California's not waiting for the SEC's climate disclosure rules

October 2023 (updated)

This publication has also been distributed under the title "*California climate disclosure laws will have global impact.*"

California is primed to lead the way in requiring companies to disclose their climate risk by setting the bar on TCFD-aligned disclosure, filling in the gaps from proposed SEC rules, and providing a blueprint for other US states to drive disclosure from non-SEC regulated entities.

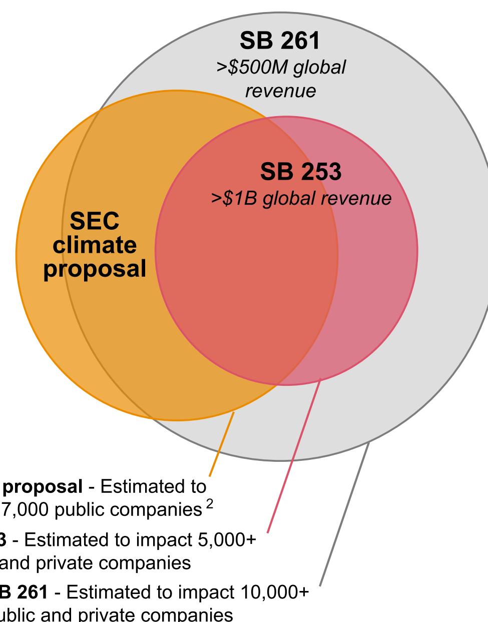
California Senate Bill No. 261, Fact Sheet, May 2023

This *In the loop* was updated in October 2023 to reflect that the California Governor signed the bills into law on October 7, 2023.

In the last days of its legislative session that ended September 14, 2023, the California Legislature approved two landmark climate disclosure bills that are poised to change the landscape of climate reporting in the United States. On October 7, 2023 the bills were signed into law by California Governor Gavin Newsom. Over 10,000 US companies — including both public and private companies as well as subsidiaries of non-US headquartered companies — will be subject to the climate disclosure requirements in the near term.

The bills require (1) greenhouse gas (GHG) emissions reporting in compliance with the Greenhouse Gas Protocol (GHG Protocol) and (2) climate-related financial risk reporting in line with the recommendations of the Task Force on Climate-Related Financial Disclosures (TCFD).[1] Both the GHG Protocol and TCFD requirements should be familiar to companies given their reference in the Securities and Exchange Commission's climate disclosure proposal, the European Sustainability Reporting Standards (ESRS), and IFRS® Sustainability Disclosure Standards. The number of entities in scope of these bills, however, goes well beyond that of the SEC's climate disclosure proposal because the requirements apply to both public and private companies that meet certain revenue thresholds and that are "doing business" in California.

The bills are brief — only a few pages each — and lack answers to some questions regarding how and when to apply the requirements. In the case of the GHG disclosures, the California Air Resources Board (CARB) is required to adopt regulations prior to January 1, 2025 which may provide more detailed application guidance. Given that the bills apply to fiscal 2025 information, however, we recommend that companies evaluate applicability and reporting requirements based on what is known now, to prepare for what may be a company's first foray into mandatory climate-related disclosures.



SEC climate proposal - Estimated to impact about 7,000 public companies[2]
SB 253 - Estimated to impact 5,000+ public and private companies
SB 261 - Estimated to impact 10,000+ public and private companies

[1] Senate Bill (SB) 253, Climate Corporate Data Accountability Act and SB 261, Greenhouse gases: climate-related financial risk.
[2] Securities and Exchange Commission, Proposed rule, The Enhancement and Standardization of Climate-Related Disclosures for Investors, page 295.

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	SB 253 — Climate Corporate Data Accountability Act	SB 261 — Greenhouse gases: climate-related financial risk
Primary disclosure topic	Scope 1, scope 2, and scope 3 greenhouse gas emissions	(1) Climate-related financial risks and (2) the measures a company has adopted to reduce and adapt to such risks
Framework	GHG Protocol	TCFD
Scope	Business entities with annual revenue over $1 billion that do business in California	Business entities with annual revenue over $500 million that do business in California
Exemptions	None specified	Insurance companies
Where filed	Publicly available digital platform	Publicly available on the company's website
Assurance	Yes, phased assurance requirements beginning with limited assurance	No
Compliance date	Annual reporting of scope 1 and scope 2 in 2026 (on prior fiscal year information); scope 3 starting in 2027	On or before January 1, 2026 and biennially thereafter

Who would be subject to the new laws?

