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5 Things To Know About Calif.'s New Climate Disclosure Law

By **Sarah Jarvis**

Law360 (October 13, 2023, 8:48 PM EDT) -- Companies should be preparing now to comply with California's new law requiring public disclosure of greenhouse gas emissions, though questions remain about the law's scope and impact, experts told Law360.

Senate Bill 253 — known as the Climate Corporate Data Accountability Act and signed into law by Gov. Gavin Newsom on Oct. 7 — could lead to legal pushback from companies and industry groups, but attorneys said it's best for companies to lay the groundwork now for complying with the measures anyway.

Here are five things to know about the new measures:

What the Law Requires

The new law requires companies making more than $1 billion in gross annual revenue to disclose the scope of their emissions for their operations and supply chains.

The act requires companies to report their Scope 1, Scope 2 and Scope 3 greenhouse gas emissions, which respectively cover their direct, operational emissions; their indirect emissions from energy use; and their indirect emissions from up and down their supply chains.

Under the law, the California Air Resources Board, or CARB, can levy fines of up to $500,000 per year for violations. The new reporting requirements apply to both public and private companies — a departure from the U.S. Securities and Exchange Commission's proposed climate disclosure rule, which applies only to public companies.

Proponents have said the law will offer transparency, allowing regulatory agencies, investors and consumers to hold companies accountable for their emissions. Newsom signed the bill into law along with a separate bill, S.B. 261, that requires every company with more than $500 million in annual revenue to develop a biennial report on its climate-related financial risks.

Though the governor said S.B. 253 shows California's continued leadership with "bold responses to the climate crisis," he flagged certain issues with the law.

"The implementation deadlines in this bill are likely infeasible, and the reporting protocol specified could result in inconsistent reporting across businesses subject to the measure," Newsom said in a letter published when he signed the bill into law. He directed his administration to work with the Legislature to address those deadlines and the bill's reporting protocol.

He added that he was concerned about the financial impact of the bill on businesses, directing CARB to "closely monitor the cost impact as it implements this new bill and to make recommendations to streamline the program."

The bill requires CARB to develop and adopt the regulations by Jan. 1, 2025.

What Gray Areas Attorneys See With the Law

Lawyers told Law360 the law includes ambiguities they anticipate CARB will address, as the entity tasked with managing and implementing the law.

Andy Jack, a partner at Covington & Burling LLP, noted that one issue is when the law will actually be implemented, pointing to Newsom's criticism of the bill's current implementation deadline.

But he added there are "a number of issues lurking in the law itself that CARB is going to have to provide guidance on, such as, what is really meant by total revenues? What does it really mean to be doing business in California for these purposes?"

David Colvin, co-chair of the environmental, social and governance practice group at Fox Rothschild LLP, echoed that concern, questioning the $1 billion threshold for the climate disclosure law and wondering if that revenue must be generated in California or if revenue generated globally would fall under the law.

He also questioned what threshold — number of offices, number of employees or revenue, for example — could count as doing business in the Golden State.

"If you're a company that has 99% of your operations outside California, but maybe you have an outpost in the state and you have an office in the state — is that really doing business in California?" Colvin asked.

Howard Sidman, deputy chair of Jones Day's ESG practice, said that while the law doesn't define "doing business," it's possible the law ends up incorporating the California Franchise Tax Board's definition, which encompasses entities that engage in any transaction for the purpose of financial gain within the state.

"I think that's going to be an area of interest and potential dispute moving forward," Sidman said.

What Legal Challenges the Law Might Face

Sidman said the law may be susceptible to legal challenges from companies or industry trade groups. He said challenges attempting to protect against compelled speech could be brought under the First Amendment, noting there's a possibility similar challenges arise against the SEC's climate disclosure rule.

"To the extent that the requirements themselves — while they're still being worked out by CARB — are analogous with federal requirements, they could also be subject to preemption arguments, that is to say that there are existing federal laws that are in place," Sidman said.

