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Transnational ESG: The Impact of EU Sustainability Directives on US Law and Policy

Abstract: The European Union’s Corporate Sustainability Reporting Directive (CSRD) and Corporate Sustainability Due Diligence Directive (CSDDD) represent transformative developments in global ESG regulation. These ambitious mandates, core to the EU’s European Green Deal, impose significant environmental and human rights obligations not only on EU companies but also on thousands of non-EU firms—including US companies—with operations or business ties within the bloc. This article explores the implications of these directives for US firms and policymakers, emphasizing their extraterritorial scope and normative ambition. Unlike US law, which is mired in debates over financial materiality and limited by anti-regulatory sentiment and anti-majoritarian structural constraints, the EU directives adopt sustainability as a stand-alone legal goal. These directives position the EU as a de facto global ESG standard-setter, displacing the influence of US corporate governance-based reforms. The Article argues that the EU’s uniform, binding rules offer a more effective and democratic pathway to sustainability than shareholder-driven approaches in the United States, which rely on inconsistent support from mutual funds and only impact public companies. Ultimately, EU leadership in ESG regulation may better reflect the values of the American public than domestic lawmaking currently can, given political dysfunction and regulatory stagnation in the US.

Keywords: sustainability reporting, European Green Deal, transnational law, corporate disclosure, Corporate Sustainability Reporting Directive (CSRD), Corporate Sustainability Due Diligence Directive (CSDDD), ESG

I. Introduction

The European Union’s Corporate Sustainability Reporting Directive (CSRD), a comprehensive ESG disclosure mandate, went into force in January 2023.¹ The EU is also close to finalizing the Corporate Sustainability Due Diligence Directive (CSDDD), which requires corporations to conduct due diligence into adverse human rights and environmental impacts potentially hidden in their supply

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¹ Directive (EU) 2022/2464 of the European Parliament and of the Council of 14 December 2022 Amending Regulation (EU) No 537/2014, Directive 2004/109/EC, Directive 2006/43/EC and Directive 2013/34/EU, as Regards Corporate Sustainability reporting. OJ L 322/15. <https://eur-lex.europa.eu/eli/dir/2022/2464/oj/eng> [referred to in the text as CSRD]. The reporting requirements are being phased in over several years. *See* CSRD Timeline: What You Need to Report and When, <https://blog.worldfavor.com/csr-d-timeline-what-you-need-to-report-and-when>.

chains (Council of the European Union 2024). These two directives are key components of the EU's "European Green Deal" and important pillars of the bloc's ESG efforts. While the directives are remarkable in both substance and scope, one aspect that stands out as much as any other is their transnational application. Each regulates the activities of both EU companies and those that do business within the EU, which includes thousands of US firms. This article considers the implications of these initiatives for US companies and policymakers, particularly with respect to environmental protection and climate change.

These initiatives not only go far beyond the current federal regulatory requirements in the US, but they also are founded on more modern and ambitious ideological underpinnings. They embrace sustainability as a stand-alone goal, and in doing so, transcend moribund debates about financial materiality and shareholder primacy that bog down US efforts. Moreover, the rules apply not only to activities of non-EU firms in the EU, but to the worldwide activities of global conglomerates that have EU operations. The extraterritorial application of CSRD and CSDDD is thus a sea change for US firms.

Equally important, the rules demote US law and US lawmakers and establish the EU as a benign ESG hegemon. I argue that this shift is underappreciated and that the EU rules better represent the values of US citizens than does US law, which is constrained by countermajoritarian and antiregulation biases. Moreover, faced with political deadlock, sustainability advocates have pushed corporations to be more sustainable through corporate governance, and in particular, through the shareholder proposal process. I argue that EU leadership is far more promising. Unlike reform through corporate governance, EU rules do not depend on support from the large mutual fund complexes, which have proven capricious. Further, the rules create uniform legal obligations rather than bespoke internal policies of unclear significance, and they apply to both public and private corporations rather than only public ones.

Part II of this article describes the substance of CSRD and CSDDD, contrasts the directives with US law, and discusses the extent to which they apply to US companies. Part III assesses the implications of the transnational scope of these rules. I argue that, while in a first-best world, the US should make its own rules through a democratic process that fairly represents its citizens' views, given the current state of government dysfunction, European leadership on ESG delivers progress on climate goals that have widespread support in the US population. In Part IV, I describe why the transnational application of EU rules is a more promising path toward sustainability than efforts to promote such goals through corporate governance. Finally, Part V considers the impact of recently arising headwinds in the EU to the bloc's sustainability efforts.

II. The Network of EU Sustainability Rules

The European Commission announced the European Green Deal in December 2019. According to the first recital of CSRD, "The Green Deal is the new growth strategy of the Union. It aims to transform the Union into a modern, resource-efficient, and competitive economy with no net emissions of greenhouse gases (GHG) by 2050. It also aims to protect, conserve and enhance the Union's natural capital, and protect the health and well-being of Union citizens from environment-related risks and impacts" (CSRD, Recital 1). The Green Deal sets forth an "initial roadmap of the key policies and measures needed to achieve" its goals (European Commission 2019). The centerpiece legislation of the Green Deal is the European Climate Law, which codifies the EU's commitment to

become climate neutral by 2050, but the Green Deal is “enormous” in scope and embraces a “host of interconnected goals covering almost every element of society and the economy” (*Economist* 2021).

One aspect of the Green Deal targets disclosure and diligence at corporations and institutional investors. Aside from CSRD and CSDDD, there is the EU Taxonomy Regulation and the Sustainable Finance Disclosure Regulation (SFDR). The former, in an effort to combat greenwashing, creates categories for what count as sustainable practices for reporting purposes.² The latter seeks to provide ESG transparency to financial services. It requires that asset managers disclose whether the investments they offer are “mainstream products, products promoting environmental or social characteristics or products with sustainable investment objectives” (Price Waterhouse Belgium n.d.).

