The ESG Collaborative

ESG Collaborative Update

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Future Uncertain for California Climate Disclosure Laws Set to Take Effect in Two Years

In 2023, California set upon a breakneck course to be the first state to create mandatory climate disclosure legislation for businesses operating within its borders. The industry response was swift, and in four short months after the passage of the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261), a number of parties, led by the U.S. Chamber of Commerce, the California Chamber of Commerce, and the American Farm Bureau Federation, sued the California Air Resources Board (CARB), the entity charged with adopting regulations under SB 253. *Chamber of Commerce of the United States of America et al. v. California Air Res. Bd*., No. 2:24-cv-00801 (C.D. Cal. Jan. 30, 2024). The industry groups seek a declaratory judgment and permanent injunction to prevent CARB from enforcing the climate disclosure legislation set to go into effect in two years. These industry plaintiffs argue that California's newly passed climate disclosure legislation is unconstitutional because the bills compel non-commercial speech in violation of the First Amendment of the U.S. Constitution, are precluded by the Clean Air Act (CAA) and U.S. Constitution, and otherwise offend long-held principles of federalism, including the Dormant Commerce Clause.

The lawsuit is the second blow to a newly passed legislative package that was already on unsure footing. In January 2024, Governor Gavin Newsom opted to not fund both bills in the state's budget proposal. It is projected that an estimated $9 million is needed for CARB to fulfill its legislative duties and issue regulations in time for the bills' implementation deadlines. Without funding these deadlines will remain unmet. It appears that for the foreseeable future, it will be difficult to decipher whether there is any remaining political will and support for the bills. In the meantime, however, a federal court in California will be the first to grapple with the question of whether this type of legislation survives strict scrutiny review.

In the litigation over the California laws, industry groups allege that mandatory disclosures force companies to engage in coerced "controversial speech" "untethered to any commercial purpose or transaction." Compl. ¶ 6. Central to their concerns is the inherently controversial and political nature of climate change and climate-related speech, which they allege is not factual. Compl. ¶ 68. Here, the industry groups find that the laws place both economic and political pressure on private companies to align their behavior to meet the demands of reigning political forces in California. The plaintiffs' pleadings also protest the costly nature and burden of assembling and auditing the emissions data needed to substantiate the disclosures, especially in the absence of a "readily verifiable way to calculate a company's total emissions." Compl. ¶ 69. In their quest to persuade the court and refine their position, the plaintiffs use Governor Newsom's own words against him by citing his public and vocalized apprehensions for the high costs, unreasonable timelines, potential for duplicative reporting, and heavy compliance burden the new laws would impose on industry.

Constitutionally, the plaintiffs believe the laws are precluded under the Supremacy Clause since the legislation has a de facto effect of regulating national greenhouse gas (GHG) emissions, which are subject to exclusive regulation by the federal government under the CAA. The plaintiffs further argue that these laws offend the Dormant Commerce Clause because they would regulate wholly extraterritorial activity, i.e., nationwide GHG emissions, and thus interstate commerce, a province exclusive to the federal government under the Dormant Commerce Clause. In support, the plaintiffs cite legislators' expressed intent for California to engage in regulation that would have effects "not just in California, but the world." Compl. ¶ 7 (citing Assembly Comm. On Nat'l Res., Analysis of SB 261 (2023–2024 Reg. Sess.) July 7, 2023 at 6). This is an authority that states lack.

California Climate Accountability Legislation Background

On October 7, 2023, Governor Newsom signed into law SB 253 and 261, a monumental set of laws that would for the first time require companies doing business in California to participate in mandatory climate disclosures. SB 253 requires companies doing business in California and making over $1 billion (gross revenue) annually to publicly disclose their GHG emissions annually. As drafted, companies will be required to report on "Scope 1 emissions," which are direct emissions made by companies in the operation of their business through sources the company owns or directly controls; "Scope 2 emissions," which are from sources that a company does not own or directly control (i.e., purchased goods and services, company and employee travel); and "Scope 3 emissions," which are emissions that come from sources the company does not directly own or control and include both upstream (i.e., by suppliers) and downstream (i.e., by customers) activities. Complying with Scope 3 disclosures may prove to be the most daunting and burdensome for companies to report since many companies are not privy to the GHG emissions of all other upstream entities and downstream end-use customers. SB 253 is expected to cover over 5,300 companies currently doing business in California.

