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Kirkland Alert

California Climate Disclosure Bills Would Have Far-Reaching Implications for Companies Doing Business in the State

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On January 30, 2023, two bills containing broad climate-related disclosure obligations for large companies were concurrently introduced to the California Senate. The bills — the Climate Corporate Data Accountability Act ("CCDAA") (SB 253) and the Climate-Related Financial Risk Act ("CFRA") (SB 261) (together, the "California Bills") — would apply to certain large U.S. companies that "do business in California."

The CCDAA would require subject companies to publicly disclose and verify their Scopes 1, 2 and 3 greenhouse gas (GHG) emissions. The CFRA would require subject companies to prepare and publicly disclose a climate-related risk report in line with the recommendations of the Task Force on Climate-related Financial Disclosures (TCFD, the "TCFD Recommendations"). Because the TCFD Recommendations call for reporting of Scope 1 and 2 emissions and material Scope 3 emissions (and encourage broader Scope 3 emissions reporting), the CCDAA is largely duplicative of the CFRA, though its Scope 3 emissions disclosure requirement is arguably broader.

The California Bills differ slightly in the scope of companies they would affect, and both propose reporting obligations that differ in important ways from the SEC's proposed rules to enhance and standardize climate-related disclosure for investors (the "Proposed SEC Rule").[1] In this *Alert*, we discuss the California Bills' provisions, how they compare to the Proposed SEC Rule and potential implications for entities with business ties to California.

CCDAA — Emissions Reporting

The CCDAA would require U.S.-organized entities[2] that "do business in California" and have total annual revenues in excess of $1 billion to calculate, independently verify[3] and publicly disclose their Scopes 1, 2 and 3 emissions to a state-administered registry annually.

The CCDAA would task the California State Air Resources Board (CARB) with developing, on or before January 1, 2025, regulations to support the bill's disclosure obligations in consultation with state officials, investors, stakeholders from consumer and environmental justice groups, and companies already voluntarily reporting emissions. The regulations would have to require companies 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 when reporting. The CCDAA specifies that Scopes 1 and 2 emissions reporting would begin "starting in 2026 on or by a date to be determined by [CARB]" for calendar year 2025. The deadline for reporting Scope 3 emissions would be 180 days later.

The CCDAA is intended to provide Californians with detailed data on emissions generated by major corporate players in the state, many of whom are not currently subject to GHG emissions reporting laws.[4] The CCDAA is nearly identical to the California Corporate Climate Accountability Act, which was introduced in January 2021 and failed to pass the California Assembly during the 2022 legislative session.[5]

CFRA — TCFD-Aligned Reporting

The CFRA would require U.S.-organized entities[6] that "do business in California" and have total annual revenues in excess of $500 million to prepare, beginning no later than the end of 2024, an annual report disclosing (1) the entity's climate-related financial risk[7] in line with the TCFD Recommendations[8] and (2) measures adopted to reduce and adapt to those risks.[9] It is unclear whether "in line with the TCFD Recommendations" would be interpreted to mean in line *with each* of the TCFD's Recommendations consistent with the latest TCFD guidance, but if interpreted that way, the CFRA would go well beyond current practice for most companies. As detailed in the 2022 TCFD Status Report, based on a review of TCFD reports for 1,400 large global companies, 80% disclosed in line with at least one of the TCFD Recommendations, but only 4% disclosed in line with all of the TCFD Recommendations.

The CFRA-required disclosures would have to be submitted to CARB and made publicly available on organizations' websites, and subject entities would also be required to issue a statement to the California Secretary of State affirming that the report properly discloses risks in accordance with the CFRA's requirements.

"Doing Business in California"

Neither the CCDAA nor the CFRA define what it means to "do business in California," but the California Tax Code uses similar language and defines "doing business" as actively engaging in any transaction for the purpose of financial gain within California, being organized or commercially domiciled in California, or having California sales, property or payroll exceed specified amounts. One of the CCDAA's sponsors, Rep. Scott Wiener (D-San Francisco), has indicated that the CCDAA's revenue threshold would capture approximately 5,400 entities; the CFRA, with its lower revenue threshold, would presumably capture even more.

The California Bills do not explicitly address whether asset managers or other financial institutions with offices in or marketing to investors in California are within the scope of the bills, so it remains to be seen how the California Bills will be applied to such entities; however, based on the California Bills' text, it seems possible that such entities could be considered within scope if they meet the revenue thresholds.[10]

Comparison with Proposed SEC Rule

The California Bills' reporting obligations in some respects would go beyond the Proposed SEC Rule, which has received over 15,000 comments and is expected to be finalized soon, albeit potentially in a different form than its proposal.[11] Most notably, the California Bills would apply to both public and private entities meeting each bill's annual revenue threshold, while the Proposed SEC Rule would apply only to publicly listed companies.

