US ESG Flash

California climate disclosure rules in flux

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California climate disclosures challenged in court…

Legal action was initiated yesterday contesting the recently enacted California laws mandating disclosures on greenhouse gas emissions and climate risks.
Business and agricultural groups, including the U.S. Chamber of Commerce, are suing California over its broad climate disclosure mandates, claiming they violate federal authority and the First Amendment. This legal challenge is the first major one against the laws signed by Governor Gavin Newsom, which drew national attention, and it introduces uncertainty into climate disclosure compliance, foreshadowing potential challenges to future SEC rules. In our view, California regulations could potentially facilitate the SEC's passage of its own rule, reducing financial burdens for both the agency and US companies. With global standards evolving and California's laws being challenged, the SEC's rule becomes increasingly important to streamline reporting.

…and face potential delays due to proposed budget cuts

The news follows proposed budget cuts by California Governor Gavin Newsom in January. As we wrote in Deciphering the US ESG regulatory climate, under the corporate climate disclosure legislation, more than 5,300 public and private companies will need to disclose emissions (SB 253) and more than 10,000 companies will need to disclose climate risks (SB 261). Yet Governor Newsom's budget proposal doesn't include government funding for these bills, which has caused concern that the bill's original reporting timeline (2026 for climate risks and Scope 1&2 emissions, and 2027 for Scope 3 emissions) will be delayed. The significance of California's laws lies in the broad impact they could have on a multitude of US companies doing business within the state, given it is the world's fifth-largest economy. The governor will release a revised budget proposal by May 14. June 15 is the deadline for lawmakers to pass the final budget bill.

Financial materiality and heat-related safety risks

Another important regulation worth discussing is worker safety from heat-related risks. Just yesterday, we saw headlines that Maryland is contemplating a rule to safeguard workers from heat stress, aligning with California, Minnesota, Oregon, and Washington. OSHA's recent "Regulatory Framework" underscores a programmatic standard for managing heat hazards at workplaces, yet it remains a draft, susceptible to legal challenges, potentially leading to prolonged implementation. Labor standards and health and safety exposure are financially material factors, notably for Consumer Discretionary, Real Estate, Materials, and Utilities sectors. Supply chain labor standards are significant for Consumer Staples companies (see Follow the numbers, not the naysayers). Mortality rates from heat-related illness are 20x higher for U.S. crop workers compared to private industry and non-federal government workers (EDF). Heat stress threatens agricultural labor productivity, compounding challenges in tight labor markets (40% of new agriculture jobs unfilled annually in the US per Purdue University), with agricultural wage growth outpacing non-agricultural wages by 11ppt between 2000 and 2022 (USDA). See Feeding the future: the intersection between climate & AgTech).

OSHA: US Occupational Safety and Health Administration

SEC: US Securities and Exchange Commission

CA climate disclosure rules challenged

Business and agricultural groups, including the U.S. Chamber of Commerce, are suing California over its broad climate disclosure mandates, claiming they violate federal authority and the First Amendment. This legal challenge is the first major one against the laws signed by Governor Gavin Newsom, which drew national attention, and it introduces uncertainty into climate disclosure compliance, foreshadowing potential challenges to future SEC rules. Notably, the lawsuit does not contest the Voluntary Carbon Market Disclosures Act.

This follows proposed budget cuts by California Governor Gavin Newsom earlier this month. It was stated that Governor Newsom's budget proposal doesn't include government funding for the California Air Resources Board (CARB) to implement California's Climate Corporate Data Accountability Act or Climate-Related Financial Risk Act, which has caused concern that the bills' implementation will be delayed. The Voluntary Carbon Market Disclosures Act does not require implementing action and therefore is not affected by the proposed budget cuts. The significance of California's laws lies in the broad impact they could have on a multitude of US companies doing business within the state, given it is the world's fifth-largest economy. As we wrote in Deciphering the US ESG regulatory climate, under the corporate climate disclosure legislation, more than 5,300 public and private companies, will need to disclose emissions (SB 253) and more than 10,000 companies will need to disclose climate risks (SB 261) - spanning all industries.

Potential delays notwithstanding, we don't see the pressure for companies disclose emissions and climate risks going away. With weather-related disasters costing the US >$1 trillion in the last decade, investors are increasingly interested in understanding the impact on their investments. Our analysis found that the ten largest asset managers in the US (with a combined total AUM of $37trn) have each disclosed membership in at least 3 different climate initiative groups. To help empower investors with better information so they can evaluate the financial implications of climate risks, various jurisdictions are enacting or proposing climate disclosure regulation, upping the likelihood that companies will be required to report on climate under at least one regime. For example, some US companies will need to report climate data under the EU's Corporate Sustainability Reporting Directive (CSRD) as soon as 2025, while a series of climate disclosure bills that would require emissions and climate risk disclosures are on the legislative agenda in New York this year. For example, a proposed bill establishing a "climate corporate accountability act" (S897A) in New York is very similar to California's Climate Corporate Data Accountability Act (SB 253). It would companies with at least $1B in revenue that do business in New York to report on Scope 1, 2, and 3 emissions annually.

