

THE RECORDER

California's New Climate Disclosure Laws Under Fire in Lawsuit Against California Air Resources Board

By David R. Carpenter and Maureen F. Gorsen

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A lawsuit filed Jan. 30, 2024, is challenging two new California climate disclosure and financial reporting laws, Senate Bill (SB) 253 and SB 261, for unconstitutionally requiring disclosure by qualifying public and privately-held businesses of greenhouse gas (GHG) emissions and climate-related risks throughout their value chain. Plaintiffs, which include a number of businesses and industry associations, allege violations of the First Amendment, Supremacy Clause, and other constitutional limitations against the California Air Resources Board (CARB).

What Are SB 253 and SB 261?

California enacted two landmark climate disclosure and financial reporting laws in 2023: the Climate Corporate Data Accountability Act (SB 253) and the Climate-Related Financial Risk Act (SB 261). Collectively known as the Climate Accountability Package, these new laws impose unprecedented reporting requirements on large U.S. public and privately-held companies doing business in California.

Climate Corporate Data Accountability Act (SB 253)

SB 253 applies to entities formed and domiciled anywhere in the United States, so long as they have a total annual revenue exceeding \$1 billion and do any business in California. It requires CARB to develop regulations to require these entities to publicly disclose and obtain third-party assurance of three categories of GHG emissions annually, regardless of location:

- Scope 1: direct GHG emissions that stem from sources the reporting entity owns or directly controls.



Courtesy photos

David R. Carpenter, left, and Maureen F. Gorsen, right, of Sidley Austin.

- Scope 2: indirect GHG emissions from consumed electricity, steam, heating, or cooling purchased or acquired by a reporting entity.
- Scope 3: indirect upstream and downstream GHG emissions from sources the reporting entity does not own or directly control.

Climate-Related Financial Risk Act (SB 261)

SB 261 applies to entities formed and domiciled anywhere in the United States with total annual revenue exceeding \$500 million that do any business in California. Under SB 261, entities would have to prepare and submit "climate-related financial risk" reports to CARB every other year, disclosing the entity's climate-related financial risks in accordance with the recommendations adopted by the Task Force on Climate-Related Financial Disclosures (TCFD).

Companies would also be required to post their reports publicly to their websites.

What Are the Claims Being Brought?

The lawsuit alleges that SB 253 and SB 261 violate constitutional rights by compelling companies to engage in nonfactual, costly speech on climate change—a controversial political matter—and by imposing California regulatory requirements on businesses nationwide. It seeks to enjoin CARB from taking any action to enforce the two laws and for the court to declare that the laws have no force or effect based on the following claims:

First Amendment: According to the lawsuit, SB 253 and SB 261 compel companies to make a public statement that is speculative, noncommercial, and politically charged in order to conform their behavior to California’s political agenda in violation of the First Amendment to the U.S. Constitution. According to plaintiffs, SB 261 provides a vague definition of the key term “climate-related financial risk,” imposing the burden on companies of making “high-stakes, public guesses” on a politically controversial topic.

Supremacy Clause: The lawsuit also raises the Clean Air Act and the structure of the federal Constitution as a basis for preempting California’s authority to regulate GHG emissions outside of its own borders.

Extraterritorial Regulation/Burdens on Commerce: The lawsuit alleges that SB 253 and SB 261 impose significant burdens on interstate and foreign commerce and force conformance with California’s policy preferences with minimal corresponding benefits.

Status of the Litigation

CARB has filed a partial motion to dismiss that, as of the writing of this article, is still being briefed. CARB seeks to dismiss the plaintiffs’ Supreme Clause and Extraterritorial Regulation/Burdens claims on the grounds that CARB has not yet adopted the implementing regulations for the statutes. CARB thus contends that the issues are not yet “ripe” for judicial review, and that the plaintiffs lack standing because they have not yet suffered any injury-in-fact. CARB also challenges those two claims on the merits,

arguing that the laws are only requiring reporting and do not regulate or prohibit the conduct of any out-of-state business.

CARB did not seek to dismiss the First Amendment claims.

The Bigger Picture

These laws are expected to apply to 10,000 businesses or more, including those that conduct a minimal amount of business in the state. Projections cited by the lawsuit include cost burdens falling disproportionately on small and medium businesses that lack the resources to comprehensively report emissions to supply chain partners.

The litigation challenging SB 253/261 is occurring at the same time as the lawsuits challenging the rules adopted by the U.S. Securities and Exchange Commission (SEC) requiring disclosure of climate-related financial risks. As compared to SEC’s climate disclosure rules, California’s new laws are far broader, including because California’s law require the assessment and disclosure of Scope 3 emissions, which the SEC declined to require. While certain of the challenges to the SEC’s rule also include a First Amendment claim, those lawsuits largely focus on whether the SEC has authority as agency to adopt climate-change-related rules (whereas the California lawsuit challenges California’s authority as a state to regulate nationwide).

Reporting under SB 253 and SB 261 would not commence until 2026, or later depending on the status of the governor’s budget negotiations, potential statutory amendments, and the development of implementation regulations by CARB. In the meantime, however, companies are already beginning to consider whether the reporting obligations will apply to them in light of their operations and/or corporate structure, and whether the burdens of complying with the laws are worth continuing to do business in the state.

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