, 2023).

⁵ On October 7, Governor Newsom vetoed an amendment to the California Business and Professions Code that would have mandated stricter diligence requirements for trading in carbon offsets. Veto Statement for SB 390, Office of the Governor (Oct. 7, 2023), *available at* <https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-390-Veto.pdf>. See also SB 390, 2023 Leg. (Cal.2023)

⁶ “Voluntary carbon offset” means any product sold or marketed in the state that claims to be a “greenhouse gas emissions offset,” a “voluntary emissions reduction,” a “retail offset,” or any like term, that connotes that the product represents or corresponds to a reduction in the amount of greenhouse gases present in the atmosphere or that prevents the emission of greenhouse gases into the atmosphere that would have otherwise been emitted.

“Voluntary carbon offset” does not include products that represent or correspond to legal or regulatory mandates for either of the following:

(i) Reduction of the amount of greenhouse gases present in the atmosphere.

(ii) Prevention of the emissions of greenhouse gases into the atmosphere. (AB 1305, 2023 Leg. § 1 (Cal.2023).

⁷ Senate Floor Analysis, SB 253, 2023 Leg., at 2 (Cal. Sep. 7, 2023).

⁸ Senate Floor Analysis, SB 261, 2023 Leg., at 5 (Cal. Sep. 8, 2023). Although the legislative materials for references an existing Revenue and Tax Code provision that defines “doing business” as “engaging in any transaction for the purpose of financial gain within California, being organized or commercially domiciled in California, or having California sales, property or payroll exceed specified amounts: as of 2020 being \$610,395, \$61,040, and \$61,040, respectively” (see Cal. Revenue and Tax Code § 23101), a definition of “doing business” has not been included in the text of either statute. Senate Judiciary Committee Bill Analysis, SB 261, 2023 Leg., at 2 (Cal. Apr. 18, 2023); Senate Judiciary Committee Bill Analysis, SB 253, 2023 Leg., at 3 (Cal. Apr. 18, 2023).

⁹ SEC Chief Says New California Law Could ‘Change Baseline’ for Coming SEC Climate Rule, Reuters (Sep. 27, 2023), *available at* <https://www.reuters.com/sustainability/sec-chief-says-new-california-law-could-change-baseline-coming-sec-climate-rule-2023-09-27/>.

¹⁰ Assembly Floor Analysis, SB 253, 2023 Leg., at 2 (Cal. Sep. 7, 2023); Senate Committee on Environmental Quality, SB 261, 2023 Leg., at 5 (Cal. Jan. 1, 2023).

¹¹ Signing Statement for SB 253, Office of the Governor (Oct. 7, 2023), *available at* <https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-253-Signing.pdf>; Signing Statement for SB 261, Office of the Governor (Oct. 7, 2023), *available at* <https://www.gov.ca.gov/wp-content/uploads/2023/10/SB-261-Signing.pdf>.

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