California's climate disclosure bills more ambitious than the SEC's proposed rule

Th three climate disclosure bills passed in October go over and beyond the SEC's own climate proposals and extend to certain private companies: (1) the Climate Corporate Data Accountability Act (SB 253) that requires emissions disclosures for companies with over $1B in revenue that do business in the state; (2) Climate-Related Financial Risk Act (SB 261) that requires climate risk disclosures from companies with over $500M in revenue that do business in the state; (3) Voluntary Carbon Market Disclosures Act (VCMDA; AB 1305) that requires companies making emissions reduction claims (e.g. net zero or carbon neutral) to disclose how these claims were determined to be accomplished, whether there is independent third-party verification, and how interim progress is measured.

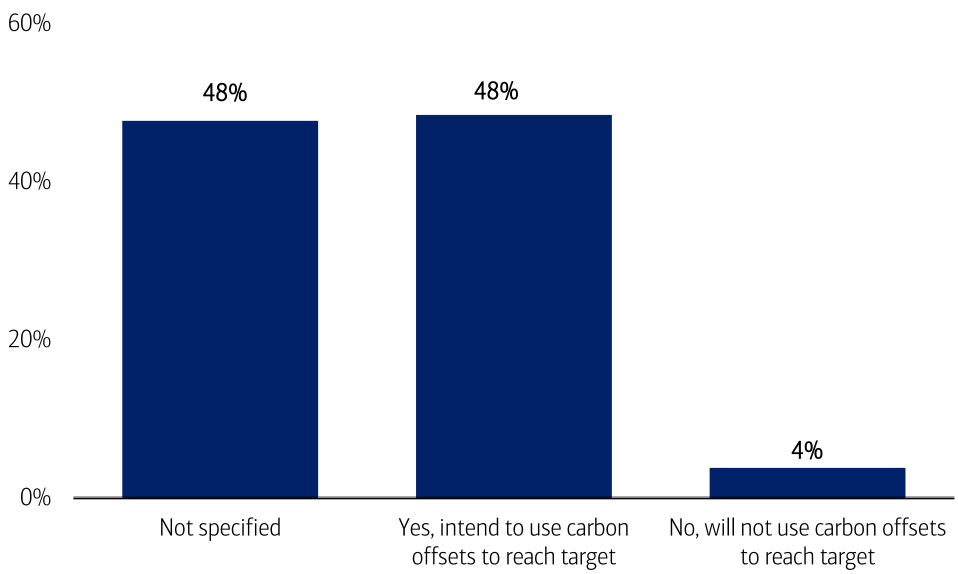
Despite initial pushback on SEC disclosure requirements on disclosing Scope 3 emissions, the mandate in SB 253 implies that as the rule is implemented, data quality will likely improve. This, in turn, could have potentially facilitated the SEC's passage of its own rule, reducing financial burdens for both the agency and US companies (assuming they were in compliance with the California regulations). While California's laws amplify the urgency for a strong SEC rule applicable to all public US companies, there remain firms unaffected by these laws, and their investors still require reliable information. With global standards evolving and California's laws being challenged, the SEC's rule becomes increasingly important to streamline reporting obligations for all publicly traded US firms, providing necessary clarity and consistency to investors.

State funding is needed to implement the climate disclosure bills

The proposed budget cut could delay implementation by hindering the California Air Resources Board's (CARB) ability to begin working on the bills this year. CARB, the lead agency for climate change programs in California, needs to define effective reporting dates and develop reporting regulations by January 1, 2025. However, Governor Newsom's proposed budget does not provide funding to CARB to do so. This could result in a delay in the bill's original reporting timeline (reporting starting in 2026 for climate risks and Scope 1&2 emissions, and 2027 for Scope 3 emissions). When signing the bills, Governor Newsom indicated concerns around the implementation timeline, financial impact to companies, and emissions reporting protocol. The governor will release a revised budget proposal by May 14, after which each house of the California legislature will finalize its version of the budget. June 15 is the deadline for lawmakers to pass the final budget bill.

Separately from the proposed budget cuts, there has also been a delay announced for the compliance date of California's Voluntary Carbon Market Disclosures Act (VCMDA; AB 1305), which requires advertisers to include specific disclosures on their websites when making certain types of carbon emissions claims. The bill reflects a growing focus on combatting climate greenwashing, at a time when many offsets are hard-to-verify yet nearly half of US companies plan to use offsets to achieve their net zero goals. The bill's sponsor submitted a formal letter this month clarifying that his intent was that the first set of required disclosures be posted to companies' websites by January 1, 2025 .

Exhibit 1: Only minority of US companies don't plan on using offsets to reach net zero
Percent of US companies with net zero targets that intend to use carbon offsets, as of 11/2023



Source: Net Zero Tracker, BofA US Equity & Quant Strategy. Considers 270 US companies captured in the Net Zero Tracker's database that have net zero targets (also includes net zero adjacent targets, e.g., carbon negative, carbon neutrality, 1.5C pathway).

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Federal heat stress regulations next?

