California Governor Gavin Newsom signed two climate disclosure bills into law on October 7, 2023.

They will impose significant reporting obligations on thousands of companies doing business in California. **SB 253, the Climate Corporate Data Accountability Act**, will require companies to annually disclose Scope 1, Scope 2, and Scope 3 emissions (which are defined in further detail below). **SB 261, Greenhouse Gases: Climate-Related Financial Risk**, will require biennial disclosure of a company's financial risk caused by climate change.

These two laws go further than any other state or federal climate disclosure legislation in the United States, including the long anticipated (but yet-to-be-adopted) climate disclosure rule being considered by the U.S. Securities and Exchange Commission (SEC). Notably, the new California laws apply to both private and public companies with qualifying revenue that do business in California and require the disclosure of Scope 1, 2, and 3 emissions. While there are many implementation details yet to be decided before the initial 2026 reporting deadline, it is not too early to begin evaluating the requirements of SB 253 and 261 and planning for compliance.

What the Laws Require

SB 253, The Climate Corporate Data Accountability Act

SB 253 will require thousands of businesses to measure and publicly disclose their greenhouse gas emissions **on an annual basis**, in conformance with the Greenhouse Gas Protocol standards and guidance. The law defines a "reporting entity" as any **public or private** U.S. business with total annual revenues exceeding $1 billion in the prior fiscal year "that does business in California." The law does not define "doing business in California," but the California Franchise Tax Board defines the term as (1) engaging in any transaction in the state for financial gain or (2) having sales, real and tangible property, or payroll in California that exceeds certain (relatively low) thresholds.

Covered businesses will be required to disclose Scope 1 (direct emissions) and Scope 2 (emissions associated with electricity consumption) data starting in 2026 for calendar year 2025. Businesses will be required to disclose Scope 3 (indirect, value chain emissions) data starting in 2027 for calendar year 2026. By requiring Scope 3 emissions disclosures from all covered businesses, SB 253 goes beyond the SEC's climate rule proposal, which would require disclosure of Scope 3 emissions only if they are material.

The disclosures required by SB 253 must consider acquisitions, divestments, mergers, and other structural changes that can affect greenhouse gas emissions reporting. In addition, reporting entities will also be required to submit assurance reports. Specifically, assurance reports would be required in 2026 for Scope 1 and 2 emissions data at the limited assurance level and at the reasonable assurance level in 2030. Assurance reports would be required for Scope 3 emissions at the limited assurance level in 2030.

To avoid duplicative reporting efforts, SB 253 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." Thus, companies that disclose emissions data under the EU's Corporate Sustainability Reporting Directive (CSRD) or another authority, such as the SEC's proposed climate disclosure rule, may be able to submit the same report to satisfy SB 253's requirements.

Reporting entities will also be required to pay an annual fee upon filing their disclosures. A business that fails to file or otherwise does not meet the requirements of SB 253 could be subject to a fine of up to $500,000 annually.

SB 261, Greenhouse Gases: Climate-Related Financial Risk

Beginning January 1, 2026, and biennially thereafter, SB 261 requires, among other things, "covered entities" to publicly report (1) climate-related financial risks in accordance with the framework published by the Task Force on Climate-Related Financial Disclosures and (2) the measures adopted to reduce and adapt to those risks. In addition to filing its report with the California Air Resources Board (CARB), a covered entity must publish its report on the company's own website. "Covered entities" are defined in the same manner as "reporting entities" under SB 253 but with a lower $500 million annual revenue threshold. Notably, insurance companies are excluded, but upwards of 10,000 other companies are expected to fall within the purview of SB 261.

"Climate-related financial risks" that must be reported under SB 261 include material risks of harm to immediate and long-term financial outcomes due to potential physical and transition impacts associated with climate change. This includes, but is not limited to, risks to corporate operations, the 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.

If a company is not able to file a complete report, SB 261 allows a covered entity to provide the recommended disclosures to the best of its ability, explain any reporting gaps, and describe the steps it will take to prepare complete disclosures. A covered entity may also consolidate climate-related financial risk reports at the parent company level, avoiding separate subsidiary reports.

In addition to the corporate reporting obligations, SB 261 directs CARB to prepare a biennial public report that (1) reviews climate-related financial risk disclosures by industry; (2) analyzes the systemic and sector-wide climate-related financial risks facing the state, including potential impacts on economically vulnerable communities; and (3) identifies inadequate or insufficient reports.

Like SB 253, SB 261 attempts to avoid imposing duplicative obligations on covered entities. If a business publicly discloses its climate-related financial risk pursuant to another law or regulation (like the SEC's proposed climate disclosure rule) or voluntarily and publicly discloses according to the International Sustainability Standards Board's standards, the business may satisfy its obligations under SB 261.

Covered entities will be required to pay an annual fee. Noncompliance with SB 261 could expose a business to a fine of up to $50,000 in a reporting year.

Anticipated Changes or Legal Challenges

Perhaps signaling that there are still many details to be ironed out and that further modifications are possible, Governor Newsom stated that the implementation deadlines in SB 253 are "likely infeasible, and the reporting protocol specified could result in inconsistent reporting across businesses subject to the measure." He expressed similar concerns regarding SB 261, noting that the implementation deadlines may not provide CARB with sufficient time to adequately carry out the requirements in SB 261. With that in mind, Newson directed his administration to work with the legislature next year to address these issues and instructed CARB to closely monitor businesses' compliance costs and make recommendations for ways to streamline the disclosure programs that are required under these laws.[1]

Outside of rulemaking and future legislative changes, the laws are likely to face both challenges in court and continued opposition from some business interests. A main focus of attack is likely to be the unprecedented reach of the new requirements, particularly pertaining to Scope 3 disclosures and mandatory reporting of financial risks posed by climate change. If the SEC finalizes its proposed rule, which is anticipated to occur by the end of 2023, there may be claims that the federal rule preempts disclosure requirements under state law. However, provisions in the respective laws that allow companies to use disclosures prepared under federal authority may head off such challenges.

California's new climate legislation is poised to lead the way to greatly expanded climate disclosure requirements in the United States. Although the reporting requirements of SB 253 and SB 261 will not go into effect until 2026, and some aspects of the laws may change, the future is now when it comes to understanding corporate emissions and climate impacts throughout the value chain. Businesses should evaluate how they currently measure, monitor, and evaluate emissions data and climate risks and assess the resources that will be required to comply with these new disclosure requirements. In addition to financial penalties that may apply for noncompliance, the increased transparency and public scrutiny that will go along with this level of disclosure are strong motivators for immediate action.

Endnotes

[1] On the same day Governor Newsom signed SB 253 and SB 261, he vetoed another climate-related bill. SB 390 would have imposed liability on anyone who knowingly certified, issued, or maintained a voluntary registered carbon offset that was not quantifiable, real, and additional.

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