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In California and Europe, a New Dawn for Corporate Climate Disclosure

Magali Delmas
UCLA Institute of the Environment

Michael B. Gerrard
Columbia Law School, michael.gerrard@law.columbia.edu

Eric Orts
University of Pennsylvania, The Wharton School

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In California and Europe, a new dawn for corporate climate disclosure

BY MAGALI DELMAS, MICHAEL GERRARD, AND ERIC ORTS, OPINION CONTRIBUTORS - 10/05/23 8:30 AM ET

AP Photo/Mark Thiessen, File

FILE – A plume of smoke being emitted into the air from a power plant, Feb. 16, 2022, in Fairbanks, Alaska. The Biden administration is proposing new limits on greenhouse gas emissions from coal- and gas-fired power plants, its most ambitious effort yet to reduce planet-warming pollution from the nation's second-largest contributor to climate change.…

The Securities and Exchange Commission (SEC) is expected to finalize a new rule this month to cover required corporate climate disclosures by public-reporting companies. But the bigger news is that California Gov. Gavin Newsom (D) has announced that he will soon sign into law two climate change disclosure bills passed by the state Legislature.

These laws will put the U.S. back into a global leadership position on efforts to contain the worsening climate emergency because of the expected impact of the "California Effect" in environmental law. This refers to the influence that California has had in leading the nation on ground-level air pollution, electric vehicle standards and other issues.

California's climate disclosure laws will also mesh with developments underway in the European Union mandating climate disclosure, which will have an analogous "Brussels Effect." The EU has already adopted regulations mandating nonfinancial disclosure by large companies doing business there.

Taken together, this means a new day for corporate climate disclosure is dawning that will replace the hodgepodge of voluntary standards collected under the increasingly suspect heading of ESG (environmental, social, and governance). The new disclosure regime will help reduce rampant greenwashing by firms that claim, for example, that they are committed to climate targets — such as "net zero" by 2050 — but then do little to act on these pledges.

One law in California, the Climate-Related Financial Risk Act, will mandate that firms with more than $500 million in annual revenues disclose every two years the climate risks they face and how they are managing those risks. A second law called the Climate Corporate Data Accountability Act will require standardized reporting of greenhouse gas emissions (carbon dioxide and methane for the most part) by firms with total global annual revenues of more than $1 billion.

Both will apply only to firms that do business in California, but most big companies do. The legal effect will be national and indeed global, given that California would be the fifth-largest economy in the world if it were a country. Many big global companies will be subject to parallel disclosure rules in Europe too.

The new climate laws mark a sea-change in climate regulation, because they include the disclosure of the greenhouse gas emissions both upstream and downstream of the company itself — that is, from its suppliers and customers. Big companies typically disclose direct emissions, such as from their factories, and sometimes they disclose the pollution produced from the electricity they use, but they rarely disclose indirect emissions, even though indirect emissions account for about 75 percent of total emissions.

For example, an oil and gas company might reduce leakage from its wells and refineries, and maybe even boast about it, but fail to disclose the emissions when its consumers burn the oil and gas. California's law will require disclosure of a reasonable and good faith estimate of these indirect emissions.

Although the SEC is expected to release its climate disclosure rules soon, these are likely to have much narrower scope than the California laws. The SEC's rule will apply only to public-traded companies, whereas the California laws will also apply to privately held firms. It is also rumored that the SEC may drop or significantly limit coverage of indirect emissions in its final rule, in part because the rule may be vulnerable to legal challenge under the "major questions" doctrine as outlined in last year's West Virginia v. EPA Supreme Court decision.

California's laws stand a much better chance of success if challenged legally. Just last May, the Supreme Court upheld the constitutionality of a California statute limiting the sale of pork produced from pigs subjected to cruel treatment, even though most of the pigs are raised outside California. This precedent, which unified conservative and liberal justices, would likely be followed, and California's new climate laws upheld too.

Although no panacea for the climate challenge, informational regulation of the kind coming online in California and Europe has worked well in other environmental contexts. It has led to reduced toxic releases into the air, water and land. Mandated disclosure in electric utility markets has created incentives for renewable energy development.

Corporate disclosures of greenhouse emissions and climate policies are also likely to prove effective in reducing some greenhouse emissions, given the power of transparency, and they are likely to be efficient too, because unlike many forms of government intervention this kind of regulation uses markets to influence behavior.

Many leading businesses supported passage of the California law, including Apple, Google, IKEA, Microsoft, Patagonia, and Salesforce. More businesses — and individual investors, consumers, and citizens too — should welcome the replacement of the current confusing choice among at least seven different competing voluntary standards.

The new dawn of a corporate climate disclosure regime with legal teeth gives reason for hope that business firms will be incentivized to find more climate solutions the world needs in time to avoid the worst outcomes. At the same time, we might adapt an adage popularized by former President Ronald Reagan as a tagline: Hope, but verify.

Magali Delmas is a professor at the Anderson School of Management and director of the UCLA Center for Corporate Environmental Performance. Michael Gerrard is a professor at Columbia Law School and director of the Sabin Center for Climate Change Law. Eric Orts is a professor at the Wharton School of the University of Pennsylvania.

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