The bills apply to what SB 253 refers to as a "reporting entity" and SB 261 refers to as a "covered entity," although other than a difference in the applicable revenue threshold, the definitions are the same.

SB 253

"Reporting entity" means a 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 one billion dollars ($1,000,000,000) and that does business in California.[3]

SB 261

"Covered entity" means 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 five hundred million United States dollars ($500,000,000) and that does business in California.[4]

These definitions do not make an exception based on the ultimate parent of the business entity — meaning that US subsidiaries of non-US companies that meet the criteria would be in scope.

Under both definitions, applicability will be measured based on the entity's revenue for the prior fiscal year. And, the revenue thresholds are not based just on revenue generated in California. Instead, an entity would need to consider its total annual

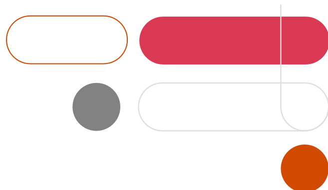
[3] SB 253, Section 2, proposed Section 38532(b)(2) to the California Health and Safety Code.
[4] SB 261, Section 2, proposed Section 38533(a)(2) to the California Health and Safety Code.

revenue, regardless of where the revenue was generated (including revenue generated outside the United States). Further, absent additional clarification, we believe that revenue should be calculated in accordance with US GAAP (or the IFRS Accounting Standards, as applicable) as reported in the annual financial statements.

We know that consistent, comparable, and reliable emissions data at scale is necessary to fully assess the global economy's risk exposure and to navigate the path to a net-zero future.[8]

Letter from 15 large corporations to the California State Assembly Appropriations Committee in support of SB 253

August 14, 2023



"Doing business" in California

A company that exceeds the revenue threshold(s) would next need to assess whether it is "doing business" in California. Although this term is not defined in the bills, it is defined in California's existing tax code, which was referenced in legislative meeting materials.[5] The California Franchise Tax Board considers a company to be "doing business" if it meets any of the following:

- Engages in any transaction for the purpose of financial gain within California,
- Organized or commercially domiciled in California, or
- California sales, property, or payroll that exceed specified amounts, which are adjusted annually.[6]

A company may need to closely assess whether it "engages in transactions for purposes of financial gain within California," as we believe this may be interpreted broadly. In addition, the specified sales, property, and payroll metrics are relatively low; in 2022, they were just over $690,000 for sales, and just under $70,000 for property and payroll.[7]

Further, the definition of sales within the California Revenue and Taxation Code is expansive. It states, in part, that sales represent:

> The gross amounts realized … on the sale or exchange of property, the performance of services, or the use of property or capital (including rents, royalties, interest, and dividends) in a transaction that produces business income, in which the income, gain, or loss, is recognized (or would be recognized if the transaction were in the United States) under the Internal Revenue Code.[8]

These definitions have some additional complexity and we recommend companies consult with their tax and legal advisors in assessing whether they meet these criteria.

Consolidated reporting

A subsidiary that meets the criteria for reporting is not required to prepare its climate-related financial risk report under SB 261 separately if its parent company prepares a consolidated report. SB 253 does not include comparable language regarding an exemption if a subsidiary is included in a parent's consolidated greenhouse gas emissions report, although this may be clarified by the state board tasked with adopting these regulations.

Exemptions

Insurance companies (i.e., business entities subject to regulation by the Department of Insurance) are fully exempt from the requirements of SB 261 because they are already required to report under the TCFD. In 2022, the National Association of Insurance Commissioners, which includes California's Insurance Commissioner, adopted a new standard for insurance companies to report their climate-related risks

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[5] Most recently included in the September 2023 SB 253 senate floor analysis.
[6] California Revenue and Taxation Code (CRTC), Section 23101.
[7] State of California Franchise Tax Board, Doing business in California, accessed on September 13, 2023.
[8] CRTC, Section 25120(f).
[9] Letter to California State Assembly Appropriations Committee.

in alignment with the TCFD framework. Importantly, however, insurance companies are not exempt from the emissions disclosure requirements in SB 253.

In addition, SB 253 specifies that its disclosures will satisfy current reporting requirements that apply to a number of California electricity generators, industrial facilities, fuel suppliers, and electricity importers under Assembly Bill 32, the Global Warming Solutions Act of 2006.

Timeline, as proposed

2026

First TCFD report by January 1

2025 scope 1 and scope 2 GHG report with third-party limited assurance

Determination of scope 3 limited assurance requirement

2027

2026 scope 3 GHG report

2030

Reasonable assurance on scope 1 and scope 2 GHG

What are the disclosure requirements?

