Calif. GHG Disclosure Law Will Affect Companies Worldwide

By **Amy Steinfeld, Rebecca Tucker and Baltazar Cornejo** (October 23, 2023)

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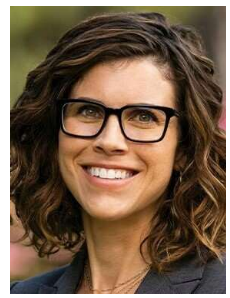

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California has a steady history of precedent-setting environmental action, and it looks like that's not changing anytime soon. The state's latest move on climate change is expected to have repercussions nationally and around the world.

Signed on Oct. 7, S.B. 253, the Climate Corporate Data Accountability Act, is the first comprehensive greenhouse gas emissions disclosure requirement for large companies in the U.S.[1] Notably, the reporting requirement requires billion-dollar companies doing business in California to disclose their direct, indirect and supply chain-related emissions.

In a few years, corporate carbon footprints will be public and easily digestible — which many predict will trigger voluntary carbon reduction efforts, and influence consumer spending habits.

The Importance of Climate Disclosures

A push for disclosures and public access to this information is based upon emerging evidence that once a negative externality is known — and publicized — companies will act quickly to stay competitive. Sen. Scott Weiner, the sponsor of the bill, cited findings demonstrating that mandatory disclosures could drastically cut emissions.

Why? As economic researchers Michael Greenstone, Christian Leuz and Patricia Breuer put it in an article published in Science on Aug. 24: "[O]ne rationale is that disclosure will provide information on material risks to investors, making it evident which firms are most exposed to future climate policies. In addition, some believe that reporting will galvanize pressure from companies' key stakeholders … leading them to voluntarily reduce their emissions."[2]

The new California law boldly asserts that "ensuring public access to the data in a manner that is easily understandable and accessible, will inform investors, empower consumers, and activate companies to improve risk management in order to move towards a net-zero carbon economy."

Key Takeaways

S.B. 253 requires any U.S.-based business, public or private, with annual revenues exceeding $1 billion that does business in California to annually report to the California Air Resources Board, or CARB, the full range of emissions attributable to their business operations and supply chain.

Reporting entities should follow the Greenhouse Gas Protocol standards and guidance published by the World Business Council for Sustainable Development of the World Resources Institute. This includes disclosure of reporting entities' Scope 1, Scope 2 and Scope 3 emissions.

Scope 1 emissions are defined as direct emissions from sources owned, operated or directly controlled by the reporting entity. For example, this would include emissions from a company's manufacturing plant.

Scope 2 emissions are indirect emissions from things like electricity purchased by the reporting entity. If a company's energy provider uses fossil fuels, its reportable emissions will be higher than those of a company that has installed on-site solar power, or that has contracted with renewable electricity providers via power purchase agreements, virtual power purchase agreements or through its utility provider.

Scope 3 emissions are described in the legislation as: "indirect upstream and downstream greenhouse gas emissions, other than scope 2 emissions, from sources that the reporting entity does not own or directly control and may include, but are not limited to, purchased goods and services, business travel, employee commutes, and processing and use of sold products."

For example, a car company will have to report emissions created by its supply chain, and emissions from employees who travel to company offices, along with the ongoing emissions from all vehicles sold.

S.B. 253 also requires a reporting entity to work with an independent third-party assurance provider and CARB to contract with an emissions reporting organization to develop a reporting program and make the disclosures publicly available. This goes beyond the proposed U.S. Securities and Exchange Commission climate reporting rule, which would only apply to public companies.

The SEC is anticipated to adopt a final version of the rule by the end of the year. CARB is instructed to minimize duplication of effort for reporting entities that are also subject to the final SEC rule.

S.B. 253 covers an estimated 5,000-plus companies. Reporting entities will self-fund the program via an annual fee paid to the Climate Accountability and Emissions Disclosure Fund.

For noncompliance, including missing filing deadlines and misstatements, CARB may seek administrative penalties of up to $500,000 per year. But a late amendment outlined that "a reporting entity shall not be subject to an administrative penalty … for any misstatements with regard to scope 3 emissions disclosures made with a reasonable basis and disclosed in good faith … Penalties assessed on scope 3 reporting, between 2027 and 2030, shall only occur for nonfiling."

Timeline

By Jan. 1, 2025, CARB must develop and adopt regulations requiring reporting entities to annually disclose to the emissions reporting organization and verify the reporting entities' Scope 1, 2 and 3 emissions. Note that CARB is required to consult stakeholders — including covered entities, investors and those "representing consumer and environmental justice interests" — in developing these regulations.

Starting in 2026, reporting entities must publicly disclose their Scope 1 and Scope 2 emissions for the prior year on an annual basis. Starting in 2027, reporting entities must also disclose Scope 3 emissions.

California-based companies must start reporting in 2026; all other applicable companies must commence reporting in 2027. The inclusion of Scope 3 emissions is notable, given that:

- They encompass indirect, upstream and downstream supply chain emissions, and often make up the lion's share of a company's total emissions. This category broadly includes emissions stemming from employee commuting, business travel, purchased goods and services, and leased assets.

- The implications of reporting emissions associated with purchased goods and services extends to nonreporting entities, and will require a new level of communication and collaboration between various industry players and service and product suppliers. There is much to be worked out in terms of guidance and assurance requirements on Scope 3 emissions, and especially at first, it is anticipated many entities will rely on estimates.