CSRD and CSDDD, like other aspects of the Green Deal, have global ambitions. According to the European Commission,

The environmental ambition of the Green Deal will not be achieved by Europe acting alone. The drivers of climate change and biodiversity loss are global and are not limited by national borders. The EU can use its influence, expertise and financial resources to mobilise its neighbours and partners to join it on a sustainable path. The EU will continue to lead international efforts and wants to build alliances with the like-minded. It also recognises the need to maintain its security of supply and competitiveness even when others are unwilling to act. (European Commission 2019)

The above paragraph makes clear the EU’s rationale for seeking extraterritorial application of CSRD and CSDDD, among other Green Deal measures. One is that the roots of climate change are global. Reducing emissions from EU firms is important, but emissions from foreign actors also play a large role. Including these firms thus furthers the EU’s goal of meeting the Paris Agreement’s targets. Similarly, climate change presents a free-rider problem because the environment is a shared resource. Compliance drives up costs for European firms, making them less competitive in the global economy, but everyone benefits from the reduced emissions. The EU rules mitigate free riding through global application.

A. The Corporate Sustainability Reporting Directive Compared to US Law

The EU has had sustainable reporting rules in place—the Non-Financial Reporting Directive (NFRD)—since 2016. There was a sense, however, that under NFRD, corporations were not providing sufficient comparable information in a reliable format (European Commission 2021). CSRD expands the obligations of reporting companies and vastly increases the number of companies required to report—from 11,700 to almost 50,000 (KPMG n.d.).

CSRD’s overarching obligation is for in-scope companies to provide all of the information “necessary to understand the [company’s] impacts on sustainability matters, and information necessary to understand how sustainability matters affect the [company’s] development, performance and

² CSRD, Recital 2 (“Regulation (EU) 2020/852 of the European Parliament and of the Council creates a classification system of environmentally sustainable economic activities with the aim of scaling up sustainable investments and combatting greenwashing of financial products that unduly claim to be sustainable.”). For further discussion, see Paces (2021); Envoria (2023).

position” (Latham & Watkins 2023). CSRD defines “sustainability matters” as “environmental, social and human rights, and governance factors” (CSRD, Article 2(b)). CSRD expands on this concept itself, but leaves the details of the reporting obligations to European Sustainability Reporting Standards (ESRS). The core set of standards was finalized in June 2023 and a supplemental set will follow in June 2024 (CSRD, Article 29(b)).

From a US perspective, there are several notable aspects of CSRD. The first is the concept of “double materiality,” which was also part of NFRD (European Commission 2021). Double materiality requires that companies disclose not only how sustainability matters impact their operations (financial materiality), but also how their operations impact sustainability (so-called impact materiality). For example, a company would need to address how climate change impacts its business and how its business contributes to climate change.

In theory, materiality is only assessed from a financial perspective in the US. That is, information is only material if it would be important to a reasonable investor. *TSC Industries v. Northway*, 426 U.S. 438, 449 (1976). This is a key challenge to the US securities regulator, the Securities and Exchange Commission (SEC). In March 2024, the SEC enacted rules on climate-related disclosures and one of the key controversies surrounding the rules is that they stretch the definition of financial materiality to arguably encompass impact materiality as well. For example, the rule requires disclosure of material Scope 1 and Scope 2 greenhouse gas (GHG) emissions (Securities and Exchange Commission 2024a). While this seems like impact materiality, the SEC defends this requirement in financial terms. It reasons that “[q]uantitative greenhouse gas (“GHG”) emissions data can enable investors to assess a registrant’s exposure to climate-related risks, including regulatory, technological, and market risks driven by a transition to a lower-GHG intensive economy” (Securities and Exchange Commission 2024a, 21344). The logic here is that the disclosures would make clear which companies are high emitters and thus at risk of, among other things, regulations calling for cuts. This is important to investors because the new regulations would potentially threaten profits. Because this expansive definition of materiality approaches impact materiality, the pretextual feel of the SEC’s arguments has led to constitutional challenges, further discussed in Part III.

CSRD, and the concept of double materiality, also extend through the corporation’s value chain. Thus, firms will be responsible for reporting not only on their own sustainability impact, but on the sustainability impact of their manufacturers, suppliers, and distributors. Including corporate value chains in disclosure obligations makes sense for two reasons. First, one cannot understand a corporation’s sustainability footprint without also understanding its value-chain emissions. Second, it would be too easy for companies to hide problematic activities by contracting for them rather than conducting them in-house.

Despite the clear importance of value-chain disclosures, the newly enacted SEC rules do not require them. A key requirement of the rules is that companies “describe any climate-related risks that have materially impacted or are reasonably likely to have a material impact on the registrant, including on its strategy, results of operations, or financial condition” (Securities and Exchange Commission 2024a). The SEC’s new rules do not require that companies report the impact of such risks on their value chain.

Under CSRD, corporate sustainability disclosures also must be subjected to a “limited assurance” audit (CSRD, Article 40(a)(3)). As the CSRD explains, “the conclusion of a limited assurance engagement is usually provided in a negative form of expression by stating that no matter has been identified by

the practitioner to conclude that the subject matter is materially misstated.”³ This is in contrast to the more thorough and expensive “reasonable assurance audit,” in which the auditor positively attests to a lack of material misstatements in the disclosures (CSRD, Article 26(a)). CSRD leaves open the prospect that such audits will eventually be required (CSRD, Article 60). The SEC’s rules also mandate a limited assurance audit, but the requirement only applies to the largest companies and only to those companies’ GHG emissions disclosures. The mandate begins in the third year of compliance, and in the seventh year, companies must switch to a reasonable assurance audit (Securities and Exchange Commission 2024a).