The following is an overview of the two bills, which create new sections within California's Health and Safety Code. While several amendments were made during the legislative process, the foundational disclosures have remained relatively consistent since the bills were proposed in January 2023.

GHG emissions reporting

SB 253, *Climate Corporate Data Accountability Act*, targets GHG emissions reporting and requires the disclosure of scope 1, scope 2, and scope 3 emissions in compliance with the GHG Protocol. Although the original bill would have required reporting of both direct and indirect emissions in the first year of reporting, the final bill phases the reporting of scope 3 emissions, providing for a one year deferral.

	Scope 1 and scope 2	Scope 3
Initial year of reporting	2026	2027
Due date	To be determined by CARB	180 days after scope 1 and scope 2
Period covered	Prior fiscal year (2025)	Prior fiscal year (2026)
Limited assurance	2025 information (filed in 2026)	Date to be determined by CARB in 2026
Reasonable assurance	2029 information (filed in 2030)	Not addressed

As summarized in the table, initial reporting will begin in 2026, covering prior year scope 1 and scope 2 emissions (with scope 3 emissions added a year later), although the logistics of how and when the information is to be published — as well as the exact due date in 2026 — will be determined by CARB and included in regulations adopted on or prior to January 1, 2025. The bill also specifies that scope 3 reporting will not be due until 180 days after scope 1 and scope 2 information is publicly disclosed.

The bill also requires independent third-party assurance over a company's GHG emissions reporting, starting with limited assurance (a review) and moving to reasonable assurance (an audit) in subsequent periods. The bill specifies the qualifications for the third-party assurance provider; these qualifications mirror those included in the proposed SEC rule.

The regulations to be adopted by CARB may provide additional clarity on some of the provisions in the bill.

Climate-related financial risk reporting

SB 261 encompasses broad reporting of climate-related financial risk prepared in accordance with the recommendations in the TCFD framework, which includes eleven recommended disclosures within four core pillars: governance, strategy, risk management, and metrics and targets.[10] Although referred to as "recommendations," the California bill mandates these disclosures for companies that are in scope.

Governance	Strategy	Risk management	Metrics and targets
a) Describe the board's oversight of climate-related risks and opportunities. b) Describe management's role in assessing and managing climate-related risks and opportunities.	a) Describe the climate-related risks and opportunities the organization has identified over the short, medium, and long term. b) Describe the impact of climate-related risks and opportunities on the organization's businesses, strategy, and financial planning. c) Describe the resilience of the organization's strategy, taking into consideration different climate-related scenarios, including a 2°C or lower scenario.	a) Describe the organization's processes for identifying and assessing climate-related risks. b) Describe the organization's processes for managing climate-related risks. c) Describe how processes for identifying, assessing, and managing climate-related risks are integrated into the organization's overall risk management.	a) Disclose the metrics used by the organization to assess climate-related risks and opportunities in line with its strategy and risk management process. b) Disclose scope 1, scope 2, and, if appropriate, scope 3 greenhouse gas (GHG) emissions, and the related risks. c) Describe the targets used by the organization to manage climate-related risks and opportunities and performance against targets.

SB 261 also requires additional disclosures related to the measures a company has adopted to reduce and adapt to the disclosed climate-related financial risks.

The TCFD disclosures under SB 261 include metrics related to greenhouse gases, but the nature of the disclosures and assurance requirements differ. Each bill requires scope 1 and scope 2 emissions, but while the TCFD, which is the basis for the SB 261 requirements, "strongly encourages" the disclosure of scope 3 emissions, SB 253 requires it. In addition, greenhouse gas metrics reported under SB 261 will not be subject to assurance requirements.

Timing

SB 261 requires a company to make its report publicly available on its website by January 1, 2026 and biennially thereafter, although the bill does not specify the "as of" date.

The bill also provides that companies unable to fully comply with the TCFD requirements may complete the disclosures to the best of their ability and provide a detailed explanation of any reporting gaps and the steps they will take to prepare complete disclosures. There is no similar relief, however, for the requirement to disclose the company's measures to reduce and adapt to climate-related financial risks.

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[10] Task Force on Climate-related Financial Disclosures Implementing the Recommendations of the Task Force on Climate-related Financial Disclosures, published October 2021, page 15.

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.

SB 253 Section 1(f)

Interoperability

With the proliferation of sustainability reporting standards, the concept of interoperability (i.e., the ability to leverage disclosures prepared under one framework to satisfy the requirements of another framework) has garnered much attention and is a common theme in public feedback regarding proposed rules.

