Securities Regulation Daily Wrap Up, ESG NEWS—C.D. Cal.: U.S. Chamber takes on California's twin climate disclosure laws, (Jan 31, 2024)

By Mark S. Nelson, J.D.



The complaint asserts that SB 253 and SB 261 violate the First Amendment, the Supremacy Clause, and the dormant commerce clause.

In October 2023, California Governor Gavin Newsom signed into law SB 253 and SB 261 to require reporting of greenhouse gas (GHG) emissions, including Scope 3 emissions, by companies doing business in California that meet separate revenue thresholds contained in each law. Those laws are now being challenged in federal court by the U.S. Chamber of Commerce and its members in a lawsuit brought against the California Air Resources Board (CARB) asserting that SB 253 and SB 261 violate the First Amendment, the Supremacy Clause, and the dormant commerce clause of the U.S. Constitution. The lawsuit does not allege any supplemental state-law-based claims. The Chamber of Commerce seeks a declaratory judgment that California's climate laws are unconstitutional, injunctive relief, and attorney's fees and costs. The case could serve as a preview of a future legal challenge if, and when, the SEC finalizes its own climate risk regulation, or it may help to inform the SEC's widely expected efforts to harden its final regulation against such legal challenges (*Chamber Of Commerce of the United States v. California Air Resources Board*, January 30, 2024).

Does California's ESG leadership have limits? California has been a leader in reducing vehicle emissions for many years, but its more recent efforts in the environmental, social, and governance (ESG) space have at times fallen flat. For example, laws enacted to increase board diversity were successfully challenged in court. Now a pair of laws aimed at curbing GHG emissions by large companies is being challenged on multiple federal constitutional grounds. There has been a pattern of recent California governors expressing some legal doubts about bills they signed into law in the ESG space, starting with former Governor Jerry Brown's concerns about the potentially fatal constitutional flaws in the board diversity legislation. Newsom has followed that same pattern, although with more emphasis on feasibility and cost regarding the state's twin climate laws.

SB 253's GHG emissions disclosure requirement would apply to businesses with total annual revenues in excess of $1 billion and that do business in California. Disclosures would be phased in with Scopes 1 and 2 disclosures due to begin in 2026 and Scope 3 disclosures to begin in 2027. CARB must adopt implementing regulations by January 1, 2025. State Senator Scott Wiener (D-San Francisco) sponsored the disclosure bill. The second bill, SB 261, sponsored by Henry Stern (D-Los Angeles), would require any business with total annual revenues in excess of $500 million and that does business in California to prepare a climate-related financial risk report. The first report would be due on or before January 1, 2026, and would be required to be posted on the business's website; the business would file such reports biennially in later years.

Governor Newsom also issued signing statements for each bill. With respect to SB 253, Newsom noted concerns about the financial impact of the law and the potential confusion over the reporting requirements. Said Newsom: "However, the implementation deadlines in this bill are likely infeasible, and the reporting protocol specified could result in inconsistent reporting across businesses subject to the measure."

Newsom expressed similar concerns regarding SB 261 in that CARB may need more time to implement the law. Newsom also expressed concern about the costs associated with the reporting requirements. "Additionally, I am concerned about the overall financial impact of this bill on businesses, so I am instructing CARB to closely monitor the cost impacts as it implements this new bill and to make recommendations to streamline the program."

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The Chamber of Commerce's complaint against CARB speaks in terms of language evocative of the federal Clean Air Act in trying to make the plaintiffs' point that the federal Environmental Protection Agency (EPA) should regulate GHG emissions, not states or other federal or state agencies. As a result, the complaint stresses the need for policy to be implemented based on "the best science" and only after having sifted the "available alternatives."

The complaint further asserts that the plaintiffs support some climate-related disclosures. "Plaintiffs support policies that reduce greenhouse-gas emissions as much and as quickly as reasonably possible, consistent with the pace of innovation and the feasibility of implementing large-scale technical change," said the complaint. "Plaintiffs likewise support policies that provide for the disclosure of material information, including climate related information, as necessary to protect investors."

The California laws, as Newsom hinted, may face some hurdles as they approach implementation. Those hurdles recently appeared to grow as Newsom put on hold the funding for many of the bills he most recently signed into law, including both climate bills, although the sponsor of one of the bills suggested the funding lapse may be only temporary. The California laws draw a stark contrast with a similar disclosure regime proposed almost two years ago by the SEC; California's laws apply to both private and public companies, while the SEC's regulation would only apply to public companies. Moreover, California's laws and the SEC's proposed regulation also differ on the extent to which companies must address Scope 3 GHG emissions, with the California law again sweeping more broadly than the SEC's proposal, which may be further scaled back in anticipation of future legal challenges.