Finally, the aspect of CSRD that has perhaps drawn the most attention is how many companies it pulls in, both from within the EU and from outside it. Article 19(a) specifies which EU companies are covered. The law applies to “large undertakings,” which are those companies that meet two of the following three criteria: an average of greater than 250 employees during the year, greater than EUR 40 million net turnover, and a balance sheet showing a value of over EUR 20 million (European Parliament 2013). CSRD further applies to “small and medium-sized undertakings . . . which are public interest entities” (CSRD, Article 19a). This includes all companies publicly listed on an EU-regulated market, excluding micro-undertakings (those that meet two out of three of the following criteria: ten or fewer employees, a balance sheet value of under EUR 350,000, and net turnover of no more than EUR 750,000) (Directive 2013/34/EU, Article 3(1)).

Article 40a explicitly brings in non-EU firms. Corporate groups with parent companies formed outside the EU are subject to the CSRD if they had a net turnover within the EU of at least EUR 150 million for the two previous consecutive years, and either have an EU subsidiary that would independently qualify under Article 19a (as set out in the paragraph above) or have a branch with EU net turnover of at least EUR 40 million (CSRD, Article 40a). According to a Refinitiv analysis, these parameters net over ten thousand foreign firms, over three thousand of them from the US (Holger 2023). And this is a vast understatement of CSRD’s extraterritorial impact. Every international firm that is in the value chain of any EU or non-EU firm that is subject to CSRD is also indirectly implicated. They will be called on to provide sustainability information so that the firm that is directly in scope can comply.

Global corporations that are directly swept into the rule under Article 40a are not subject to all the CSRD’s reporting requirements, but they are required to submit a “sustainability report” (CSRD, Article 40a(1)). Because the requirements are brief, clear, and important for understanding the breadth of CSRD, I include them here. According to Article 29(a)(2)(a), non-EU companies must draft “a brief description of the group’s business model and strategy, including”:

...

(iii) the plans of the group, including implementing actions and related financial and investment plans, to ensure that its business model and strategy are compatible with the transition to a sustainable economy and with the limiting of global warming to 1,5 °C in line with the Paris Agreement and the objective of achieving climate

³ CSRD, Article 60 states: “In a limited assurance engagement, the auditor performs fewer tests than in a reasonable assurance engagement. The amount of work for a limited assurance engagement is therefore less than for a reasonable assurance engagement. The amount of work in a reasonable assurance engagement entails extensive procedures including consideration of internal controls of the reporting undertaking and substantive testing, and is therefore significantly greater than in a limited assurance engagement.”

neutrality by 2050 as established in Regulation (EU) 2021/1119 and where relevant, the exposure of the group to coal-, oil- and gas-related activities;

(iv) the opportunities for the group related to sustainability matters;

(v) how the group's business model and strategy take account of the interests of the group's stakeholders and of the impacts of the group on sustainability matters;

Non-EU firms must also provide the following, according to Article 29(a)(2)(b)–(f):

(b) a description of the time-bound targets related to sustainability matters set by the group, including, where appropriate, absolute greenhouse gas emission reduction targets at least for 2030 and 2050, a description of the progress the group has made towards achieving those targets, and a statement of whether the group's targets related to environmental factors are based on conclusive scientific evidence;

(c) a description of the role of the administrative, management and supervisory bodies with regard to sustainability matters, and of their expertise and skills in relation to fulfilling that role or the access such bodies have to such expertise and skills;

(d) a description of the group's policies in relation to sustainability matters;

(e) information about the existence of incentive schemes linked to sustainability matters which are offered to members of the administrative, management and supervisory bodies;

(f) a description of:

(i) the due diligence process implemented by the undertaking with regard to sustainability matters, and, where applicable, in line with Union requirements on undertakings to conduct a due diligence process;

(ii) the principal actual or potential adverse impacts connected with the undertaking's own operations and with its value chain, including its products and services, its business relationships and its supply chain, actions taken to identify and monitor those impacts, and other adverse impacts which the undertaking is required to identify pursuant to other Union requirements on undertakings to conduct a due diligence process;

(iii) any actions taken by the undertaking to prevent, mitigate, remediate or bring an end to actual or potential adverse impacts, and the result of such actions. (CSRD, Article 29a(2)(f))⁴

These requirements apply to “the undertaking's own operations and . . . its value chain, including its products and services, its business relationships and its supply chain” (CSRD, Article 29a(3)).

⁴ Where relevant, companies are also required to comply with Article 29(a)(2)(h), which calls for them to discuss “indicators relevant to the disclosures referred to in points (a) to (g)” (CSRD, Article 40a(1)).

These rules are ambitious, although perhaps not quite as ambitious as they first appear. Most prominently, 29a(2)(a)(iii) requires that companies report on their plan to operate in conformity with the Paris Agreement. It would appear that, in order to make this disclosure, companies must actually have a plan to comply with the Paris Agreement. CSRD also instructs, in 29a(2)(b), that companies report on their specific GHG emission targets and progress toward those targets. This suggests that companies must have targets and, ideally, progress toward them. Recital 30, however, makes clear that neither of these rules create substantive obligations. Companies do not need to create climate transition plans or adopt targets. Simply reporting on whether they have them is enough.⁵

CSRD also instructs companies to report on how they take stakeholder interests into account. Again, while this suggests that companies must consider stakeholders in their decision-making, Recital 30 makes clear that companies can disclose “whether” they do so. Nevertheless, the nudge to consider stakeholders contrasts with US law, which requires that firms do so only if it increases the long-term value of the enterprise. Because “long-term value” is such a slippery concept, many US firms likely consider stakeholder interests for moral reasons while defending their actions on value grounds. Unlike EU law, however, which encourages such actions, US law allows firms to only take such actions if they serve shareholders.

Finally, companies are required to report on their sustainability due diligence. This disclosure requirement is linked to CSDDD, discussed further below. Companies required to conduct due diligence under CSDDD are required to report on that due diligence in the sustainability report prepared in compliance with CSRD (CSRD, Article 29(a)(2)(f)). As discussed further below, CSDDD does apply to non-EU firms, but it is not as expansive as CSRD. The CSRD language quoted above (Article 29a(2)(f)(i)) does, however, include a stand-alone obligation—to report “the due diligence process implemented by the undertaking with regard to sustainability matters.” While this implies a legal requirement to conduct due diligence, non-EU companies outside the scope of CSDDD could potentially comply by stating that they do not conduct such diligence.

