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California's New Climate Disclosure Requirements: A Work in Progress

In groundbreaking legislation, California continues to lead the nation in climate change regulation by enacting the bulk of the California Climate Accountability Package – an unprecedented climate disclosure mandate for public and private companies that will take effect as early as 2026. The Climate Accountability Package is comprised of the Climate Corporate Data Accountability Act ("CCDAA" or "SB 253"), the Climate-Related Financial Risk Act ("CRFRA" or "SB 261"), and Senate Bill 252 (a proposed bill to require California's public pension funds, CalPERS and CalSTRS, to divest their holdings in fossil fuel companies). The CCDA and CRFRA are the first-of-their-kind in the U.S. and are broader, in terms of both entities regulated and information required to be disclosed, than the Securities and Exchange Commission's proposed climate rules that are expected, based on the SEC's Spring 2023 regulatory agenda, to be finalized by the end of 2023.

Mandating climate disclosures is a complicated task and will impose significant burdens on the reporting companies. California Governor Gavin Newsom has recognized these complexities and proposes additional legislative and administrative fixes to address the reporting burdens. This Client Alert provides an overview of the CCDAA and CRFRA, the concerns voiced by Governor Newsom about their implementation, and how companies doing business in California can take steps to prepare for their duties under these new laws.

THE CLIMATE CORPORATE DATA ACCOUNTABILITY ACT (SB 253)

Overview. The CCDAA requires public and private companies with more than $1 billion in annual revenues (based on total revenue in the prior fiscal year) that do business in the state of California to file annual reports publicly disclosing their direct ("Scope 1"), indirect ("Scope 2"), and supply chain ("Scope 3") greenhouse gas ("GHG") emissions. For example:

- Scope 1 emissions are direct GHG emissions from sources controlled or owned by a reporting entity such as emissions associated with fuel combustion in furnaces, boilers, or vehicles.

- Scope 2 emissions are indirect GHG emissions that are associated with the organizations' energy use but do not occur at a reporting entity's facilities, such as the purchase of electricity, steam, or heat/cooling.
- Scope 3 emissions are indirect GHG emissions from all upstream and downstream sources of a reporting entity's value chain not encompassed by Scope 1 or Scope 2. Examples include GHG emissions associated with purchased goods and services, transportation and distribution, processing and sale of products, and investments.

Under the CCDAA, the California Air Resources Board ("CARB") must promulgate implementing regulations by January 1, 2025 and reporting for Scope 1 and Scope 2 emissions may begin as early as January 1, 2026 with Scope 3 emissions reporting starting as early as one year later on January 1, 2027. Reporting entities will be required to account for acquisitions, divestments, mergers, and other corporate structural changes that can affect GHGs and verify all reported emissions by an independent assurance provider at a limited assurance level beginning in 2026 and at a reasonable assurance level beginning in 2030.

Penalties. Reporting entities can only be subject to penalties for failing to report Scope 3 emissions through 2030. Starting in 2030, CARB will be authorized to impose administrative penalties up to $500,000 per year on a reporting entity for violating the reporting requirements, including failing to file or filing reports late. In all years subsequent to 2030, an entity cannot be subject to penalties based on Scope 3 disclosures as long as they were made in good faith and with a reasonable basis.

Implementation Concerns. In a letter accompanying the signing of SB 253, Governor Gavin Newsom stated that "the implementation deadlines in [CCDAA] are likely infeasible, and the reporting protocol specified could result in inconsistent reporting across businesses subject to the measure." He directed his "Administration to work with [SB253's] author and the Legislature next year to address these issues." In addition, Governor Newsom penned further concerns about the overall financial impact of the CCDAA's requirements on business. He instructed CARB to "closely monitor the cost impacts as it implements [CCDAA] and make recommendations to streamline the program."

THE CLIMATE-RELATED FINANCIAL RISK ACT (SB 261)

Overview. The CRFRA requires each public and private company with more than $500 million in annual revenues (based on total revenue in the prior fiscal year) that do business in the state of California to prepare and post to their website biennial reports disclosing: (1) climate-related financial risk and (2) measures adopted to reduce and adapt to that risk. The first reports are due on or before January 1, 2026. Reports that contain a description of an entity's GHG emissions, or voluntary mitigation of those emissions, must be verified by an independent third-party.

Penalties. CARB must promulgate regulations under the CRFRA, including rules that (a) establish a fee for administering the reporting program and (b) authorize administrative penalties of up to $50,000 per year for a noncompliant reporting entity, with actual penalties reflective of a company's past and present compliance and any good faith measures taken.

Implementation Concerns. The CRFRA does not set a date by which CARB must implement regulations, but based on the January 1, 2026 compliance date for the first biannual report, the regulations must be final before 2026. In a letter to the California State Senate, Governor Newsom expressed concern over the Board's ability to "adequately carry out the requirements" of the CRFRA before January 1, 2026 and directed that his Administration "work with [SB 261's] author and the Legislature next year to address this issue." Similar to the CCDAA, the Governor expressed additional concerns about the overall financial impact of the Act's requirements on business. He instructed CARB to "closely monitor the cost impacts as it implements [CRFRA] and make recommendations to streamline the program."

HOW COMPANIES SHOULD PLAN FOR THE ROAD AHEAD

During the rulemaking for the CCDAA, CARB must consult with the California Attorney General, investors, government stakeholders, stakeholders representing consumer and environmental justice interests, and reporting entities that have demonstrated leadership in full-scope greenhouse gas emissions accounting and public disclosure and greenhouse gas emissions reductions. Coupled with the Governor's concerns about the CCDAA's burden to business entities, the potential exists for implementation of the CCDAA and CRFRA to be narrowed in scope through the rulemaking process. Accordingly, industry input during the rulemaking process will be instrumental in defining the scope of CCDAA and CRFRA requirements. For example, CARB must promulgate implementing regulations for both the CCDAA and CRFRA and can either draft a tailored definition of doing business in the State or adopt an existing definition from elsewhere in California law. For another example, California tax regulations extend beyond those companies which are incorporated in the State to include any entity that "Engage[s] in any transaction for the purpose of financial gain within California."

Regardless of how applicability is defined, the scope of impacted companies may be even broader than those "doing business" in California with revenues exceeding the CCDA or CRFRA thresholds. For example, companies with annual revenues below either reporting threshold may still be responsible for reporting climate risks for its parent company's report under the CRFRA or reporting GHG emissions for other entities' Scope 3 reporting under the CCDAA. Thus, regardless of whether a company believes it will be required to report under either the CCDAA or the CRFRA, planning and engagement with CARB's regulatory processes can and should start now.

***King & Spalding LLP** has one of the nation's largest environmental and corporate governance groups dedicated to assisting clients with all aspects of their environment and social governance requirements. With three offices in California, the firm is closely involved in the state's regulatory and agency rulemaking proceedings. We can also assist with creating, implementing and auditing sustainable corporate ESG programs. If you have any questions about this Client Alert, please contact any of the authors listed above.*