

**MEMO# 35606**

January 31, 2024

# California Climate Disclosure Laws Challenged

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TO: ESG Advisory Group

SEC Rules Committee RE: California Climate Disclosure Laws Challenged

On January 30, 2024, the Chamber of Commerce along with several other business federations and associations, filed a complaint in the United States District Court for the Central District of California against the California Air Resources Board ("CARB") and two of its leaders.[\[1\]](#) The complaint challenges California Senate Bills 253 and 261, signed by Governor Newsom on October 7, 2023,[\[2\]](#) and seeks to have the Court declare the laws as null and void and enjoin CARB from enforcing the laws.

The complaint asserts that the "laws unconstitutionally compel speech in violation of the First Amendment and seek to regulate an area that is outside California's jurisdiction and subject to exclusive federal control by virtue of the Clean Air Act and the federalism principles embodied in [the] federal Constitution." The complaint further asserts that the "laws stand in conflict with existing federal law and the Constitution's delegation to Congress of the power to regulate interstate commerce."

## Background

The California Climate Accountability Package, composed of Senate Bills 253 and 261, applies to any reporting entity, which includes any public or private partnership, corporation, or other business entity doing business in California that meets certain gross revenue requirements. Senate Bill 253 applies to companies with greater than one billion dollars in revenue, and Senate Bill 261 applies to companies with greater than five hundred million dollars in revenue.

Under Senate Bill 253, reporting entities doing business in California will have to annually disclose their Scopes 1 and 2 greenhouse gas emissions (beginning in 2026) and Scope 3 greenhouse gas emissions (beginning in 2027) to CARB. In addition, they will have to obtain limited assurance (beginning in 2026) and reasonable assurance (beginning in 2030) for their reported emissions by an appropriately experienced third-party assurance provider. Emissions disclosures would be housed on a new publicly available digital registry. The registry would enable users to review individual reporting entity disclosures and analyze underlying data elements.

Reporting entities will have to pay CARB an annual fee, which must be set at an amount sufficient to cover CARB's full costs. CARB may impose a penalty of up to \$500,000 on a company in a reporting year for failure to file, filing late, or any other failure to meet the program's requirements. CARB also is required to consider all relevant circumstances, including the company's past and present compliance and its good faith efforts to comply, before assessing a penalty.

Senate Bill 261 requires any covered entity to report, by January 1, 2026 (and biennially thereafter), their climate-related financial risk<sup>[3]</sup> as well as steps undertaken to reduce such risks. Reports must be in accordance with Task Force on Climate-Related Disclosures (TCFD) (and its successors).<sup>[4]</sup> CARB will have to contract with a climate reporting organization to biennially prepare a public report, which includes: (i) a review of the disclosure of climate-related financial risks by industry; (ii) an analysis of the system and sector-wide climate-related financial risks facing California; and (iii) identification of insufficient reports. In addition, CARB may impose a penalty of up to \$50,000 in a reporting year against any covered entity for failing to make reports publicly available on its website or publishing insufficient reports. CARB also is required to consider all relevant circumstances, including past and present compliance and good faith efforts to comply before assessing penalties.

## **Complaint**

The Chamber is joined in its complaint by the California Chamber of Commerce, the American Farm Bureau Federation, the Los Angeles County Business Federation, the Central Valley Business Federation, and the Western Growers Association. Plaintiffs proffer three principal arguments.

### **1. First Amendment to the United States Constitution**

The complaint alleges that the laws "violate the First Amendment to the United States Constitution, which protects both the freedom from being compelled to speak and the freedom to engage in speech." It argues that California's "plan for compelling speech to combat climate change ... violates the First Amendment" as it "forces thousands of companies to engage in controversial speech that they do not wish to make, untethered to any commercial purpose or transaction."

The complaint states that "[s]mall businesses nationwide will incur significant costs monitoring and reporting emissions to suppliers and customers swept within the ... reach [of Senate Bill 253]," and notes that "scores of family farm members of [American Farm Bureau Federation] will need to report emissions to business partners that do business with entities covered by S.B. 253." Specific examples of farmers in Missouri and Texas are cited as being "concerned that the documentation and recordkeeping required to supply [their] greenhouse gas emissions" to reporting entities in California "will be incredibly onerous and burdensome."