Speaking of those challenges, SEC Commissioner Hester Peirce foreshadowed the emphasis on the First Amendment as the primary basis for challenging SEC and other regulator's climate disclosure regimes in her statement objecting to putting out the agency's climate risk disclosure proposal. Noting the lower scrutiny applicable to commercial speech, Peirce observed: "For this reason, our disclosure mandates are at their strongest when there is a clear and indisputable connection between the factual information to be disclosed and our three-part mission."

Constitutional claims. A foundational issue for the court will be whether the Chamber of Commerce can assert associational standing in order to meet the standing requirement of Article III of the U.S. Constitution. The complaint asserts that at least one member of each plaintiff association—i.e., the Chamber of Commerce, 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—would have standing in their own right, that the association's protectable interests are germane to its purpose, and that the individual members will not have to directly participate in the case because of the claims asserted or the relief requested.

The individual members of the several association plaintiffs include Chevron Corp, which the complaint said meets the financial threshold of SB 253 and which is headquartered in San Ramon, California. U-Haul Holding Company, whose most recent Form 8-K lists its principal executive office as being in Reno, Nevada, is included because, as the complaint asserted, the company meets the financial threshold of SB 253 and the company does business in California. The complaint also asserts that several member companies are within the supply chains of other companies, including two family-owned and -operated farms that would fall within other companies' Scope 3 reporting obligations under SB 253. The complaint, however, does not explicitly assert standing based on SB 261 (note that a company that meets the financial threshold of SB 253 would also meet the financial threshold of SB 261).

With respect to the substantive claims, violation of the First Amendment is the primary claim. Here, the complaint asserts that strict scrutiny should apply to both SB 253 and SB 261 because California is mandating that companies speak publicly on noncommercial, politically controversial matters (i.e., "climate change"); as a result, the complaint said the two California laws must be narrowly tailored to serve a compelling state interest. The complaint said the lower standard for most commercial speech should not apply because California's laws do not address purely factual

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and uncontroversial information. From the Chamber of Commerce's perspective, both SB 253 and SB 261 cannot qualify as commercial speech because they are not connected to proposals of commercial transactions. Even if the lower standard applied, the complaint said, the laws would fail that test because they remain "unjustified and unduly burdensome."

For example, in the case of SB 253, the complaint said that "[a]lthough the law purports to require each company to report 'its emissions,' the reported emissions actually include emissions from utility providers, upstream suppliers, downstream customers, and others. Thus, S.B. 253 requires a company to falsely state that the emissions of other entities are its own" (citations omitted).

According to California legislative analyses cited by the complaint, SB 253 and SB 261 would apply to 5,300 and 10,000 businesses, respectively. Moreover, said the complaint, the Scope 3 reporting required by SB 253 is not an exact science; the Chamber of Commerce even cited the SEC's climate risk disclosure proposal for the notion that direct observation of GHG emissions would be the best way to measure GHG emissions.

The complaint added that requirements to use the Greenhouse Gas Protocol further skew any GHG emissions measurements because the protocol excludes Scope 4 emissions, which are emissions avoided by companies and, thus, deducted from Scopes 1, 2, and 3 emissions. As a result, the complaint posited that Scope 3 emissions reporting under SB 253 will be materially misleading and, thus, cannot function as purely factual information.

The complaint also asserts two additional claims. First, the complaint said that the Supremacy Clause of the U.S. Constitution and the federal Clear Air Act preempt state regulations that purport to regulate industry beyond state borders. According to the complaint, the Clean Air Act granted the federal government the exclusive authority to regulate GHG emissions on a nationwide basis.

The second additional claim asserts that Constitutional principles limiting extraterritorial regulation, including the dormant commerce clause, prohibit California's attempts to regulate GHG emission via compelled speech that may not even aid California. The complaint summed up the claim thus: "The State does not (and cannot reasonably) maintain that the laws will have a meaningful impact on climate change, a *global* phenomenon. Nor does the State explain, let alone demonstrate, how the compelled speech would benefit anyone. The State does not identify any risk of fraud or danger associated with any particular transaction and does not (and cannot) establish that the compelled speech (which applies to private as well as public companies) will be material to investors" (emphasis in original).

The case is No. 2:24-cv-00801.

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Companies: Chamber of Commerce of the United States of America; California Chamber of Commerce; American Farm Bureau Federation; Los Angeles County Business Federation; Central Valley Business Federation; Western Growers Association; Chevron Corp; U-Haul Holding Company

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