SB 261 requires companies doing business in California and making over $500 million (gross revenue) annually to publicly disclose information relating to the company's "climate-related financial risk[s]" and their plans to mitigate any such climate-related risks biannually. Beyond the reporting requirement, SB 261 also requires that companies post their findings related to climate-related risks on their website. SB 261 is expected to cover over 10,000 companies currently doing business in California.

Both bills' first reporting period deadlines are on January 1, 2026. Scope 3 emissions, however, are required to be publicly disclosed in 2027. Both laws enable CARB to fine companies failing to comply with the deadlines, with a maximum yearly penalty of $500,000, which can be assessed separately under each law.

Other States with Similar Climate Disclosure Legislation

It appears that SB 253 and 261 have served as a model for other states like New York,[1] Illinois and Washington,[2] which have introduced their own analogous climate disclosure laws. These pending bills closely mirror California's legislation and would also require entities with over $1 billion in annual revenue to disclose Scope 1, Scope 2, and Scope 3 GHG emissions. All three states define a reporting entity similarly and more broadly (i.e., both publicly traded and private companies) than the SEC's proposed and forthcoming climate disclosure rulemaking.

Illinois' Climate Corporate Accountability Act (HB4268) has a much more aggressive timeline than California's and would require the Secretary of State to issue rules for reporting entities by July 1, 2024.

Implications of Recent Litigation on Climate Accountability Legislation and Rulemakings

At the time of this writing, CARB had not yet filed a responsive pleading or motion in response to the plaintiffs' complaint. Assuming there are no jurisdictional deficiencies, and based upon an evaluation of the complaint, CARB has a few defenses to the First Amendment claims, particularly that GHG emissions are information that can be collected and quantified and that ultimately the state has a legitimate interest in collecting GHG emissions data so it can fully assess and understand the impact upon its population and environs. The state also has a legitimate interest in collecting this information to create policy and laws related to the rapid climate change the state is currently experiencing. Further, with other states, possibly the SEC, and other international bodies requiring similar data, the plaintiffs' unduly burdensome argument appears weak if the same data can be submitted to multiple entities.

As for the constitutional arguments, CARB could argue that because the laws only require the reporting of emissions data and do not require any affirmative changes, they are not emissions regulations. Since they are not emissions regulations, they could not possibly conflict with the CAA, so preclusion should not apply. It could also take the position that any unintended impacts outside of the state are ancillary and not the central focus of the bills' intent. As previously expressed, the same defense would be applicable for any balancing test a court would apply under the Dormant Commerce Clause – the laws are not overly burdensome when viewed appropriately in the context of the state's inherent interests and responsibilities.

It is possible that this litigation could further delay the SEC's climate disclosure rulemaking, which is scheduled to be completed later this year. Also, this recent litigation in California may cause pending legislation in other states to undergo additional legislative review and potential amendment.

Despite the ensuing litigation and regulatory uncertainty that abounds, businesses would be best served by not attempting to read the tea leaves or predict an outcome. Doing so is not even an option for multinational companies that are already faced with climate disclosure regulation in the EU. And it may prove perilous for U.S.-based companies that do not give themselves enough time to purchase and create the infrastructure needed to develop a GHG inventory. A stop-and-start approach is not suitable for collecting and auditing this type of information.

Members of Thompson Hine's ESG Collaborative will continue to follow developments in this litigation, updates related to regulations and funding allotted for California's SB 253 and SB 261, and legislative developments related to climate accountability legislation in other states.

FOR MORE INFORMATION

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[1] Climate Corporate Accountability Act, New York A4123 and S897; S5437; S7704 and S7705.

[2] Washington SB 6092, Concerning Disclosure of Greenhouse Gas Emissions.