CCDAA

With respect to **emissions disclosures**, several aspects of the CCDAA differ from the current version of the Proposed SEC Rule, including:

- **Mandatory Scope 3 disclosure**: The CCDAA would require mandatory disclosure of Scope 3 emissions for all reporting entities, while the Proposed SEC Rule would require Scope 3 disclosure only when Scope 3 emissions are determined to be "material" or if the company has set a GHG emissions reduction target or goal that includes Scope 3 emissions. The Proposed SEC Rule's Scope 3 requirement has been the subject of significant debate, so it is unclear what form the final rule will take on this point. Also of note, unlike the current Proposed SEC Rule, the CCDAA does not include any sort of "safe harbor" for Scope 3 disclosures, and in fact authorizes the California Attorney General to bring a civil action seeking civil penalties against reporting entities found to violate the bill's reporting requirements.

- **Independent verification for all emissions**: The CCDAA would require "independent verification" by a CARB-approved verifier for Scopes 1, 2 and 3 emissions. It does not specify the level of assurance required; CARB is expected to develop more detailed regulations. Although Scope 3 coverage remains uncertain (see above), the Proposed SEC Rule would require independent attestation of Scopes 1 and 2 emissions for large accelerated and accelerated filers, starting at the limited assurance level and progressing to reasonable assurance in subsequent years.
- **Organizational boundaries**: The CCDAA would require companies to disclose emissions in line with the GHG Protocol, which allows disclosing entities to set organizational boundaries using *either* an equity share or a control approach.[12] In contrast, the current version of the Proposed SEC Rule would require companies to set organizational boundaries in line with the accounting principles used in preparing their consolidated financial statements.

CFRA

With respect to **climate-related financial risk**, the CFRA appears to fully embrace the TCFD Recommendations as its disclosure requirements. As noted above, if the CFRA is interpreted to require reporting in line with each of the TCFD's Recommendations consistent with the latest TCFD guidance, it would go well beyond current practice for most companies. Further, although the SEC drew heavily on the work of the TCFD, the Proposed SEC Rule as drafted departs from the TCFD Recommendations in certain respects, including[13]:

- **Transition plans**: The current version of the Proposed SEC Rule would require disclosure of transition plans only if they have been adopted as part of an entity's climate-related risk management strategy. The TCFD has indicated that the TCFD Recommendations related to strategy "implicitly cover the key aspects of transition plans," and has said that entities should disclose transition plans if they have made GHG reduction commitments, operate in jurisdictions that have made such commitments or have agreed to meet investor expectations regarding emissions reductions.

- **Scenario analysis**: The TCFD Recommendations require organizations to conduct scenario analysis to assess their climate-related risks and opportunities. The current version of the Proposed SEC Rule would not require organizations to conduct scenario analysis; rather, it would require organizations that *have conducted* scenario analysis to disclose the parameters, assumptions, analytical choices and projected financial impacts of that analysis. Therefore, publicly listed entities fulfilling the requirements of the CFRA could have to disclose information about their scenario analysis to the SEC.
- **Climate-related opportunities**: The TCFD Recommendations require entities to consider and report climate-related opportunities in addition to risks, while the Proposed SEC Rule would make disclosure of climate-related opportunities optional.
- **Sector-specific reporting**: While the Proposed SEC Rule is sector-agnostic, the TCFD has published supplemental guidance for specific sectors such as financial institutions, energy, transportation, materials and buildings, and agriculture and forestry. Entities in sectors for which the TCFD has issued additional guidance could arguably be required to make sector-specific disclosures under the CFRA.
- **Financial statement metrics**: Assuming threshold requirements are met, the current version of the Proposed SEC Rule requires companies to provide climate-related financial metrics addressing the impact of various climate-related events and mitigation and transition expenditures on line items in the financials, together with related estimates and assumptions, in a note to the company's audited financial statements. This requirement goes beyond the TCFD Recommendations and, presumably, the CFRA, but is another area of significant debate, making it uncertain what, if any form, it will take in the final SEC rule.

Notably, the CFRA provides that, if a federal law or regulation is passed that requires an entity to disclose information that is "materially similar" to the CFRA's requirements, then a copy of the entity's relevant federal climate risk disclosure may be submitted to CARB in lieu of a California-specific report. It remains to be seen whether the final SEC rule would be determined to meet this bar.

Key Considerations

Since their introduction, both California Bills have passed through an initial review by the California Senate Environmental Quality Committee. However, it remains unclear whether either of the California Bills will be signed into law. In order to do so, the California Bills must survive multiple rounds of committee and full chamber votes in both the California Senate and Assembly and be signed by Governor Gavin Newsom before October 15, 2023. Future review and revision of the California Bills may lead to significant changes in their requirements.