Like many disclosure laws, CSRD aims to change corporate behavior despite being primarily about transparency. The goal of the Green Deal is to combat climate change, not learn more about it. The hope is that the pressure of transparency will incentivize companies to act on sustainability issues. The extent to which these rules succeed is therefore tied to the market’s reaction to either underwhelming or stellar disclosures and associated corporate expectations. Since investors overwhelmingly stress the importance of sustainability disclosures, there is some reason for optimism that CSRD will lead to substantive changes. As discussed further below, CSDDD, unlike CSRD, contains substantive obligations. Most important, it requires companies to adopt a climate action plan in conformity with the Paris Agreement (CSDDD, Article 15(2)).

As noted, CSRD’s disclosure obligations are not limited to EU firms. Global conglomerates that do business in the EU are also covered. What is particularly noteworthy is that the reporting obligations are at the “group” level, meaning that they apply to the entirety of a firm’s global business. For example, non-EU firms must report on their plans to conduct *all* their operations in line with the Paris

⁵ For example, with respect to a climate transition plan, Recital 30 indicates that companies “should . . . be required to disclose *any* plans they may have to ensure that their business model and strategy are compatible with the transition to a sustainable economy and with the objectives of limiting global warming to 1,5 °C in line with the Paris Agreement” (CSRD, Recital 30, emphasis added).

Agreement. While such breadth has led to alarm in the financial press and Congress (Holger 2023),⁶ the rule provides an important caveat with respect to how it applies to the non-EU operations of non-EU firms. The rules require the EU subsidiary or branch to comply with the rule's reporting requirements and to seek such information from the group. If, however, it is unable to procure the information, the subsidiary or branch must "issue a statement indicating that the [non-EU parent] did not make the necessary information available" (CSRD, Article 40a(2)).⁷

CSRD's extraterritorial application is, therefore, softer than it first appears. With respect to reporting on non-EU operations, the rules can be seen as taking a "comply-or-explain" approach in that either the parent can comply by providing the requested information or its subsidiary must explain that the parent did not do so. The goal of this approach appears to be to shame non-EU firms into global compliance with the rules. To avoid the inevitable blacklist of companies that do not fully comply with CSRD, parents need to provide comprehensive information. Though the success of comply-or-explain approaches has been mixed, as discussed further in the next section, there is good reason to think that US companies will take these obligations seriously.

In sum, CSRD goes much further than US federal law, including the SEC's climate disclosure rules.⁸ Even though the SEC's rules are highly controversial, they are modest in comparison. The goal of CSRD is to provide insight into the full range of a corporation's sustainability impacts. The SEC rules, in contrast, focus on climate risks and related governance. The only sustainability impacts that the rules cover relate to corporate GHG emissions. These disclosures are important, but far narrower. Applying CSRD to US companies is, therefore, a significant departure from the status quo.

B. The Corporate Sustainable Due Diligence Directive

CSDDD requires that companies identify actual and potential adverse human rights impacts and adverse environmental impacts arising from their own operations, those of their subsidiaries, and those in their supply chains (CSDDD, Article 6(1)). It defines adverse human rights and environmental impacts by reference to an Annex (referred to in the text as CSDDD Proposal Annex) that lists international agreements on these topics (European Commission 2022). Companies must conduct due diligence to identify practices that violate or potentially violate the agreements (CSDDD, Articles 5–7). Once found, companies also have an obligation to eliminate them (CSDDD, Article 8). What seems to be anticipated is a system of certifications stretching over corporate supply chains in which suppliers, manufacturers, and others attest to the absence of violative practices. Companies are also obligated to obtain independent verification that they and their supply chains are not complicit in any adverse human rights or environmental impacts (CSDDD, Article 8(6)).

⁶ A letter from Senator Tom Scott and Representative James Comer to the Treasury Department outlines concerns about the imposition of EU sustainability standards on US companies (Scott and Comer 2023).

⁷ A similar provision is included in Recital 20, which differs only to the extent that it suggests that subsidiaries and branches must use "best efforts" to obtain the required information. "The subsidiary undertaking or branch of a third-country undertaking should also be able to report in accordance with the standards applying to undertakings established in the Union, or in accordance with standards which are deemed equivalent pursuant to an implementing act. In the event that not all the information required under this amending Directive is provided by the third-country undertaking, despite the best efforts of the subsidiary undertaking or branch of that third-country undertaking to obtain the necessary information, that subsidiary undertaking or branch should provide all the information in its possession and issue a statement indicating that the third-country undertaking did not make the rest of the required information available" (CSRD, Recital 20).

⁸ As noted above, California has adopted ambitious ESG disclosure rules. These rules, however, offer less promise than the EU rules because they face significant legal uncertainty.

While the human rights aspects of CSDDD's due diligence requirements are quite broad (CSDDD Annex, Part I), the environmental aspects are fairly narrow (CSDDD Annex, Part II). The agreements listed in the Annex have to do with discrete environmental issues, like the handling of hazardous waste. CSDDD does address climate change, however, and it does so directly and ambitiously. It requires companies to "adopt and put into effect a transition plan for climate-change mitigation which aims to ensure, through best efforts, that the business model and strategy of the company are compatible with the transition to a sustainable economy and with the limiting of global warming to 1.5 °C in line with the Paris Agreement" (CSDDD, Article 15(1)). Importantly, CSDDD goes beyond the disclosure-only mandate of CSRD.

