

# The New ESG Landscape: What Global Companies Need to Know

## Client Alerts

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## Introduction

Companies around the world have an increasingly delicate balancing act when considering environmental, social and governance factors—collectively referred to as “ESG”—in their business decisions. The term “ESG” has become controversial and political, with governments around the world taking divergent approaches to regulation. In the EU, companies face onerous compliance and reporting obligations on pain of significant fines. Meanwhile, in some parts of the United States, there has been a backlash against “ESG”: companies may face litigation, enforcement action—as well as negative attention from the White House and Congress—for considering ESG factors in their decision making. The uptick in anti-ESG sentiment is only expected to rise under the new Trump Administration, which, by as early as Days 1 and 2 of his Presidency, had announced U.S. withdrawal from the Paris Agreement on climate change and issued a series of Executive Orders targeting diversity, equity and inclusion (DEI) initiatives.

As positions on either side of the Atlantic become increasingly polarised, global companies may find themselves damned if they do, and damned if they don't. Multinationals that take a siloed approach to their DEI, climate and human rights issues in one jurisdiction run the risk of creating legal and public relations issues in another. We set out the background to this conundrum and propose steps for global companies to build a comprehensive compliance strategy that balances different international risks.

## Current State of ESG Regulations – What Obligations Apply to Global Companies?

### European Union

The Corporate Sustainability Due Diligence and Reporting Directives serve as the cornerstones for European ESG regulatory compliance, having entered into force on 5 January 2023 and 25 July 2024 respectively.

- **Corporate Sustainability Due Diligence Directive (CSDDD):** As we previously reported for Law360, the CSDDD will apply to EU companies with €450 million in net turnover and over 1000 employees, and non-EU companies that generated over €450 million in net turnover in the EU in

the previous fiscal year. Companies in scope will be required to assess, prevent or mitigate and remedy actual and potential adverse impacts of their activities on environmental, human rights and certain compliance governance matters. The obligations under the CSDDD apply not only to a company's own operations but its entire global chain of activities, both upstream, e.g., design, supply and manufacture, and downstream as related to distribution, transport and storage. Limited exception is made for regulated financial undertakings, for whom only their upstream chain of activities is included in scope. Application of the CSDDD will be phased in from 2027, with penalties for non-compliance amounting to up to 5% of net global turnover.

- **Corporate Sustainability Reporting Directive (CSRD):** The CSRD applies to all “large” EU companies<sup>1</sup> all companies listed on EU regulated markets (except “micro undertakings”)<sup>2</sup> and all non-EU companies with “significant activity” in the EU. For the purposes of the CSRD, a non-EU company will have significant activity if it generated over €150 million in net turnover in the EU for two consecutive years and has either an EU subsidiary that would classify as a “large” company or an EU branch with a net turnover of over €40 million. Companies in-scope are required to report on their material environmental, human rights and governance impacts. To understand these impacts, companies must conduct an impact assessment—known as a double materiality assessment—looking both inwardly at the financial risk of their operations for the company itself and outwardly at the environmental and social impact of their operations on the world. Similar to the CSDDD, the reporting obligations extend to a company's entire global supply chain, with phased in application for EU companies starting this year for reporting on FYE 2024. Penalties set are at the discretion of individual EU member states; however, in some countries, such as Germany, fines of up to €10 million or 5% of annual turnover can be applied.

Complementing the broad scope of the CSDDD and CSRD, once voluntary ESG initiatives have also crystallised into specific hard law EU norms on, *inter alia*, Forced Labour, Deforestation, Conflict Minerals and Critical Raw Materials.

### **United States**

Whilst the United States is expected to move in the opposite direction to the EU on climate and DEI; on the human rights side, it, too, has tough federal laws to combat forced labour. The 1930 Tariff Act contains a general prohibition on importing forced labour-made goods, while the 2022 Uyghur Forced Labor Prevention Act goes further and requires companies importing products from the Xinjiang region in China (known for its use of forced labour in prison camps) affirmatively to prove to the Customs authorities that those products were not produced with forced labour.

Although the new Republican-led Securities and Exchange Commission is likely to disband federal climate disclosure rules, environmental disclosure obligations in Democrat-controlled states will also still apply, along with voluntary frameworks driven by shareholder demands. California, for example, will continue to require companies with revenues greater than \$1 billion doing business in California to report on their emissions – beginning in 2026. Further, Democrat-led State Attorneys General offices could focus on claims arising from issues relating to greenwashing, either by

pursuing claims arising from specific state laws or more broadly using a state's consumer protection laws to claim that a company made false representations about the environmental impact of their products in a way that materially induced consumers to buy the product.