Another important regulation worth discussing is worker safety from heat-related risks. Maryland is considering a proposed rule to protect workers from heat stress, aligning with California, Minnesota, Oregon, and Washington. This comes as OSHA has been ramping up enforcement of heat-safety violations and increasing inspections in high-risk industries.

According to our materiality analysis, our backtests reveal that labor standards (and Health & Safety exposure) rank among the most financially material factors for the Consumer Discretionary, Real Estate, Materials, and Utilities sectors, while supply chain labor standards are financially material for Consumer Staples companies. See report: Follow the numbers, not the naysayers.

On August 30, 2023, OSHA unveiled a "Regulatory Framework" aiming to outline potential components for a future OSHA standard. This framework indicates OSHA's emphasis on a programmatic standard, requiring employers to establish plans for assessing and managing heat hazards in their workplaces. However, this framework is not a finalized OSHA standard. There is risk that the eventual heat-safety standard could face legal challenges, potentially leading to prolonged implementation.

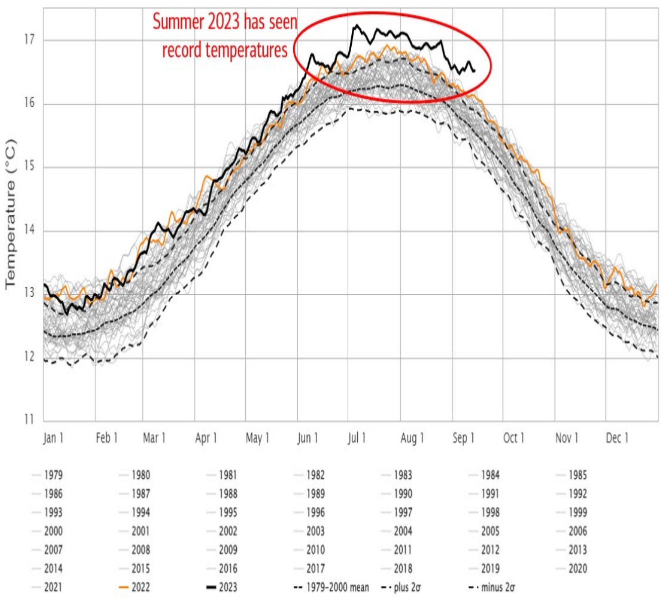
On a state level, proposed regulations cover both indoor and outdoor labor, setting the trigger temperature for precautions at an 80-degree heat index, differing from the rejected 2022 edition, which had an 88-degree trigger. Employers would need to implement a written "effective heat illness prevention" plan, ensuring access to shade, cooled spaces, and water, with acceptable alternatives like water-cooled garments and misting equipment. The proposal mandates enough water for each worker every hour on hot days. Newly hired or returning employees after a seven-day absence must acclimatize to hot conditions, though short workdays are not mandated.

> Mortality from heat-related illness is 20x higher for crop workers in the U.S. than private industry and non-federal government workers. (EDF)

We have previously written about the risks that climate change poses to agricultural workers (see Feeding the future: the intersection between climate & AgTech). Heat stress from rising temperatures puts pressure on agricultural labor productivity at a time when farm labor markets are becoming tighter (40% of new agriculture jobs unfilled each year in the US, per Purdue University) and labor costs are skyrocketing. Agricultural wage growth outpaced that of non-agricultural wages by 11ppt between 2000 and 2022.

Exhibit 2: The average global temperature has been at a 50-year record for the last 3.5 months

Daily 2-meter global air temperature average between 1979 and 2023



Source: NCEP CFSV2/CFSR, ClimateReanalyzer.org, Climate Change Institute, University of Maine,

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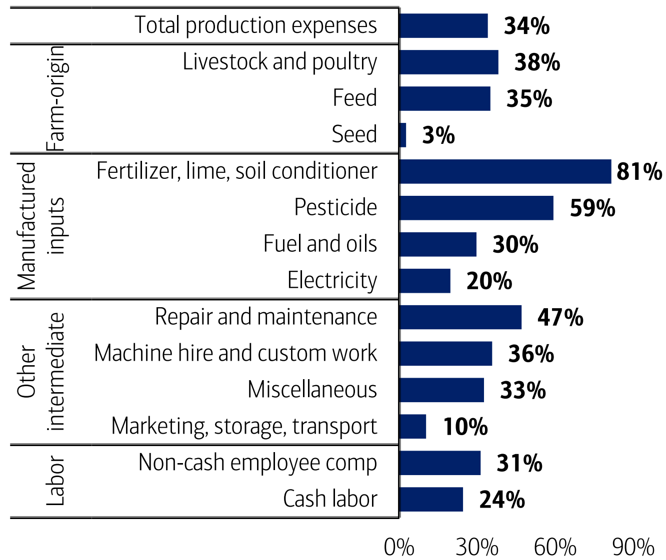
Exhibit 3: US farm production expenses have gone up a whopping 34% in the last 5 years

Change in nominal production expenses (excl. operator dwellings), 2023F vs 2018



Source: USDA, BofA Global Research

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