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Climate Change–Related Disclosures and Disinvestment: Where Are We Now?

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Investors, regulators and environmental advocates are putting increasing pressure on companies, particularly publicly traded ones, to disclose and quantify climate change risks and opportunities. However, despite the heated political rhetoric around environmental, social and governance (ESG), there is a disconnect between what stakeholders are demanding and what the law actually requires in terms of climate disclosures.

That is about to change. This article therefore presents the current state of the law for climate disclosures in select major markets (particularly New York) and likely developments in 2024.

The Current State of U.S. Climate Disclosure Law

Background

The requirement that businesses disclose climate-related risks is not new. Federal securities law has long required a public company's financial statements to disclose *"material" risks* to business operations and financial performance. In 2010, the U.S. Securities and Exchange Commission (SEC) issued guidance underscoring that this requirement includes disclosure of climate-related risks, including risks from potential or actual regulatory changes, physical damage, industry trends and related indirect impacts.

State Blue Sky laws like New York's Martin Act and common law principles prohibiting fraudulent misrepresentations in business dealings also have long required accurate representations about climate risks to investors, lenders and counterparties (e.g., in a merger or acquisition), at least to the extent that such risks are material to a company's operations or financial performance.

In other words, even before the latest round of climate regulation, a business would have had to disclose how climate change related events would materially impact the company—for example, (1) New York City's Local Law 97 requiring reductions in greenhouse gas (GHG) emissions from large buildings; (2) the New York State Department of Environmental Conservation's (DEC) 2016 NOx rules that effectively phased out coal-fired power plants in New York state; (3) recent or potential future hurricane damage to coastal property holdings; or (4) the acceleration of electric car adoption by consumers.

Nevertheless, existing laws leave a great deal of room for interpretation, resulting in a wide range of disclosure approaches, many highly qualitative. Investors, climate activists and others have clamored for greater consistency and transparency in reporting to allow data-driven apples-to-apples comparisons and assessments.

Proposed SEC Rules

In spring 2022, the SEC proposed rules to require registrants to provide information about climate- related risks and metrics in registration statements and annual reports. The rules would require a company to provide information about "climate-related risks that are reasonably likely to have a material impact on its business, results of operations or financial conditions" and to make various disclosures about its GHG emissions, described by the SEC as a "commonly used metric to assess a registrant's exposure to such risks." 87 Fed. Reg. 21334.

The proposed rules would require three categories of GHG emissions disclosures: direct GHG emissions (Scope 1), indirect emissions (via utility usage) (Scope 2) and value chain emissions (Scope 3).

The SEC received over 16,000 comments, many of them objections to Scope 3 reporting. It also received litigation threats by entities seeking to seize on recent Supreme Court cases narrowing (or

seeking to narrow) the scope of federal agency discretion. While some commentators have pointed out (convincingly, in our opinion) that the SEC is acting well within the scope of its authorizing statute, it will nevertheless need to tread carefully (*see*, *e.g.*, Cynthia Hanawalt and Chloe Field, "The SEC's Final Climate Disclosure Rule Must Respond to Emerging Legal Risks", Climate Law Blog, Columbia Law School, Dec. 11, 2023). It seems to be doing so; the proposed rules have yet to be finalized.

California Disclosure Laws

In October 2023, California enacted two laws that closely resemble the SEC's proposed disclosure rules, but in other ways go further. SB 261 will require any U.S. company with over $500 million in annual revenues that "does business" in California to disclose climate-related financial risks consistent with recommendations of the Task Force on Climate-Related Financial Disclosures, an entity created by the international Financial Stability Board. It would also require disclosure of any mitigations taken to reduce those risks. Disclosure would begin in 2026 and be required every two years thereafter.

Although many aspects of the Task Force recommendations appear to align with the proposed SEC requirement to disclose "material" information, other aspects appear to impose additional requirements such as a "scenario analysis." More information is available at www.fsb-tcfd.org.

SB 253 requires U.S. companies with over $1 billion in revenue and doing business in California to disclose the same three types of GHG emissions proposed under the SEC rules, but takes Scope 3 disclosure a step further. For example, the SEC Scope 3 provisions only require disclosure of emissions from upstream and downstream value chain sources if such emissions are *material* (with some exceptions), but California's law has no comparable materiality limitation.