Like CSRD, CSDDD directly and indirectly applies to countries outside of the EU. It applies to all EU firms that have over one thousand employees and EUR 450 million in net turnover (CSDDD, Article 15(2)(1)(a)). Thus, the subsidiary of a non-EU parent that meets such criteria will have to comply with CSDDD's obligations. The CSDDD also applies directly to non-EU firms with significant operations in the EU—those with over EUR 450 million in net turnover (CSDDD, Article 15(2)(2)(a)). Finally, CSDDD applies indirectly to every firm in the supply chain of any of the covered EU and non-EU firms (CSDDD, Article 6(1)(a)). Firms directly subject to the rules will seek certifications and verifications from these firms showing the absence of adverse impacts.

Note the breadth and boundaries of the rule. If a non-EU firm is only bound because of an EU subsidiary, then only the subsidiary is technically bound by the rule, though the parent (or other sister companies) may be in the subsidiary's value chain depending on the extent to which the company is vertically integrated. Since this is a legal compliance obligation, there is also potential *Caremark* liability for board oversight at the parent level (Enriques and Gatti 2022). This means that board members would be responsible for putting in place a reporting-and-compliance system to ensure that the corporate subsidiary meets its obligations. If a non-EU company itself conducts qualifying activities in the EU without shielding the activities in a subsidiary, then the company's entire operations will be covered, inside or outside of the EU. Given the proclivity of corporations to operate through arcane corporate structures that insulate them from liability and unwanted compliance obligations, this latter prospect is probably unlikely. Moreover, even companies that currently operate in the EU without a specific EU subsidiary could create one to house their EU operations if they wished to avoid the broader impact of the rule.

Although foreign firms can sidestep the application of the rules to their non-EU operations, they are nevertheless subject to the rules for their activities within the EU. They are also indirectly implicated to the extent that they are in the value chains of in-scope firms. One implication of all of this is that US firms will be forced to comply with vague and aspirational international treaties, certain of which the US has not endorsed (Enriques and Gatti 2022). There is no analogy to CSDDD in US law.⁹

C. Summary and Compliance Concerns

The transnational application of CSRD and CSDDD can be summarized as follows: Non-EU firms with significant EU operations are bound to comply with respect to their EU operations. Non-EU firms in the value chains of in-scope companies are indirectly bound to comply as part of the in-scope

⁹ CSDDD was likely inspired, at least in part, by the US's effort to regulate to regulate conflict mineral supply chains through due diligence obligations (Schwartz 2016).

company's obligations. With respect to the non-EU operations of non-EU firms with significant EU operations, CSRD adopts a comply-or-explain approach. CSDDD only applies to such operations if the non-EU firm conducts business in the EU directly, rather than through a subsidiary.

This structure raises several compliance concerns with respect to non-EU firms. Non-EU firms in the value chains of in-scope firms may not take their obligations seriously because they are not directly bound. Moreover, non-EU firms may choose to explain rather than comply with CSRD's group-level obligations, and they may incorporate a subsidiary to avoid the global reach of CSDDD.

There are several reasons, however, to be optimistic about compliance. First, there is significant pressure from customers, employees, and shareholders for US companies to act sustainably. Almost universally, US companies tout their sustainability efforts. Similarly, companies commonly produce sustainability reports and collect emissions data. It would be difficult for companies to please these stakeholders and maintain the appearance of sustainability while evading EU rules.

There is also the possibility that compliance takes hold as an example of the so-called "Brussels Effect." Professor Anu Bradford coined this term to describe how regulations imposed by the EU for operations within the EU's borders become international standards (Bradford 2020, 1). Typically, EU rules require firms to meet certain requirements to sell their products in the EU. For example, the EU forbids animal testing on cosmetics sold within its boundaries. In an example of the Brussels Effect, this caused many firms to abandon animal testing rather than carve out an exception to their practices for products sold in the EU (ibid. at 215). Similarly, the EU's regulation of data privacy through the General Data Protection Regulation has become the default global standard for data privacy (Huddleston 2023). The EU rule thus expands worldwide because corporations choose to comply globally (in an example of the de facto Brussels Effect) (Bradford 2020, 1). Similarly, EU rules may be borrowed by other jurisdictions, also expanding the impact of EU rules (the de jure Brussels Effect) (ibid. at 2).

The prospects that the US will adopt rules like CSRD or CSDDD appear slim, but it might make sense for US companies to adopt such standards on a global scale nonetheless. Professor Bradford describes the type of regulations that are likely to become global standards. First, the regulations must apply to "inelastic targets," meaning "products or producers that are non-responsive to regulatory change and hence tied to a certain regulatory regime" (Bradford 2020, 38). Products and producers are inelastic targets if they cannot easily escape the rules of the regulated market while maintaining access to it. For example, if the EU insists that products sold in its markets must be free of animal testing, there is no way to sell to European consumers without complying. The target would be elastic, however, if the EU rule was to forbid animal testing on cosmetics within its borders. If that were the case, the manufacturing would move out of the region. The second condition is "non-divisibility" (ibid. at 53). This means that it is preferable for the regulated company to conduct its global operations in line with EU rules rather than have special EU-only practices. EU rules will only grow beyond their borders in cases where the regulated activity or product is nondivisible.

The targets of CSRD and CSDDD are inelastic because companies must comply with them to maintain access to EU markets. Divisibility, however, is theoretically possible. Companies could comply with CSRD by producing sustainability reports solely for their EU operations. Likewise, they could theoretically only have a plan for how the in-scope EU subsidiary will comply with the Paris Agreement, leaving global operations out of it. Whether a company chooses to render EU-only compliance will likely depend on the company and the sector. The larger the EU share of the

company's business and the more entangled its global operations with the EU, the more likely a corporation will globally comply. Global compliance may also arise because companies have already collected such data for their own sustainability reports. It might be easier to work with this data than to break out EU information. Moreover, CSRD's comply-or-explain approach imposes a cost on firms that choose to omit their global operations. A non-EU parent that chooses divisibility risks whatever blowback comes from the CSRD-required disclosure that the company failed to provide international information.