In this spirit, California lawmakers hope to ease the administrative burden on preparers by allowing a company to satisfy its reporting requirements under the two bills by leveraging disclosures prepared to meet other national and international reporting requirements as long as those reports meet the requirements of the bills. In addition, SB 261 specifies that its requirements may be satisfied through voluntary reporting in accordance with other national and international reporting requirements, including reports prepared in compliance with the IFRS Sustainability Disclosure Standards.

Further, in the discussion leading up to the final California Senate vote on SB 261, the bill's author committed to consider a "clean-up component" that will "create space for pathways of reporting that take into account other climate risk reporting work being done at the federal level … as well as some other states and local governments." This suggests that there may follow-on legislation allowing additional interoperability.

Interaction with the "big three" frameworks

While the commitment to interoperability is intended to create efficiency, SB 253 clarifies that leveraging another report is only permitted "as long as those reports satisfy all of the requirements of this section."[11] It is unclear, however, if reporting in accordance with the "big three" frameworks would satisfy SB 253's requirements because none of them fully comply with the GHG Protocol. Even the IFRS Sustainability Disclosure Standards — which SB 261 touts as compliant with that bill — do not meet all of the requirements of SB 253 (because the ISSB standards do not require both location-based and market-based disclosures for scope 2 emissions, however, both are required by the GHG Protocol). There may be additional clarification when CARB creates the regulations. Otherwise, for both SB 253 and SB 261 — which includes similar language — additional analysis will be needed to determine which other frameworks meet the requirements.

Monitoring

Both bills direct CARB to identify third parties to monitor company disclosures by:

SB 253

Engaging with "the University of California, the California State University, a national laboratory, or other equivalent academic institution" on or before July 1, 2027, to evaluate, and report publicly on, the disclosures in the context of state greenhouse gas emissions reduction and climate goals.[12]

SB 261

Contracting with a nonprofit climate reporting organization operating in the United States and experienced with climate-related financial risk disclosures by companies operating in California.[13] Such entity will review a sample of the TCFD disclosures by industry and prepare a biennial public report with specified elements, including the identification of inadequate or insufficient reports.

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[11] SB 253.
[12] Ibid.
[13] SB 261.

The bills also authorize CARB to establish penalties for nonfiling, late filing, or other compliance failures, although the two bills have different thresholds:

- SB 253: The penalty is not to exceed $500,000 in any year
- SB 261: The penalty is not to exceed $50,000 in any year

In both cases, the amount of penalty will take into account the company's history of compliance and whether it makes a "good faith" effort to comply. In addition, the final bill provides a safe harbor for scope 3 disclosures if they are "made with a reasonable basis and disclosed in good faith;" until 2030, penalties can only be assessed for nonfiling of scope 3 emissions.[14]

What's next?

Both bills were approved by the California State Assembly and Senate in rapid succession in the final days before the September 14, 2023 end of the legislative session and signed into law by Governor Gavin Newsom on October 7, 2023. The governor's approvals of the bills were accompanied by signing messages indicating that he plans to work with the California Legislature next year to address certain concerns including the implementation deadlines.[15] Given the scope of the requirements and uncertainty around any changes, however, we recommend companies start to prepare now.

Although some companies will be subject to the requirements of CSRD in 2024, these California bills may trigger the first sustainability reporting requirements for many — if not most — of the companies in scope (at least for now).[16] Companies potentially in scope of the California bills should start to prepare for their reporting obligations now. Prudent steps to take would include evaluating scope, understanding the requirements, and assessing how to comply. Given some of the unanswered questions, these determinations may require judgment and a company should assess the need for early involvement of its legal counsel.

In addition, it will be important to understand where these requirements align and diverge from the requirements in other frameworks to which they are subject in order to leverage systems, processes, and resources most efficiently. Our In the loop, *Navigating the ESG landscape*, provides an overview of the key differences among the "big three" frameworks, which companies may find helpful in identifying opportunities to align all of their reporting obligations. If not started already, now is the time to begin to prepare. See our In the loop, *ESG reporting: Preparing for tomorrow's rules today*, for some helpful steps that can be applied to preparing for any sustainability framework.

[14] SB 253.
[15] California Governor Gavin Newsom signing messages on SB 253 and SB 261
[16] With limited exceptions, all companies with debt or equity securities listed on EU-regulated markets will be subject to the requirements of CSRD in 2024. Exceptions to the listed company reporting requirements include "micro-undertakings." See our In the loop, Worldwide impact of CSRD - are you ready?, for further information.

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