If passed, the California Bills would apply to entities outside and require reporting beyond the scope of the Proposed SEC Rule, as currently drafted. Private and public companies that fall (or likely fall) within the definition of a "reporting entity" under either of the California Bills can start preparing for the possibility of enactment by taking measures such as:

- Conducting an enterprise-wide[14] GHG inventory across their Scopes 1, 2 and 3 emissions;
- Engaging with a CARB-approved verifier to understand their typical scopes of work, timing and costs, and whether they are also capable of meeting the independent attestation requirements in the Proposed SEC Rule; and
- Conducting a gap analysis against the TCFD Recommendations.

Companies that would not directly be subject to the CCDAA or CFRA but that lie within the value chains of reporting entities, if the California Bills are enacted, could be pressured to report their emissions and other climate-related information in order to help a reporting entity fulfill its disclosure obligations. Many large companies that would be subject to the California Bills' reporting obligations have supply chains or investments encompassing thousands of individual companies across multiple global jurisdictions.

Certain companies may wish to consider participating in the political process in addition to monitoring the progress of the CCDAA, the CFRA, the Proposed SEC Rule and other climate reporting legislation that could impact them. Additionally, companies should expect that if either or both of the California Bills is signed into law, they could — like the Proposed SEC Rule — be the subject of litigation that extends the period of regulatory uncertainty.

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1. We discuss the Proposed SEC Rule in our March 24, 2022, *Kirkland Alert*, "SEC Proposes New Climate Disclosure Requirements." ↩

2. This requirement captures all partnerships, corporations, limited liability companies or other businesses formed under the laws of any state or the District of Colombia, or under an act of Congress. ↩

3. Reported emissions inventories would have to be independently verified by a third-party auditor approved by the California Air Resources Board (CARB). A list of CARB-accredited verifying bodies and individual verifiers — as well as the criteria and process for accreditation — can be found here. ↩

4. Industrial sources, fuel suppliers and electricity importers are required to report their annual GHG emissions to CARB under the state's Regulation for the Mandatory Reporting of Greenhouse Gas Emissions. Those reporters subject to the California Cap-and-Trade Program are required to seek independent, third-party auditing of their emissions inventories by a CARB-approved verifier. The Act expands similar requirements to additional firms. ↩

5. The CCDAA is also similar to a New York State Senate Bill introduced in January 2023. ↩

6. The CFRA defines "covered entities" the same as the CCDAA, except that it expressly exempts insurers, likely because on April 8, 2022, the National Association of Insurance Commissioners, which includes California's Insurance Commissioner, adopted a new standard requiring insurers to report climate-related risks in line with the TCFD Recommendations. ↩

7. The CFRA defines "climate-related financial risk" as "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." ↩

8. We explore the TCFD Recommendations in our November 10, 2021, *Kirkland Alert*, "TCFD Issues New Guidance as Its Climate Reporting Framework Continues to Gain Traction." ↩

9. The second requirement is somewhat redundant, as the TCFD Recommendations include disclosure of how an organization "identifies, assesses, and manages climate-related risks." ↩

10. *Cf*. Bill Myers, "California ESG Bill Gets Closer" (Mar. 27, 2023) ("[The CCDAA] would cover nearly 5,400 companies — including private fund advisers and their portfolio companies."). During a March 15, 2023, Senate Environmental Quality Committee Hearing, Senator Stern, a sponsor of the CFRA, indicated that the intent of the CFRA is to cover alternative asset managers. ↩

11. The SEC's latest Reg-Flex agenda suggests final action in April 2023. ↩

12. Under equity share GHG accounting as defined by the GHG Protocol, companies report emissions from other entities based on their percentage ownership of that entity. Under control-based GHG accounting, companies claim the full emissions inventory of entities over which they hold either operational or financial control, between which companies are allowed to choose. ↩

13. During a March 15, 2023, Senate Environmental Quality Committee Hearing, Senator Stern, a sponsor of the CFRA, indicated that the intent of the CFRA is to fill gaps in the Proposed SEC Rule, suggesting it is meant to be broader than the Proposed SEC Rule in at least some respects. ↩

14. Companies preparing to disclose in line with the Proposed SEC Rule should be aware that they may be required to report emissions to the California Secretary of State along different organizational boundaries than those reported to the SEC. ↩

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Suggested Reading

- 30 June 2023 Kirkland Alert Supreme Court Issues Decision Overturning Affirmative Action in Higher Education

- 29 June 2023 Kirkland Alert ISSB Releases Final Global Sustainability Disclosure Standards
- 01 May 2023 Kirkland Alert EU Climate Action: Imminent Introduction of the Carbon Border Adjustment Mechanism