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California's sweeping climate disclosure laws: possible impact to asset managers

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On Oct. 7, 2023, California Governor Gavin Newsom signed into law two watershed climate bills that will require companies with significant revenue to make climate-related disclosures starting in 2026. The stated purpose of the new laws is to enhance transparency, standardize disclosures, align public investments with climate goals, and raise the standards for businesses to drive action on addressing climate change.

The new laws, known as the Climate Corporate Data Accountability Act (SB 253) and Climate-Related Financial Risk Act (SB 261) apply to essentially any large company, whether public or private, that is "doing business in California." This is a broad concept that is likely to be subject to additional legal analysis and potential clarification.

The Senate floor analysis notes that existing California law "[d]efines 'doing business'" in the state as "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: as of 2020 being $610,395, $61,040, and $61,040, respectively." (Revenue and Tax Code § 23101.) Hence, even companies with only limited business activity in California are likely to be deemed as "doing business" in the state and thus subject to these new laws.

The scope of the laws (now and following future regulations) will likely be the subject of some legal wrangling. For example, with respect to asset managers, the broad application of SB 253 and SB 261 and the requirement to disclose so-called Scope 3 emissions (described below) could mean that asset managers that exceed the laws' revenue thresholds, whether based in California or not, might need to disclose emissions data not just for their operations, but also GHG emissions information with respect to companies in which their funds hold securities. This is discussed further below.

SB 253 — Climate Corporate Data Accountability Act

SB 253 requires U.S. companies with annual revenues exceeding $1 billion and doing business in California to disclose their Scope 1 and 2 greenhouse gas (GHG) emissions data starting in 2026 and their Scope 3 GHG emissions data by 2027 (and annually thereafter). There is no minimum emissions threshold that triggers reporting duties. It is solely based on the company's revenue and whether it is "doing business" in California.

Scope 1 emissions include all direct GHG emissions that stem from sources that a company owns or directly controls, regardless of location, including fuel combustion activities. Scope 2 emissions include all indirect GHG emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a company.

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Scope 3 emissions, the most difficult to assess of the three categories, encompass all indirect upstream and downstream GHG emissions (other than Scope 2 emissions) from sources that the reporting entity does not own or directly control. These may include purchased goods and services, business travel, employee commutes, and processing and use of sold products. Consequently, covered entities will need to collect this information from third parties, even if those third parties would not be covered by the law themselves.

All disclosed emissions data must be made publicly available and should be provided in a manner that is consistent with Greenhouse Gas Protocol standards and guidance, as well as "easily understandable and accessible." SB 253 directs the California Air Resources Board (CARB) to develop and adopt regulations by Jan. 1, 2025, detailing how businesses should publicly disclose their annual GHG emissions.

Companies also must obtain, and submit to regulators, third-party assurance for their emissions reporting, at a "limited assurance" level, beginning in 2026 for Scopes 1 and 2 emissions, and at a more stringent "reasonable assurance" level in 2030. CARB is required to evaluate the feasibility of obtaining assurance for Scope 3 emissions and has been directed to establish an assurance requirement for Scope 3 emissions beginning in 2030.

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SB 253 is the first widely applicable law in the United States to require the assurance of Scope 1 and Scope 2 emissions reporting. Approximately 5,000 companies that do business in California have been identified as potentially subject to its provisions. Companies not already reporting this information will need to develop the infrastructure and processes necessary to gather and report emissions data and obtain the required GHG emissions attestation. Those not in compliance could face administrative penalties of up to $500,000 per year.

SB 261 — Climate-Related Financial Risk Act

SB 261 requires any U.S.-based company with total annual revenues exceeding $500 million and that is "doing business" in California to prepare and submit climate-related financial risk reports, in accordance with the Task Force on Climate-Related Financial Disclosures (TCFD) recommendations, as well as any measures they have adopted to mitigate and adapt to those risks.

Clearly the new laws are intended to regulate companies generally, but one interesting question is the extent to which they might apply to asset managers related to their underlying investments.

The reports must include climate-related vulnerabilities concerning their employees, supply chains, consumer demand, and shareholder value, among others. Reports must be submitted by Jan. 1, 2026, and biennially thereafter, as well as published on the company's website. Due to its lower revenue threshold, SB 261 is expected to apply to approximately 10,000 companies doing business in California.

The law defines "Climate-related financial risk" as "material risk of harm to immediate and long-term financial outcomes due to physical and transition risks." Climate-related financial risks include, but are 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."

If a company cannot provide all required disclosures in its report, it must submit a detailed explanation of any reporting gaps, describe the steps it is taking to comply, and provide complete disclosures in the future.

SB 261 imposes penalties of up to $50,000 per year for any company that "fails to make the report required by this section publicly available on its internet website or publishes an inadequate or insufficient report." However, the ultimate penalty can be impacted by the company's past and present compliance and whether the company undertook "good faith measures to comply" and "when those measures were taken."

General implications

SB 261 and SB 253 make California the first state to mandate GHG emissions and climate risk reporting from companies with significant revenues. Failure to comply with reporting obligations could create significant legal exposure for companies. Plaintiffs can also be expected to scrutinize companies' reported emissions data for any inconsistency with prior public statements.

Possible concerns for asset managers

Clearly the new laws are intended to regulate companies generally, but one interesting question is the extent to which they might apply to asset managers related to their underlying investments. For asset managers, these new laws present several legal questions. Based on their broad applicability, it seems California's intent is to cover *any* company meeting the revenue requirements regardless of industry. This makes it unlikely that any industries will fall outside the scope of these laws. The question this presents is whether asset managers will have a reporting obligation and if so will it sweep in the GHG emissions of underlying asset holdings.

As mentioned above, Scope 3 emissions reporting will entail collecting emissions data from third parties in a company's supply chain, both upstream and downstream. For asset managers, *depending upon forthcoming regulations that California still needs to issue and potential agency guidance,* this could require asset managers to make disclosures that includes information from companies in which their funds hold securities. This could be a sea change, and could at least require new infrastructure and processes necessary to effectively capture and report this data.

Next steps

It is worth noting that in his official statement when he enacted these laws, Governor Newsom expressed concerns 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." Newsom said that his administration will work with the Legislature over the next year to address these issues.

Additionally, the governor expressed concern about "the overall financial impact of [SB 253] on businesses," and has asked CARB to "closely monitor the cost impact as it implements this new bill and to make recommendations to streamline the program."

For all potentially impacted companies, including asset managers, a next step could be to engage with counsel now and continue to monitor developments around the rulemaking associated with these laws to ensure they are properly prepared to provide the required information by the laws' implementation dates.

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