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

By Jurgita Ashley, Heidi B. (Goldstein) Friedman and Tanya C. Nesbitt*

In this article, the authors review pushback to California's mandatory climate disclosure legislation.

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[1] and the Climate-Related Financial Risk Act,[2] a number of parties, led by the U.S. Chamber of Commerce, California Chamber of Commerce, and American Farm Bureau Federation, sued the California Air Resources Board (CARB), the entity charged with adopting regulations under SB 253.[3] 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. The groups 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 Constitution's 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

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[1] SB 253.

[2] SB 261.

[3] 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).

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, the industry group plaintiffs allege that mandatory disclosures force companies to engage in coerced "controversial speech" that is "untethered to any commercial purpose or transaction."[4] Central to their concerns is the inherently controversial and political nature of climate change and climate-related speech, which they allege is not factual.[5] Here, the 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."[6] In their quest to persuade the court and refine their position, the plaintiffs use Governor Newsom's own words against him, citing his publicly stated 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 Constitution's Supremacy Clause since the legislation has a de facto effect of regulating national greenhouse gas (GHG) emissions, which is 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."[7] 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

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[4] Compl. ¶ 6.

[5] Compl. ¶ 68.

[6] Compl. ¶ 69.

[7] Compl. ¶ 7 (citing Assembly Comm. On Nat'l Res., Analysis of SB 261 (2023–2024 Reg. Sess.) July 7, 2023 at 6).

requires companies doing business in California with yearly gross revenue exceeding $1 billion to publicly disclose their GHG emissions annually. As drafted, SB 253 will require companies to report on "Scope 1 emissions," which are direct emissions a company makes in the operation of its business through sources the company owns or directly controls; "Scope 2 emissions," which are from sources a company does not own or directly control (i.e., indirect emissions associated with the purchase of electricity, steam, heat or cooling); and "Scope 3 emissions," which are emissions 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 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 with annual gross revenue over $500 million to publicly disclose information relating to their "climate-related financial risk[s]" and their plans to mitigate any such 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.

SIMILAR CLIMATE DISCLOSURE LEGISLATION IN OTHER STATES

It appears that SB 253 and 261 have served as models for other states like New York,[8] Illinois and Washington,[9] 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.

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

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

Illinois' Climate Corporate Accountability Act[10] 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.

LITIGATION'S IMPACT ON CLIMATE ACCOUNTABILITY LEGISLATION AND RULEMAKINGS

On March 27, the California attorney general on behalf of CARB filed a motion to dismiss the case. Seizing upon the absence of any implementing regulations, the attorney general argues that the plaintiffs' Supremacy Clause and extraterritoriality claims are not yet ripe for judicial review because the statute does not impose any affirmative obligations on plaintiffs subject to the new reporting requirements. The California attorney general urged the Court to find that "Plaintiffs' allegations are based on speculation about how the disclosure requirements will be applied and enforced."[11] The attorney general moved on to attack the plaintiffs' standing and ability to articulate an injury related to the climate accountability legislation beyond purely speculative risks that it might infringe First Amendment rights at some future point in time. The California attorney general pointed out that the plaintiffs made no specific allegations regarding costs related to the Scope 1 or Scope 2 requirements, especially because many of these entities are already subject to existing voluntary and mandatory climate change reporting regimes.

Because the legislation does not regulate GHG emissions and are instead informational disclosures, the attorney general requested that the court dismiss the Supremacy Clause claim under Rule 12(b)(6), contending that any "pressure" companies may feel to reduce their GHG emissions would come not from the state of California, but from investors and customers. Def's Mot. to Dismiss at 22. The attorney general also asserts that the Supremacy Clause claim should be dismissed because there is no federal law precluding California from requiring climate-related disclosures, noting that Congress has expressly stated its intention that only four provisions of the CAA have preemptive force and that the plaintiffs fail to identify any constitutional provision or principle of federalism that would preclude states from collecting information about "corporations' out-of-state activities."

The attorney general also took the position that the plaintiffs' Dormant Commerce Clause claims should be dismissed because precedent shows similar claims were dismissed based on extraterritorial effects, finding that most state laws have effects beyond their borders. Additionally, the laws treat all

[10] HB 4268.

[11] Defs' Mot. to Dismiss at 19.

corporations, even in-state resident corporations, similarly once they meet the applicable thresholds and do not impose a substantial burden on interstate commerce.

The state also asserts that the suit is barred by the Eleventh Amendment's sovereign immunity provisions because California has not consented to be sued and the legislation's enforcement provisions all point to oversight by CARB and not the attorney general.

The litigation in California may result in other states considering additional legislative review of and potential amendments to pending similar legislation.

Despite the ensuing litigation and regulatory uncertainty, 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 already face climate disclosure regulation in the EU. And it may prove perilous for U.S.-based companies that do not give themselves enough time to implement the infrastructure needed to develop a GHG inventory. A stop-and-start approach is not suitable for collecting and auditing this type of information.