February 22, 2023

California Senate Takes Second Shot at Corporate Climate Disclosures as Part of Proposed Climate Accountability Package

Attorneys
Michael R. Littenberg
Marc Rotter
Samantha Elliott
Katherine Donohue

On January 30, the Climate Accountability Package was introduced in the California Senate. The Package consists of three bills: the Climate Corporate Data Accountability Act (SB 253), the Climate-Related Financial Risk Act (SB 261) and the Fossil Fuel Divestment Act (SB 252). The Climate Corporate Data Accountability Act and the Climate-Related Financial Risk Act would create significant climate risk disclosure and other compliance obligations for larger companies doing business in California, which, in at least some respects, would go beyond the climate disclosure rules proposed by the Securities and Exchange Commission. The Fossil Fuel Divestment Act would limit investments by California's public pension funds in fossil fuel companies. In this Alert, we describe aspects of the three bills of the most relevance to corporates. We also compare and contrast the proposed Climate Corporate Data Accountability Act and Climate-Related Financial Risk Act to the SEC's proposed climate disclosure rules.

The bills were introduced by California Senators Scott Wiener (D-San Francisco), Lena Gonzalez (D-Long Beach) and Henry Stern (D-Los Angeles).

The Climate Corporate Data Accountability Act (SB 253)

SB 253 comes less than six months after the Climate Corporate Accountability Act (SB 260) failed to pass the California Assembly. The disclosure requirements under the current bill and the bill that failed to pass last session are almost identical. However, Senator Wiener said that he is more confident of succeeding with this bill: "Our coalition is even bigger and stronger this year, and we know that we can get this important legislation passed."

Subject Companies

The Act would apply to U.S.-organized entities that do business in California and have total annual revenues in excess of $1 billion. According to Politico, approximately 5,400 companies doing business in California would be required to make disclosures under the Act as proposed.

Reporting Requirements

The Act would require the California State Air Resources Board, on or before January 1, 2025, to develop and adopt regulations requiring subject companies to publicly disclose their scope 1, scope 2 and scope 3 greenhouse gas emissions to an emissions registry (which is further discussed below).

The definitions of scope 1, 2 and 3 emissions are consistent with the definitions used by the Greenhouse Gas Protocol.

- **"Scope 1 emissions"** would mean all direct greenhouse gas emissions that stem from sources that a reporting entity owns or directly controls, regardless of location, including, but not limited to, fuel combustion activities.
- **"Scope 2 emissions"** would mean indirect greenhouse gas emissions from electricity purchased and used by a reporting entity, regardless of location.
- **"Scope 3 emissions"** would mean indirect greenhouse gas emissions, other than scope 2 emissions, from activities of a reporting entity that stem from sources that the reporting entity does not own or directly control

ATTORNEY ADVERTISING

and may include, but are not limited to, emissions associated with the reporting entity's supply chain, business travel, employee commutes, procurement, waste, and water usage, regardless of location.

When calculating emissions, subject companies would need to use the Greenhouse Gas Protocol Corporate Accounting and Reporting Standard and the Greenhouse Gas Protocol Corporate Value Chain (Scope 3) Accounting and Reporting Standard.

Under the Act, the implementing regulations adopted by the State Air Resources Board would be required to be structured to streamline and maximize reporting entities' ability to use reports under the Act to meet the requirements of other leading climate disclosure programs and standards.

Third Party Assurance

Emissions disclosures would be required to be independently verified by the emissions registry or a third-party auditor approved by the State Air Resources Board. The Act would require the State Air Resources Board to establish auditor qualifications and an approval process for auditors.

Timing

Annual reporting would commence in 2026 (on or by a date to be determined by the State Air Resources Board) for the prior calendar year.

The Act acknowledges the lag time in obtaining scope 3 emissions data. The regulations adopted by the State Air Resources Board may provide up to an additional 180 days to make scope 3 emissions disclosures. However, as noted in many comment letters submitted to the SEC in connection with its proposed rules, that may not be a long enough time period for many reporting companies.

Emissions Registry

The emissions registry would be a nonprofit registry organization contracted by the State Air Resources Board. The emissions registry would be required to create a publicly available digital platform to house all disclosures submitted by subject companies. The registry would be required to enable users to review individual reporting entity disclosures. The registry also would be required to enable users to analyze underlying data elements aggregated in a variety of ways, such as multi-year data.

Enforcement of the Act

The Act would authorize the California Attorney General to bring civil actions against subject companies and seek civil penalties for violations of the Act.

The Climate-Related Financial Risk Act (SB 261)

Subject Companies

This Act generally would apply to U.S.-organized entities that do business in California and have total annual revenues that exceed $500 million. Companies subject to regulation by the California Department of Insurance or that are in the business of insurance in any other state would be excluded.

ATTORNEY ADVERTISING

The financial threshold is lower than that under the Climate Corporate Data Accountability Act. Therefore, if passed with the current threshold, many companies that are not required to report on greenhouse gas emissions under the Climate Corporate Data Accountability Act would have obligations under the Climate-Related Financial Risk Act.