To outline the complexity, a few examples of what Scope 3 reporting would mean for different industries are supplied below.

Agriculture

Agriculture emits GHGs through animal husbandry, soil preparation, the manufacture and use of nitrogen fertilizer, irrigation and shipment of products.

For example, a strawberry farmer selling berries to a billion-dollar food company will be required to provide data on the associated emissions from growing (e.g., tilling, fertilizing, treating water supplies and irrigating), processing (e.g., washing, freezing and packaging), and delivering that product to market (e.g., trucking).

Real Estate and Development

Buildings consume a considerable amount of energy through manufacture of building materials, the construction process, and heating, cooling and lighting the building once operational. It is estimated that Scope 3 emissions account for, on average, over 85% of a commercial real estate company's total emissions.[4]

Developers will be required to provide data on emissions associated with the building materials they purchase for construction, and the emissions associated with transporting those materials to construction sites.

Building owners will need to understand emissions from leased assets, and for elements outside their full control, such as the behavior of the landlord's lessees and their energy use.

Finance

Emissions that result from investment activities and lending are part of a financial institution's Scope 3 emissions. Looking at hundreds of financial institutions, the Carbon Disclosure Project found such activities were responsible for 700 times more emissions than institutions' Scope 1 emissions.

For example, a large bank will be required to report its customers' emissions, which likely includes diverse industries. Whether this will result in more investors pushing banks to reduce their financing to new fossil fuel-intensive assets remains to be seen.

Who's Saying What

Supporters

Supporters include Big Tech and some major brands.[3] Some of these businesses ultimately supported the bill following late amendments, including that reporting entities would not be subject to penalties for Scope 3 misstatements as outlined above.

Opponents

Opponents include the California Chamber of Commerce — which describes the bill as a "costly mandate that will negatively impact businesses of all sizes … and will not directly reduce emissions" — as well as several utilities and trade groups.[5]

Mixed Reactions

Some thought leaders have shared their ambivalence over the limitations of disclosure. The managing director of Stanford University's Sustainable Finance Initiative, Alicia Seiger, said the following in a LinkedIn post about the passage of the bill in September: "I worry California will drive revenue for carbon counting software companies, consultants, and lawyers while doing very little to remove the headwinds keeping investment in decarbonization from reaching #speedandscale or to mitigate #climaterisk."[6]

What Comes Next

Now that the bill is signed, CARB will commence its regulatory process. At that time, stakeholders are invited to provide input before final regulatory adoption. Given this opportunity, companies should consider how to best engage with CARB to understand and streamline the process.

Companies should also evaluate whether they "do business in California" — which is not defined in the bill — to determine if they qualify as a reporting entity, and even if they are technically exempt, to understand how this bill could affect them and industry norms.

Given California's stance on carbon reduction, and its national and global dominance — it is the fourth-largest global economy — one may be hard-pressed to find a large company that will not feel the weight of this shift.

Companies that emit more carbon than their peers may see pushback from investors and consumers. The impacts will undoubtedly trickle out and down, as reporting entities push data gathering and reporting requirements through supply chains, and add emission metrics, data quality and ease to their list of considerations in choosing corporate partners.

For those feeling overwhelmed, you are not alone — surveys find that 32% of U.S. organizations do not report or track emissions.[7] It will be a significant task, at least initially, for companies to create an inventory of emissions, to develop processes for ongoing collection and synthesis of data, and to understand the verification process.[8]

Once emissions are known, and in a format suitable for reporting, the next big lift will be to prioritize strategies and emissions reduction tactics to keep pace with peers and consumer demands for corporate action.

Studies show more Americans are significantly or somewhat more concerned about the effects of climate change than they were previously.[9] And the majority of consumers think corporations can do more to address the problem.[10]

It is important to not lose sight of the larger picture here. Setting aside the pains of regulatory compliance, the pain of climate change and environmental risks are here and growing.

A recent Global Supply Chain report finds that companies may face up to $120 billion in costs from environmental risks in their supply chains within the next 5 years.[11] Prioritizing understanding, managing and mitigating environmental and regulatory risks is increasingly essential to remaining competitive and relevant.

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[1] https://leginfo.legislature.ca.gov/faces/billNavClient.xhtml?bill_id=202320240SB253.

[2] https://www.science.org/doi/10.1126/science.add6815.

[3] https://www.ceres.org/news-center/press-releases/companies-call-climate-disclosure-legislation-california-lawmakers.

[4] https://www.ukgbc.org/wp-content/uploads/2019/07/Scope-3-guide-for-commercial-real-estate.pdf.

[5] https://www.wsj.com/politics/policy/california-legislature-passes-sweeping-emissions-bill-398b586c.

[6] https://www.linkedin.com/posts/activity-7107858125789007872-h6aJ/.

[7] https://www.thomsonreuters.com/en-us/posts/esg/sec-climate-rules/.

[8] This link provides a list of CARB-accredited verification bodies: https://ww2.arb.ca.gov/mrr-vb.

[9] https://www.msn.com/en-us/news/politics/20-percent-in-new-poll-say-climate-change-could-force-them-to-leave-their-homes/ar-AA1gkXoy#image=1.

[10] https://justcapital.com/reports/corporations-have-a-role-to-play-in-addressing-climate-change/#Most%20Americans%20Accept%20That%20Climate%20Change%20Is%20A%20Reality.

[11] https://www.cdp.net/en/research/global-reports/transparency-to-transformation.