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Red Tape or Green Future? Unpacking California's Climate Disclosure Laws and the Pushback

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As the federal government works to roll back climate regulations and climate-focused initiatives, states are developing avenues to fill in the gaps left behind. In 2024, the Securities and Exchange Commission (SEC) adopted The Enhancement and Standardization of Climate-Related Disclosures for Investors rule (the Rule) to standardize climate-related disclosures by public companies, which is currently being challenged in the Eighth Circuit. On February 11, 2025, the SEC's acting Chairman, Mark Uyeda, issued a statement that he intends to pause litigation of the Rule because he believes the Rule is "deeply flawed and could inflict significant harm on the capital markets and our economy." Acting Chairman Uyeda's announcement signals that the Trump administration's new SEC leadership intends to abandon its support of the highly contested Rule and scale back the regulatory and enforcement measures introduced during the Biden administration. But as the federal government steps back, states have begun stepping forward, and at the forefront of this state-led response is California.

In October 2023, California enacted two landmark climate disclosure laws that require thousands of large public and private companies doing business in California to report greenhouse gas (GHG) emissions and publicly disclose climate-related financial risks. These laws not only solidify California as a national leader in climate accountability but also impose substantial new compliance obligations on affected companies. While the state's ambitious climate disclosure efforts have been met with significant legal challenges and political opposition – including lawsuits from major business groups and a recent executive order aimed at blocking state-level emissions reporting requirements – California's climate disclosure laws are poised to reshape corporate climate transparency by pressuring companies to disclose their environmental impact and financial risk exposure or face penalties.

As California sets the pace on corporate emissions transparency, other states are quickly catching up. New York, Illinois, Colorado, and New Jersey are each advancing legislation modeled in part after California's groundbreaking Climate Corporate Data Accountability Act. A second article will explore these bills in more detail and what they could mean for companies operating across multiple states.

The Climate Corporate Data Accountability Act (SB 253)

1. Who Does This Affect?

California's Climate Corporate Data Accountability Act applies to companies formed under the laws of any state or the District of Columbia that: (i) do business in California; and (ii) have total annual revenues in excess of $1 billion (Reporting Entity). Total revenues are determined by the company's revenues in the prior fiscal year. While SB 253 does not define "doing business in California," the California Air Resources Board (CARB) issued an Information Solicitation on December 16, 2024, soliciting public comments on how to define "doing business in California" and will be required to issue regulations clarifying the scope of "doing business in California" by July 1, 2025.

In the meantime, companies have looked to California tax law as a potential predictor as to scope. California tax law defines "doing business in California" as "engaging in any transaction for the purpose of financial gain within California," "being organized or commercially domiciled in California," or having California sales, property or payroll that exceed $735,019 (or 25% of total sales), $73,502 (or 25% of total property), or $73,502 (or 25% of total payroll), respectively, as of 2024. CA Revenue and Tax Code § 23101.

2. What are the Requirements?

Reporting Entities are required to annually disclose Scope 1, 2, and 3 emissions data beginning in 2026 (for 2025 data). GHG gas emissions fall into one of these three categories:

- ***Scope 1 Emissions (Direct)***: Scope 1 emissions are direct GHG emissions from sources that are owned or directly controlled by the company, regardless of location;

- ***Scope 2 Emissions (Indirect)***: Scope 2 emissions are indirect GHG emissions arising from the use of purchased energy; and

- ***Scope 3 Emissions (Indirect)***: Scope 3 emissions include all other indirect GHG emissions that occur outside the company's direct operations and control, both upstream and downstream in its value chain. These emissions are notoriously hard to record as they encompass indirect emissions from purchased goods and services, business travel, employee commutes, and the processing and use of sold products. However, SB 253 expressly permits the use of industry average, proxy, and other data in a company's Scope 3 emissions calculations.

Additionally, California will require that an independent third-party assurance provider conduct an assurance assessment to offer an independent opinion on the reports issued in accordance with the reporting rules.