Divisibility is also possible with respect to CSDDD. Non-EU companies subject to the rule because of an EU subsidiary can choose to conduct due diligence only into the supply chain of that subsidiary. Whether a company will limit its diligence in this way depends on the nature of its supply chain. Supply chains are usually complex and difficult to untangle and many suppliers likely provide goods to both EU and non-EU subsidiaries. Similarly, many companies—like Coca-Cola, Apple, and Microsoft—sell basically the same products in the US and Europe. Due diligence into the value chains of products sold in Europe likely covers their US equivalents as well. Because of overlapping supply chains, many companies may find that it takes little extra effort to conduct diligence on a global scale.

In sum, US companies can sidestep compliance with the EU rules with respect to their non-EU operations if they choose. The decision will depend on the extent to which they anticipate stakeholder blowback from noncompliance and how easy it is to untangle their EU operations from the remainder of their business for compliance purposes. While not ironclad, CSRD and CSDDD show a clear effort by the EU to set global environmental and human rights standards.

III. Normative Implications of EU Extraterritoriality

One significant benefit of the EU's extraterritoriality is that environmental concerns are best addressed through a single set of global rules. It is more efficient for companies to only have to comply with one set of requirements and this creates more effective governance because it allows for consistent and comparable reporting. Further, the issues are global in nature, and therefore call for a global solution.

Another benefit of EU transnationalism is that it overcomes the countermajoritarian and antiregulation biases that block similar efforts in the US. Because they sidestep the US government's dysfunction, the EU rules better represent US public opinion than does the status quo. Moreover, because EU transnationalism is insulated from US politics, it is a more fruitful path toward sustainability than current efforts in the US to change corporate practices through the corporate governance process.

There is widespread support in the US for the concepts behind the EU's key climate-change initiatives. A recent Pew Survey showed that 69 percent of Americans "favor the U.S. taking steps to become carbon neutral by 2050" (Tyson et al. 2023). This means that Americans agree with the Green Deal, which does exactly the same for the EU—outlines steps for the bloc to become carbon neutral by 2050. Similarly, 67 percent of respondents indicated that "large businesses and corporations are doing too little to reduce climate change effects" (ibid.). This suggests that not only do US citizens support efforts to combat climate change, but that they would support regulations that push corporations to do more to mitigate their climate impact. This is exactly the goal of CSRD and CSDDD. And this poll is not an outlier. A March 2018 Gallup poll asked, among other things, whether people would support specific policy proposals. The results were strongly in favor of environmental

reforms, such as more strongly enforcing environmental regulations (73 percent), “higher emissions and pollution standards for business and industry” (74 percent), and “imposing mandatory controls on carbon dioxide emissions and other greenhouse gases” (67 percent) (Gallup n.d.).¹⁰

Generally speaking, a democratic government should enact and enforce laws that reflect the will of a substantial majority of the population. Doing so is central to democratic legitimacy.¹¹ The above numbers, which show such strong support for environmental reforms, illustrate that the failure to enact responsive legislation and regulation is the result of government dysfunction. More specifically, it likely results from the countermajoritarian and antiregulation biases in US federal institutions.

The structure of the US federal government is famously countermajoritarian. Each branch has countermajoritarian features. Each state has two senators regardless of the size of its population. Within the Senate, a small group can block legislation with a filibuster. The congressional districts that determine house seats are grotesquely gerrymandered. The president is elected by the Electoral College rather than the popular vote. The Electoral College is countermajoritarian because it bases the number of electors for each state on the state’s number of House and Senate seats rather than its population. Finally, members of the Supreme Court and other federal judges are unelected. Rather, they are chosen by the president and confirmed by the Senate. Courts are also inherently countermajoritarian because they have the power to overrule laws enacted by democratically elected institutions (Karlan 2021).

There are abstract reasons for countermajoritarian aspects of government. The majority may oppress the minority without limitations on its power (Woodruff 2022). The majority could discriminate against minority ethnic groups or races or mistreat the sick or the poor. Largely, however, the countermajoritarian structure described above was a compromise at the founding to get buy-in from smaller states (Karlan 2021) (or accidental, as in the case of the filibuster) (Reynolds 2020), rather than a thoughtful way to protect “discrete and insular minorities.” *United States v. Carolene Products Co.*, 304 U.S. 144, 152 n.4 (1938). Moreover, environmental rules do not trigger concerns about the downsides of majority rule. If anything, environmental rules aid disadvantaged groups, because they suffer the most from environmental hazards. Stricter environmental rules are supported by a supermajority and are unoppressive, yet they are politically toxic.

Countermajoritarian institutional structures are not necessarily antiregulation. Such institutions could use their power to enact unpopular rules. In this case, however, the countermajoritarian aspects of government are standing in the way of broadly supported reforms. The favored minority have leveraged this structure to block progressive policies, including efforts to combat climate change (Karlan 2001). Moreover, the courts, in particular the Supreme Court, have used judicial review to entrench the minority’s antiregulation political leanings. The SEC’s protracted effort to enact climate disclosure rules and the immediate—and already successful—legal challenges to it illustrate the severe political friction around regulation attempts.

The Supreme Court’s aggressive antiregulation stance—and the obstacle it poses to climate regulation—is best illustrated by its 2022 decision *West Virginia v. EPA*, 597 U.S. 697 (2022). The Environmental Protection Agency, which has the authority to regulate power plants, had regularly

¹⁰ See also Daly and Dolby (2022) (“Nearly two-thirds of Americans think the federal government is not doing enough to fight climate change.”).

¹¹ Wrátil and Wäckerle (2022) (“A key aspect of political decisions that should influence their evaluation by citizens on the legitimacy dimension is whether the decisions are in line with the preferences of the majority of citizens.”).

imposed regulations requiring power plants to operate more cleanly (*ibid.* at 698). In 2015, however, it proposed a regulation that “included a requirement that such facilities reduce their own production of electricity, or subsidize increased generation by natural gas, wind, or solar sources” (706). The Supreme Court struck down this requirement (735). It leaned on the “major questions” doctrine to find that the EPA lacked the statutory authority to “substantially restructure the American energy market” (724). This loosely defined doctrine provides that, when an agency engages in rulemaking with “vast economic and political significance” (716), it must do so based on “clear congressional authorization” (723). Here, the Court reasoned, the EPA’s goal was to shift “from coal to natural gas and renewables” (713). Whether to reduce domestic coal production was a “major question” for which the EPA lacked the necessary authority (732).