Disclosure of Scope 1 and 2 emissions would begin in 2026 and Scope 3 in 2027. U.S. companies with any operations in California will need to quickly develop emissions tracking systems, which should be readily achievable for Scope 1 and Scope 2 but will be far more complex and require the cooperation of third parties for Scope 3.

Companies also have to consider that SB 253 requires the California Air Resources Board to issue regulations that will inform the tracking and reporting system.

Last week, the U.S. Chamber of Commerce made good on its threat to challenge the Constitutionality of the California laws under the dormant commerce clause and the First Amendment. *Chamber of Commerce of the United States v. California Air Resources Board*, No. 2:24-cv-00801 (C.D. Cal. Jan. 30, 2024).

A recent Supreme Court decision on the dormant commerce clause may offer California some protection from that particular challenge. In *National Pork Producers v. Ross*, a plurality of the Supreme Court affirmed the U.S. Court of Appeals for the Ninth Circuit's holding that

California's regulation of pork sales in the state was constitutional even though it imposed requirements on out-of- state producers, because the regulations did not discriminate against such producers. 598 U.S. 396 (2023).

The California disclosure laws would, like the law in *National Pork Producers*, impose the same requirements on in-state and out-of-state businesses. The First Amendment challenge is harder to predict but admittedly SEC regulations and Blue Sky laws have long required businesses to disclose material risks they might otherwise not want to speak about—climate change is just the latest subject.

New York Developments

New York has climate disclosure bills that closely mirror the California legislation. *See, e.g.*, S897A and A4123 (introduced in 2023). Shortly after California passed SB 253 and SB 261, the sponsors of

New York's bills urged passage, arguing that current disclosures are "often limited, unverified and cover only a fraction of the supply chain" leaving "consumers, investors and shareholders in the dark." (*See* Brad Hoylman-Sigal, Deborah Glick and Vanessa Fajans-Turner, "Opinion: New York must require companies to disclose greenhouse gas emissions", City & State New York, Oct. 25, 2023).

It is unclear whether the legislature will pass the bills in the current session. Regardless, companies doing business in both states will need to comply with the California requirements.

Although New York has not yet passed the legislation, New York regulators and watchdogs have exerted pressure within their spheres of influence. For example, in December 2023, the New York State Financial Services Department issued guidance to regulated banking and mortgage institutions on managing material risk from climate change. While non-binding, the guidance provides a roadmap to developing governance and data tracking systems to assess, reassess and mitigate climate risk, and to do so in ways that ensure continued compliance with fair lending laws.

New York City's pension funds, in conjunction with the New York City Comptroller, have used their influence as major shareholders to seek disclosure commitments from financial institutions.

Backlash: The Case of Texas SB 13

Many states have purportedly moved to limit climate disclosures and disinvestments by passing so- called anti-ESG bills. While a comprehensive review of this legislation is beyond the scope of this article, we speculate based on our review of Texas SB 13 that the alleged backlash is more bark than bite.

Texas SB 13 prohibits investment by state actors, including pension funds, in publicly traded financial services, banking and investment companies that "boycott[s] energy companies" without an "ordinary business purpose." But this is a difficult standard to enforce. So long as the entity had an "ordinary business purpose," for disinvesting in a fossil fuel company, it would not be blacklisted by the state.

SB 13 requires the Texas State Comptroller to compile a list of institutions that engaged in prohibited boycotts. Ultimately, only 1 of 10 targeted US financial institutions—Blackrock—was deemed to have engaged in an unlawful "boycott." Texas is likely to realize that cutting off its residents from investments in leading U.S. and international corporations makes for bad politics.

Implications for Businesses

In sum, any major U.S. company that "does business" in California, as well as companies registered with the SEC, needs to prepare for mandatory reporting. Investors increasingly have serious questions about how companies will fare in the face of extreme weather, shifting regulatory landscapes (like New York's Climate Leadership and Community Protection Act) and increased consumer demand for climate-friendly products and services.

The benefit for businesses of uniform action by California, the SEC and other states will be more predictable structures for providing this climate data. But for some companies such reporting will require major changes to data collection, risk management and governance procedures.

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