Reporting Requirements

Subject companies would be required to annually prepare a climate-related financial risk report. The first report would be required to be prepared by December 31, 2024. The report would be required to disclose the following:

- The company's climate-related financial risk in accordance with the recommended framework and disclosures published by the Task Force on Climate-related Financial Disclosures.

  "Climate-related financial risk" would mean material risk of harm to immediate and long-term financial outcomes due to physical and transition risks, including, but not limited to, risks to corporate operations, 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.

- The measures adopted to reduce and adapt to the disclosed climate-related financial risks.

Reports would be required to be submitted to the State Air Resources Board and made available on the company's website. Subject companies also would need to submit a statement to the California Secretary of State affirming that the report discloses climate-related financial risk in accordance with the requirements of the Act.

The Fossil Fuel Divestment Act (SB 252)

The Fossil Fuel Divestment Act would expand upon existing California law. Current legislation generally prohibits the boards of the California Public Employees' Retirement System and the California State Teachers' Retirement System from making new investments or renewing existing investments of public employee retirement funds in thermal coal companies and requires the boards to liquidate preexisting investments in these companies.

The Fossil Fuel Divestment Act would require the state's two major public pension funds—the California Public Employees' Retirement System and the California State Teachers' Retirement System—to divest from the 200 largest publicly traded fossil fuel companies, as established by the carbon content in the companies' proven oil, gas and coal reserves. Divestment would be required by July 1, 2030, subject to limited exceptions.

SB 252 is another bite at the apple after a similar bill (SB 1173) failed to progress through the California Assembly in 2022. SB 252 is part of a larger wave of state divestment, anti-boycott, and anti-ESG legislation that has been adopted and proposed. Ropes & Gray is actively tracking these developments nationally. State-by-state information can be found on our state tracker here.

A Comparison to the SEC's Proposed Climate Disclosure Rules

On March 21, 2022, the SEC issued proposed rules that would require SEC registrants to disclose a significant amount of information regarding climate-related financial risks. The proposed SEC rules are described in detail in our earlier Alert here. The SEC is widely expected to adopt final rules in the next few months. In at least some respects, the final rules will be scaled back from the 2022 proposed rules. Areas of particular contention that overlap with the proposed Climate Corporate Data Accountability Act are scope 3 emissions reporting and the third-party assurance requirement.

Although the SEC's proposed rules and the Climate Corporate Data Accountability Act and Climate-Related Financial Risk Act would all require public disclosure regarding climate matters, the California proposals, in some respects, go

ATTORNEY ADVERTISING

further. Furthermore, because the California Acts leave much of the detail to future implementing regulations, California presumably would seek to address in its regulations what it perceives as shortcomings in the final SEC rules.

- As a threshold matter, the SEC's proposed rules would only apply to SEC registrants (i.e., public companies or companies that are offering securities in SEC-registered transactions). In contrast, the California Acts would apply to both public and private companies doing business in California that meet the requisite revenue thresholds.
- The SEC's proposed rules would not necessarily require a subject registrant to disclose scope 3 emissions. Under the proposed SEC rules, a registrant only would be required to report scope 3 emissions if they are material or if the registrant has set reduction goals that include scope 3 emissions. In contrast, the Climate Corporate Data Accountability Act would require all reporting entities to disclose scope 3 emissions.
- While both the SEC's proposal and the Climate Corporate Data Accountability Act draw from the Greenhouse Gas Protocol, the final rules adopted by the SEC and the implementing regulations adopted by the State Air Resources Board may be different or could diverge over time. This would result in companies needing to make somewhat different emissions disclosures for SEC and California purposes.
- Similarly, although the SEC's proposal draws from the TCFD, it does not incorporate the TCFD recommendations wholesale. Therefore, over time, the disclosures required by the Climate-Related Financial Risk Act may diverge from those required by SEC rules.

Although beyond the scope of this Alert, note that additional climate disclosure and risk management requirements will apply to many U.S.-based companies. For a discussion of two of these requirements, see our recent Alerts on the proposed Federal Acquisition Regulation rules for government contractors here and the recently adopted EU Corporate Sustainability Reporting Directive here.

About Our ESG, CSR and Business and Human Rights Compliance Practice

Ropes & Gray has a leading ESG, CSR and business and human rights compliance practice. We offer clients a comprehensive approach in these subject areas through a global team with members in the United States, Europe and Asia. In addition, senior members of the practice have advised on these matters for more than 30 years, enabling us to provide a long-term perspective that few firms can match.

For further information on the practice, click here.

This alert should not be construed as legal advice or a legal opinion on any specific facts or circumstances. This alert is not intended to create, and receipt of it does not constitute, a lawyer-client relationship. The contents are intended for general informational purposes only, and you are urged to consult your attorney concerning any particular situation and any specific legal question you may have. © 2022 Ropes & Gray LLP

ATTORNEY ADVERTISING