This ruling thwarted an attempt by the EPA to combat climate change in the absence of a congressional mandate. In support of its ruling, the Supreme Court even noted that the EPA’s scheme included a cap-and-trade system (*West Virginia v. EPA*, 597 U.S. 697, 733 (2022))—something that had been considered and rejected by Congress (*ibid.* at 702). The Supreme Court thus shut the door on an administrative agency’s attempt to circumvent the minority blockade. Moreover, this ruling likely chilled the SEC’s effort to require environmental disclosures. It was issued between the SEC’s proposed and final rules. After years of delay, the recently issued final rules omitted the most controversial aspect—the requirement that companies report so-called Scope 3 emissions (i.e., those that occur in the corporation’s value chain) (Securities and Exchange Commission 2024a, 213). The final rules also added a spate of materiality qualifiers to deflect criticism that the rules had drifted into impact materiality.

Even so, since the SEC’s rules may plausibly be characterized as a response to climate change—something beyond the agency’s traditional investor protection mission—there is a real risk that they could fall as well (Ho 2023). Indeed, within days of their issuance, the US Court of Appeals for the Fifth Circuit issued a stay preventing them from going into force (*Liberty Energy v. SEC*, No. 24-60109 (5th Cir. Mar. 15, 2024) (unpublished order); Bains et al. 2024). The stay was issued to allow consideration of the plaintiffs’ legal arguments, chief among them that the new rules failed the “major questions doctrine” because they dealt with the “controversial issue of climate change,” a power reserved for Congress.¹² The stay was lifted one week later so that the numerous legal challenges to the SEC’s rules could be consolidated for review by the Eighth Circuit (Latham & Watkins 2024b). The SEC, however, voluntarily stayed the rules shortly after that to allow for judicial review (Securities and Exchange Commission. 2024b).

An additional hurdle for climate-change regulation is the requirement that federal agencies conduct quantified cost-benefit analysis before adopting new rules (Schwartz and Nelson 2016). This is a difficult endeavor (and a dubious concept) and the SEC has been stung by it. Most notably, in *Business Roundtable v. SEC*, 647 F.3d 1144 (D.C. Cir. 2011), the D.C. Circuit Court struck down the SEC’s proxy access rule for failure to conduct a proper cost-benefit analysis despite the agency’s thorough, rigorous, and expensive attempt to do so (Ahdieh 2013). More recently, in May 2023, the Fifth Circuit held that the SEC’s share repurchase rule was invalid because the “SEC acted arbitrarily and capriciously, in violation of the [Administrative Procedure Act], when it failed to . . . conduct a proper cost-benefit analysis.” *Chamber of Commerce of the U.S. v. SEC*, No. 23-60255, at 26 (5th Cir. Oct. 31,

¹² Emergency Motion for Administrative Stay and Stay Pending Judicial Review at 2, *Liberty Energy Inc. v. SEC*, No. 24-60109 (5th Cir. Mar. 8, 2024). <https://boydengray.com/wp-content/uploads/2024/03/Liberty-Energy-v-SEC-Emergency-Motion.pdf>.

2013). The plaintiffs who recently won a stay of the SEC's climate disclosure rules also raised this claim.¹³

The EU, in contrast, has adopted the precautionary principle (Bradford 2020, 45). This principle allows for regulation even when “the available data preclude a detailed risk evaluation” (European Union n.d.). The European courts consistently stand by this principle in contrast to the “relative strict scrutiny” applied by US courts (Bradford 2020, 45).

The Supreme Court has also marshaled the First Amendment's freedom-of-speech guarantee to stymie regulation. In *Citizens United v. FEC*, 558 U.S. 310 (2010), the Court, on free speech grounds, gave corporations the unfettered right to make political contributions. While corporations do not oppose all regulations all of the time, their opposition is a notorious hurdle and the *Citizens United* decision gives them significantly more sway. In the EU, by contrast, “business interests are considerably less influential” (Bradford 2020, 250).

More recently, in 2023, the Supreme Court decided *303 Creative v. Elenis*, 600 U.S. 570 (2023), on First Amendment grounds. The Court held that it was unconstitutional for the state's antidiscrimination laws to forbid a company that designs wedding websites for opposite-sex couples to refuse to do the same for same-sex couples. The case viewed the commercial activity as speech and the law's requirement to serve all customers as unlawfully compelling speech (ibid. at 602–03). Because of its broad grounds, this holding jeopardizes all forms of government-compelled speech—including aspects of the federal securities laws. Indeed, the National Association of Manufacturers, in an amicus brief, is arguing, based on this case, that the SEC's shareholder proposal rule violates the First Amendment by requiring that corporations include such proposals in the companies' proxy materials.¹⁴ The plaintiffs challenging the climate disclosure rules have also raised this claim, arguing that the SEC's rules violate the First Amendment “by mandating controversial disclosures using controversial frameworks and effectively mandating discussions about climate change.”¹⁵

In sum, even though environmental rules are broadly popular in the US, they face a gauntlet of opposition within the federal government. Congress, which has the authority to enact sweeping reform, is flooded with corporate influence and rendered impotent by minority views. If agencies try to push the boundaries of their authority, the courts overrule them. The “major questions doctrine,” the requirement to conduct quantified cost-benefit analysis, and, increasingly, the First Amendment pose significant challenges to meaningful regulation. The result is that strong public preferences are being ignored and democracy is failing its citizens. Transnational application of EU rules provides a back channel for the voice of the US public to get through.

IV. Comparison to US Corporate Governance Sustainability Efforts

EU transnationalism may be more effective at pushing policy forward than the highly publicized and hard-fought effort to reform corporations from within through corporate governance.