### **2. Supremacy Clause of the United States Constitution**

Plaintiffs point out that "[u]nder the Supremacy Clause, the Clean Air Act displaces state regulation of interstate greenhouse-gas emissions." The complaint alleges that the "legislation violates the federal Constitution's Supremacy Clause" as the laws "are not limited to companies that are headquartered or incorporated in the State of California; rather, they reach any company above a certain revenue threshold that does any business in California."

According to the complaint, "California lacks the authority to regulate greenhouse-gas emissions outside of its own borders," yet plaintiffs contend that is "precisely what this legislation intentionally accomplishes, using a legal mechanism (requiring extensive disclosure of information about out-of-state emissions) that is itself precluded by the Clean Air Act and the Constitution...."

### **3. Dormant Commerce Clause**

The complaint notes that "[t]he Constitution vests Congress, not each of the fifty states, with authority to regulate interstate and foreign commerce," and alleges that because the laws' disclosure requirements "operate as de facto regulations of greenhouse-gas emissions nationwide, they are precluded by the Clean Air Act and are invalid under the Dormant Commerce Clause and principles of federalism."

It asserts that "[b]ecause the laws so heavily intrude on Congress's authority to regulate interstate and foreign commerce, and because the benefits to California are so limited, the laws are invalid under the Constitution's limitations on extraterritorial regulation, including the Dormant Commerce Clause."

The plaintiffs observe that the legislation "does not limit reporting requirements to emissions produced in California or to companies' expected climate change financial risks in California—rather, both laws require companies to make sweeping reports about their emissions and risks everywhere they operate, whether in California, in other states, or even abroad." The complaint asserts that "[s]tates may not regulate out-of-state emissions by requiring disclosure of data about such emissions in this manner," and "[n]or, for that matter, may states enact measures to force actual reductions in out-of-state emissions, whether by disclosure or by any other legal tools." In arguing that the legislation is "beyond the limits of what state law is allowed to do," the complaint argues that "under the Clean Air Act, the regulation of nationwide greenhouse-gas emissions is exclusively the domain of the federal government, and "[s]tates may not engage in de facto regulation of greenhouse-gas emissions nationwide, running afoul of Congress's exclusive authority to regulate interstate commerce."

Following the filing of the complaint, the California State Senator responsible for introducing Senate Bill 253 issued a statement in defense of the legislation which characterized the complaint as "extremist" and "baseless" and described the First Amendment argument as "bizarre and frivolous."<sup>[5]</sup>

We will continue to monitor this matter.

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#### **Notes**

<sup>[1]</sup> Chamber of Commerce of the United States of America, et al. vs. California Air Resources Board, et al., Case No. 2:24-cv-00801, United States District Court for the Central District of California, Western Division (Jan. 30, 2024), available at <https://www.uschamber.com/assets/documents/FILED-Chamber-v.-CARB-Complaint.pdf>.

[2] For a summary of California's Climate Accountability Package, see ICI Memo 35482 (Oct. 10, 2023), available at <https://www.ici.org/memo35482>.

[3] The bill defines "climate-related financial risk" as a 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.

[4] The bill also requires CARB to contract with a qualified climate reporting organization to review and publish an analysis of those reports. If a covered entity does not complete the required disclosures, they must provide the recommended disclosures to the best of its ability with a detailed explanation for any reporting gaps and describe steps the covered entity will take to prepare complete disclosure. The bill defines "Climate reporting organization" as a nonprofit climate reporting organization that currently operates a voluntary climate reporting organization for organizations operating in the U.S. and that has experience with voluntary climate-related financial risk disclosure in California.

[5] Senator Wiener Responds to US Chamber's Climate Denier Extremist Lawsuit to Block Landmark Climate Law (Jan. 30, 2024), available at <https://sd11.senate.ca.gov/news/20240130-senator-wiener-responds-us-chamber%E2%80%99s-climate-denier-extremist-lawsuit-block-landmark>.