3. Are There Penalties for Noncompliance?

The CARB must adopt regulations that authorize it to seek administrative penalties up to $500,000 per reporting year for noncompliance. At the end of 2024, CARB announced that it would exercise its enforcement discretion for the first reports due in 2026. This means that CARB will not take enforcement action against companies in 2026 for incomplete Scope 1 and Scope 2 GHG emissions reporting as long as the companies make a good-faith effort to comply with SB 253.

4. What is the Timeline for Enforcement?

Beginning in 2026, companies will be required to report Scope 1 and Scope 2 GHG emissions from the prior fiscal year, followed by Scope 3 emissions reporting starting in 2027. By July 1, 2025, CARB must finalize implementing regulations that will establish the precise 2026 reporting deadline for companies' Scope 1 and Scope 2 GHG emissions (using FY 2025 data) and a 2027 reporting deadline for companies to report their Scope 3 GHG emissions.

The Climate-Related Financial Risk Act (SB 261)

1. Who Does This Affect?

California's Climate-Related Financial Risk Act applies to companies formed under the laws of any state or the District of Columbia that: (i) do business in California; and (ii) have total annual revenues in excess of $500 million (Covered Entity) – a lower threshold than SB 253. Total revenues are determined by the company's revenues in the prior fiscal year. As with SB 253, SB 261 does not define "doing business in California," but CARB will be required to issue regulations clarifying this definition by July 1, 2025.

2. What are the Requirements?

Covered Entities are required to prepare and publicly disclose climate-related financial risks on a biennial basis beginning in January 2026. Climate-related financial risk is defined as material risk of harm to immediate and long-term financial outcomes due to physical and transition risks. These risks include, but are 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.

The climate-related financial risk report must be made publicly available on the company's website, and it must include both: (i) the company's climate-related financial risk; and (ii) the measures the company has adopted to reduce and adapt to such climate-related financial risks.

3. Are There Penalties for Noncompliance?

CARB may impose penalties of up to $50,000 per reporting year for failure to publicly report a company's climate-related financial risk disclosures or for reporting inadequate or insufficient data.

4. What is the Timeline for Enforcement?

Beginning in 2026 and continuing on a biennial basis, companies will be required to prepare and publicly disclose climate-related financial risks as well as the measures they are taking to mitigate and adapt to those disclosed risks.

Efforts to Block State-Led Climate Regulation in California

The U.S. Chamber of Commerce, the California Chamber of Commerce, and other business groups have sued CARB in federal district court, challenging the constitutionality of SB 253 and SB 261. The lawsuit asserts three claims: (1) that the laws force speech on climate change in violation of the First Amendment; (2) that the laws violate the Supremacy Clause by attempting to supersede federal regulations, such as the Clean Air Act; and (3) that the laws violate the Constitution's limits on extraterritorial regulation, including the Dormant Commerce Clause.

On February 3, 2025, the U.S. District Court for the Central District of California dismissed the latter two claims related to SB 253 without prejudice, and with respect to SB 261, it dismissed the second claim with prejudice and the third claim without prejudice. First, the Court dismissed the SB 253 claims without prejudice on ripeness grounds, reasoning that the law does not yet impose direct obligations on companies, as it requires CARB to first issue implementing regulations. Because those regulations have not been finalized, the Court found it premature to assess potential constitutional or interstate commerce concerns. Second, the Court dismissed the Supremacy Clause claim against SB 261 with prejudice, finding that the law does not regulate emissions or impose liability for failure to reduce emissions but merely requires disclosure of climate-related financial risks – an area not preempted by the Clean Air Act. Lastly, the extraterritoriality claim was dismissed without prejudice, with the Court concluding that the plaintiffs had not plausibly alleged a significant burden on interstate commerce.

The plaintiffs recently filed a motion for a preliminary injunction, seeking to enjoin CARB's enforcement of both laws on the grounds that the compelled disclosure on the "controversial issue" of climate change would cause them irreparable harm. Based on the briefing schedule, the plaintiffs' motion will likely be heard this summer.