¹³ Emergency Motion, note 12 above.

¹⁴ Brief for National Association of Manufacturers as Intervenor, *Nat'l Ctr. for Pub. Pol'y Res. v. SEC*, No. 23-60230 (5th Cir. July 21, 2023).

¹⁵ Emergency Motion, note 12 above, at 3.

Shareholders have been pushing sustainability with shareholder proposals that call for companies to, among other things, disclose their emissions and adopt plans to comply with the Paris Agreement (Fisch and Schwartz 2023). Such proposals have gained traction in recent years largely thanks to support from the large mutual fund complexes (Schwartz 2022). Similarly, climate-change activists won their biggest victory in 2021, when a little-known hedge fund, Engine Company No. 12, successfully waged a proxy contest to elect three members to Exxon's board with the explicit goal of transitioning the company to renewable energy (*ibid.*).

Shareholder proposals have become the go-to work-around for government dysfunction, but they have several shortcomings. First, relying on corporate commitments that are not backed by regulatory requirements is inherently weak. There is no regulator to assess compliance and no hope of consistent comparable information. Second, these efforts rely on support from the large mutual fund complexes, but their motives are complex and their actions capricious (Schwartz and Jensen 2025). There is evidence that their appetite for such proposals is waning as a result of backlash from politicians favoring the status quo.¹⁶ Texas, for instance, pulled over \$8 billion from BlackRock because of its ESG stance (Catenacci 2024). Moreover, relying on the large mutual fund complexes to guide social policy is inherently undemocratic. It is highly questionable whether they represent the views of their investors, and even if they did, investors are an unrepresentative slice of the US population. Finally, as noted above, even this avenue may be cut off on First Amendment grounds.

Regulating US companies through EU laws is much more promising.¹⁷ The internal policies wrought by shareholder advocacy are self-policed, whereas the EU rules envision oversight and enforcement by a public regulator (CSRD, Article 28d; CSDDD, Article 18), vastly increasing the prospects that corporations will take their obligations seriously. There is also no clear way for opposing politicians to thwart the EU's rules (Bradford 2020, 260). In fact, corporations subject to EU rules may become advocates of such laws in the US. Since they are bound to comply, it is better for them if everyone does so. According to Professor Bradford, this is a key way in which the *de facto* Brussels Effect can become the *de jure* Brussels Effect (*ibid.* at 256).

Finally, the EU rules go further than anything that can be accomplished through corporate governance. At best, corporate governance activists can only achieve change at public companies. The EU rules apply to companies regardless of whether they are listed on a public exchange. The rules also move past the intractable and frustrating debates in corporate and securities law about stakeholder theory versus shareholder primacy and financial materiality versus double materiality. The EU rules embrace both stakeholder theory and double materiality. A shift to these perspectives cannot be accomplished piecemeal through corporate governance. EU regulations fully circumvent these debates.

¹⁶ See Michael Posner, *How BlackRock Abandoned Social and Environmental Engagement* (Sept. 4, 2024), <https://www.forbes.com/sites/michaelposner/2024/09/04/how-blackrock-abandoned-social-and-environmental-engagement/>.

¹⁷ Though EU law is more promising, there is also the prospect of reform through state efforts. California has adopted two sustainability disclosure laws, the Climate-Related Financial Risk Act and the Climate Corporate Data Accountability Act. These laws apply to companies doing business in California with over \$1 billion in annual revenues, which is likely about ten thousand firms. The laws call for extensive ESG disclosures, including Scope 1, Scope 2, and Scope 3 emissions (Feeney 2023). California law, like EU law, provides a potential work-around for federal government dysfunction. These laws, however, are subject to some of the same antiregulation biases. For example, the California laws have already been challenged under grounds similar to those for which a stay of the SEC rules was granted (Littenberg and Rotter 2024).

V. European Headwinds

While the EU is the global sustainability leader, there have been signs of slippage. As *Politico* put it,

Europe's hopes for a greener future are being doused in pesticides, thrown in the furnace, hunted down, hit by cars and crushed by herds of cows.

And Green parties are taking the hit—polling shows they will face deep electoral pain when EU citizens vote in June. European Commission President Ursula von der Leyen is also trying to run away from the green parts of her legacy. In fact, those pushing for faster action to protect the climate and nature are being left high and dry almost everywhere, fighting to recapture momentum. (Mathiesen et al. 2024)

While these are worrisome trends, it is important that CSDDD won approval—after two failed attempts—by the European Parliament in March 2024 (the same month as the *Politico* assessment) (Jones Day 2024). The most significant concessions were to increase the threshold for the number of employees triggering CSDDD from five hundred to one thousand, to increase the net turnover requirement from \$150 million to \$450 million, and to eliminate lower thresholds that would have triggered application of the rule to high-risk industries (Latham & Watkins 2024a).¹⁸ This cut the number of firms covered by two-thirds (*ibid.*). That CSDDD passed with its substance (if not its scope) still largely intact, despite electoral headwinds, shows that EU climate policy remains far ahead of US climate policy and the EU regulatory process far less compromised.

VI. Conclusion

The EU has global ambitions with respect to climate change. Its recent Green Deal initiatives—CSRD and CSDDD—apply to thousands of US and other international firms. Notably, the rules apply to the global operations of these firms, not just their EU businesses. The US should welcome the EU's attempt to become a de facto global sustainability regulator. The EU legislation aligns with the policy views of US citizens and thus serves as a work-around for the government dysfunction that currently hamstring US lawmakers. Moreover, EU regulation is a more effective counter to the antimajoritarian and antiregulation biases in the US federal government than recent attempts to bring about change through corporate governance.

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¹⁸ Germany led opposition to the rule, followed by France and Italy (Mathiesen et al. 2024). France proposed that the rule be limited to companies with over five thousand employees rather than five hundred, which would have exempted 80 percent of European businesses (3Bee 2024).

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