### **The 'ESG Backlash' and Case Against Compliance**

In the United States, ESG has become a political issue, including on Capitol Hill, in the White House, and in the states. For example, on Capitol Hill, committees in both the Senate and the House of Representatives have claimed companies may be engaging in antitrust violations; namely, by entering into agreements that some claim will restrict the supply of oil, gas and coal. At the White House, President Trump withdrew from the Paris Agreement on climate change and signed other Executive Orders aimed at rolling back clean energy initiatives and DEI programs. At the state-level, over 40 anti-ESG laws have been passed and enacted, blocking financial institutions that "boycott" certain industries (i.e. fossil fuels, agribusiness, firearms, and timber) or which consider ESG factors in investment decisions from procuring public contracts or managing state pension funds. There have also been at least five lawsuits filed by State Attorneys General relating to anti-ESG claims, in addition to the myriad investigations State Attorneys General have initiated against companies for promoting their ESG initiatives.

Whilst the European debate around ESG does not have the same political tenor as that in the United States, EU member states and stakeholders have argued that the high burden of sustainability reporting is hurting EU commercial competitiveness. In response, on 26 February 2025, the European Commission will publish the first of a series of Omnibus Proposals aimed at simplifying sustainable finance reporting and due diligence. It remains to be seen, however, what form this will take and how it will affect the current ambit of EU ESG obligations.

### **"Damned if you do, damned if you don't" – The Conundrum for Global Companies**

Globally, the politicisation of ESG has left multinationals in a bind as to how best to proceed. In Europe, beyond the hardening regulatory landscape, businesses must be cognisant of the commercial ripple effect of the EU ESG laws. Companies are required to provide transparency to their investors, customers and vendors to meet their obligations to report on their supply chains and sustainable investments, with failure to do so potentially resulting in loss of business or funding. More generally, adverse environmental and human rights impact can result in commercial and reputational risk in Europe, such as through consumers boycotting products or investors litigating for losses in profits. In addition, activist investors and increasingly well-funded NGOs are bringing claims against multinationals and pressuring regulators to take action in respect of greenwashing (that is, falsely or misleadingly overstating environmental credentials) or "bluwashing" (which is the same practice of false or misleading marketing, as applied to the human rights or social context) and other adverse human rights and environmental impacts. In stark contrast, however, companies may be subject to public criticism and scrutiny in the United States for their adherence to, and promotion of, ESG initiatives. This criticism could come, for example, from Capitol Hill in the form of a

congressional inquiry, from the White House's use of the President's bully pulpit, or from Republican State Attorneys General enforcing anti-ESG laws or other more generic laws that they may claim are implicated by ESG-related activities. While global companies must comply with laws globally, including in the EU, they should be cognisant of the effect—legally and politically—of compliance elsewhere.

### **Threading the Needle – How Global Companies Can Chart a Path Forward**

Whilst the unpredictability of the current climate may tempt corporates to hedge their bets, those with pro-ESG obligations remain bound and will be expected to comply under pain of sanction – be it regulatory, commercial, reputational or otherwise. To thread the needle and navigate this fractured landscape, global companies should consider the following steps:

- **Conduct a global regulatory exposure assessment** to better understand the scope of their obligations and the steps needed to ensure full compliance.
- **Align ESG obligations with core business practices** by thinking about how compliance helps manage long-term risks for the company. For example, the environmental benefits of reducing operational costs through energy efficiency, the social benefits of improving workforce satisfaction and retention, and how good governance practices mitigate risks and avoid regulatory fines in areas such as anti-corruption and money-laundering.
- **Move beyond ESG as a shorthand**, which has now become a loaded term. Instead, look to break down more precisely what risks they are looking to prevent, such as climate or forced labour, and articulate to stakeholders the financial benefits of managing these risks.
- **Develop a comprehensive compliance framework** to combat those risks, such as through risk mapping and impact assessments, developing a coordinated reporting strategy, and implementing a global and centralised third-party management system to conduct due diligence, assess risks, and monitor compliance. Critically, climate, human rights, people and culture risks, and supply chain governance can be integrated into existing compliance programs, to the extent that they are not already.
- **Avoid siloed thinking** to enable them to take a strategic, centralised approach to compliance across multiple departments and jurisdictions. Compliance and reporting should not be put in the hands of a few individuals with specific focus on the requirement at issue. Companies who take a siloed approach to compliance and reporting run the risk of the right hand not talking to the left due to a lack of internal coordination. They could find themselves making green claims in statements that cannot be substantiated (leading to greenwashing risks) or reporting how they have sacrificed—or failed to consider—shareholder profit to combat climate change and advance DEI objectives (leading to public relations and litigation risks in the United States).

Charting a path forward is possible. To do so, however, companies will need to think holistically about their regulatory exposure and ensure that all departments and offices work in symphony – from Sustainability to Legal and Compliance to Human Resources to Communications. By aligning on different internal objectives at the global level, companies can ensure that they are protected in this very fast-evolving and ever political field.

## Footnotes

[1] A large EU company is one that meets two out of three of the following: (1) net turnover of more than €40 million; (2) balance sheet total assets greater than €20 million; (3) more than 250 employees.

[2] Micro undertakings are those that do not exceed two out of three of the following: (i) balance sheet total of €350 000; (ii) net turnover of €700 000; and (iii) average of 10 employees during the financial year.

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