Meanwhile, CARB has until July 1, 2025, to finalize the implementing regulations for these laws, after which plaintiffs' claims that were dismissed without prejudice on ripeness grounds could be amended and refiled.

Amid this legal battle, California's climate disclosure laws face additional opposition from the Trump administration. On April 9, 2025, President Trump issued an Executive Order that directs the U.S. Attorney General to identify and challenge any state or local regulations aimed at reducing greenhouse gas emissions that may conflict with federal authority or energy objectives. This move comes on the heels of the SEC's announcement in early 2025 that it would pause litigation of the federal Enhancement and Standardization of Climate-Related Disclosures for Investors rule, signaling a broader effort by the Trump administration to dismantle climate-related regulatory and enforcement measures introduced during the Biden administration. This Executive Order marks another shift in federal policy, one that actively seeks to eliminate efforts to address climate change by aggressively undermining state-led climate action.

While ongoing litigation creates uncertainty about future enforcement, neither the lawsuit nor this Executive Order forestalls the initial compliance disclosure requirements in California. Under SB 253, covered organizations will need to file their annual Scope 1 and 2 GHG emissions reports (using data from FY 2025) beginning in 2026, and under SB 261, covered entities will need to publicly disclose their biennial climate-related financial risk reports by January 1, 2026.

Steps Entities Can Take

California's climate disclosure laws will compel thousands of companies across the nation to publicly disclose their emissions impact and climate-related financial risks. These mandatory public disclosures may increase regulatory and market pressure on high-emitting companies to decarbonize by enabling consumers, investors, and regulators to clearly identify companies failing to actively engage in emissions reduction.

Starting this year, companies doing business in California with total annual revenues exceeding $1 billion will be required to implement systems to track and report their Scope 1, 2, and 3 GHG emissions. These companies must report their Scope 1 and Scope 2 emissions from the fiscal year 2025 in reports due in 2026, accompanied by an assurance assessment conducted by an independent third-party provider. In addition, companies that do business in California and have annual revenues of more than $500 million must take steps to assess their exposure to climate-related financial risks and prepare to create a comprehensive report of those risks in accordance with the law's requirements. Entities will want to choose a climate-related financial risk disclosure framework to publish a climate-related financial risk report publicly on their websites beginning in January 2026.

Entities engaging in business activities in California are strongly encouraged to consult with an attorney to ensure compliance with SB 253 and SB 261. Companies should take proactive steps to prepare for these emissions-reporting and climate-related financial risk reporting requirements, such as:

- Determining if they qualify as a Reporting Entity under SB 253 or a Covered Entity under SB 261;
- Developing internal processes to quantify direct and indirect emissions across their value chains;
- Establishing systems to collect data on Scope 1, 2, and 3 emissions;
- Engaging qualified assurance providers to verify disclosures and submit reports;
- Implementing accurate and verifiable mechanisms for the public disclosure of climate-related risks and emissions data;

- Coordinating with suppliers to gather Scope 3 GHG emissions data and ensuring contracts with suppliers allow access to this data; and

- Preparing for demands for emissions data from supply chain partners and reputational harm that could result from public disclosure of emissions data.

How Baker Donelson Can Assist

It is essential for corporate leaders to monitor evolving regulatory developments that may impact their disclosure responsibilities and compliance strategies. Our Environmental Group is available to support your organization in navigating the new compliance requirements and in identifying potential risks and liabilities associated with noncompliance or inaccurate reporting. We will work closely with your team to ensure a thorough understanding of the implications of these laws and help you stay compliant as reporting requirements evolve. At Baker Donelson, we are committed to monitoring developments in climate-related reporting legislation and will provide timely updates as needed. If you have any questions or need guidance, please reach out to a member of Baker Donelson's Environmental Group to discuss how we can support your organization through this dynamic and uncertain regulatory landscape.