Fox Rothschild's Colvin said companies that are disproportionately affected by the new law could file suit, as could industry groups challenging the law as overly broad or overly punitive in terms of cost-benefit analysis.

"I think it's fair to assume there will be some legal challenge to the scope of the law as well," Colvin said.

How Companies Can Prepare to Comply With the Law

Sidman said the biggest issues for companies preparing for measures are their scope, impact and compliance costs, as well as potentially inconsistent requirements between the California measures, European Union regulations and the SEC's eventual rule.

Sidman said the way companies go about tracking their emissions will vary from company to company and depend on their ESG functions.

Some companies have in-house personnel who can handle some of that work, while others don't have that capacity, he said.

"So they're going to have to either hire more people, which goes to the cost issue, or retain third parties to help — again, more costs," Sidman said.

Companies that start now in good faith to establish processes to comply with the new laws may be viewed by regulators with more leniency when the law is in effect, he said. But he noted that the laws already include fines, and he said he doesn't know at the moment how regulators will view compliance failures when deciding whether to dole out those fines.

Covington's Jack said companies need to build "carbon fluency" among their ranks, including those who execute the company's strategy and those tasked with reporting and disclosing the strategy.

"Carbon accounting is somewhat arcane," he said, adding that companies need expertise in that area or access to experts, as well as "fluency around carbon accounting and carbon disclosure issues."

He added that there is a "burgeoning field" of carbon accounting consultants and assurance providers and verifiers, whether they are backed by venture capital, new businesses within large companies or part of the Big Four accounting firms.

"Companies really just need to evaluate their third-party assurance providers and carbon accounting consultants carefully, just as they would selecting auditors," he said.

Colvin said many public companies in California have already begun building out their compliance programs in anticipation of the SEC's climate disclosure rule, putting them generally ahead of the game with the state law compared to private companies, which he said may not have taken the same steps to prepare.

Those companies need teams of in-house personnel — from the operations, finance and legal divisions at a minimum — to familiarize themselves with the greenhouse gas protocol and the company's various types of emissions, he said. They also need procedures and controls in place at every step to monitor the data and make sure appropriate security is in place.

And companies should identify and retain accounting professionals who can provide assurance for the disclosures, he said, adding that those professionals must be approved by CARB.

What Challenges Companies Face in Complying

Rick Rothman, a partner at Morgan Lewis & Bockius LLP, said companies will likely run into the most difficulty in tracking their Scope 3 emissions, which cover indirect emissions from supply chains.

He said there's a lot of potential for omissions in tracking Scope 3 emissions, noting that current methodologies for estimating those emissions require companies to "query up the chain."

"I don't think that the sophistication of the mechanisms by which companies can estimate the Scope 3 emissions has developed to the point where it is feasible for them to get a reasonably accurate estimate," Rothman said. "And I think that that's going to create a lot of consternation."

Scope 3 emissions have been a controversial element of the SEC's climate disclosure proposal, with a group of Democratic lawmakers led by Sen. Elizabeth Warren, D-Mass., urging the agency last month to keep Scope 3 requirements in its finalized rule.

Rothman noted that despite some significant differences, the SEC's proposal is largely similar to the California law, saying, "I think overall, there is going to be a coordinated effort to make sure that companies are providing relatively similar information regarding their climate-related disclosures."

Fox Rothschild's Colvin said tracking Scope 3 emissions requires companies to have access to the emissions data of their supply chain partners, adding that many companies probably don't currently have such information agreements in place. Companies also need audit rights to ensure the information they get is legitimate and complete, he added.

Considering the number of partners many companies have in their supply chains, that process can become burdensome and "the scope can become pretty unwieldy," he said, noting the costs also add up.

"The aspirational nature of these laws is well understood. The cost and the burden, however, on companies of complying with the requirements of these types of laws is also very significant," Colvin said.

He later added, "At some point, I think there needs to be a balance between what the laws are attempting to achieve and the burden on those who will be subject to it."

--Editing by Alex Hubbard.
