

Risks and Pitfalls from Increasing Balkanization of State-Level ESG Regulation

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Summary

- The current trajectory of state and national policies suggests prolonged fragmentation and confusion, leaving companies to navigate an increasingly complex patchwork of state-level regulations.
- In the absence of clear and focused guidance from the executive branch, federal preemption appears unlikely given persistent congressional gridlock. The gridlock can and likely will expose companies to additional litigation, including class actions.
- For companies that previously announced forward-looking ESG investments and goals, continued investments and reporting progress toward those goals could result in enforcement actions in certain states.



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Companies operating across state lines face an unprecedented compliance paradox: Meeting regulatory requirements in one jurisdiction may trigger financial penalties in another. This fragmentation—driven by diametrically opposed state approaches to environmental, social, and governance (ESG) regulation—creates material legal, financial, and operational risks that defy more traditional compliance frameworks. While the federal government has seemingly limited its enforcement of ESG practices and representations, state attorneys general and the private plaintiff bar have increasingly asserted greenwashing class actions—and all actions, for that matter.

The Broad Spectrum of ESG Regulation

At one end of the regulatory spectrum are California's twin disclosure mandates: California Senate Bill 261 (codified at [Cal. Health & Safety Code § 38533](#)) (S.B. 261) and California Senate Bill 253 (codified at [Cal. Health & Safety Code § 38532](#)) (S.B. 253). The two pieces of legislation aim to establish a comprehensive climate risk disclosure regime that imposes broad disclosure obligations on large entities doing business in California, irrespective of their place of incorporation within the U.S.

S.B. 261 requires covered business entities to disclose (1) their climate-related financial risk, in accordance with the Task Force on Climate-Related Financial Disclosures framework, or an equivalent reporting requirement; and (2) the measures adopted to reduce and adapt such risks by January 1, 2026, and biennially thereafter. These climate-related financial risk reports must be made publicly available on the company's website.

S.B. 253 requires covered business entities to comprehensively report their greenhouse gas emissions—scope 1 (direct emissions), scope 2 (indirect emissions from purchased energy), and scope 3 emissions (all other indirect emissions across the value chain)—in accordance with certain specified standards. Further, companies must obtain independent verification of their disclosures under S.B. 253 from third-party assurance providers with proven expertise in greenhouse gas measurement and reporting.

However, even the regulatory landscape under S.B. 261 and S.B. 253 is quickly evolving, as demonstrated by the U.S. Chamber of Commerce’s lawsuits challenging the legality of these statutes. On November 18, 2025, the [Ninth Circuit enjoined enforcement of S.B. 261, but not S.B. 253](#), pending appeal and scheduled an expedited oral argument for January 9, 2026—notably, this is after the deadline for the first reports under S.B. 261 of January 1, 2026. Recently, others have also challenged the statutes, including by arguing that the disclosure requirements imposed thereunder amount to unconstitutional government-mandated speech in violation of the First Amendment. Complaint, [Exxon Mobil Corp. v. Sanchez, et al.](#), No. 2:25-at-01462 (E.D. Cal. filed Oct. 24, 2025). Such challenges—which have been frequently mounted against both pro- and anti-ESG regulations by various states—add another layer of complexity to the rapidly evolving legal landscape surrounding ESG regulation. S.B. 253 and S.B. 261 are also subject to ongoing rulemaking and enforcement of other guidance by the California Air Resources Board, including as to the deadline for first reports under S.B. 253 and the minimum mandatory content of first reports under S.B. 253 and S.B. 261.

Toward the other end of the regulatory spectrum is [Texas Senate Bill 13](#) (S.B. 13), which creates the first comprehensive state-level prohibition on ESG-based investment practices. Several other states have enacted similar laws since. Texas S.B. 13 requires the Texas Comptroller of Public Accounts to maintain a list of financial companies that boycott energy companies and prohibits state agencies from investing funds in the listed companies. It also bars state agencies from contracting for goods or services with companies that have 10 or more full-time employees, unless the contract contains a written verification from the company that it does not boycott energy companies and will not boycott energy companies during the term of the contract. This requirement applies to contracts of \$100,000 or more.

Since the enactment of S.B.13, [Texas’s state comptroller has backlisted 11 major financial institutions, along with 350 investment funds, pursuant to the statute’s requirements](#). The [Texas Attorney General’s October 2023 advisory](#) expands enforcement beyond the comptroller’s list, instructing state agencies to “exercise due diligence” and consider “evidence [that] is readily and publicly available [of whether] a company is a boycotter” of energy companies.

And the plaintiff bar is likely to exploit this divergence in state legislation. In recent years, there has been a sharp increase in the number of greenwashing class actions filed against companies. At core, a greenwashing action asserts that a company has engaged in a deceptive marketing practice whereby it falsely presents its products or operations as more environmentally friendly or sustainable than they actually are. Companies' inability to comply with contradictory state regulatory schemes will create fertile grounds for the private litigation.



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Compliance Considerations Going Forward

For companies doing business in boycott states, the ambiguity of the phrases “boycott” and “ordinary business purpose” (as used in Texas’s S.B. 13) has the potential to create persistent legal uncertainty. When financial institutions maintain billions in Texas energy investments, yet still appear on the [state’s blacklist due to their climate risk policies](#), the signal to compliance officers seems clear: No safe harbor exists. Similarly, the breadth of California’s S.B. 261’s climate risk definition may require companies to make materiality determinations knowing that any disclosure may become evidence in enforcement actions in anti-ESG jurisdictions.

Financial institutions in particular potentially face disclosure traps born of conflicting state-level approaches. For example, California’s S.B. 261 requires these institutions to publicly disclose climate-related financial risks and mitigation measures. But when a bank publishes its TCFD-compliant climate risk report to comply with S.B. 261, Texas authorities could potentially cite that very disclosure as evidence of energy company boycotting. Mandatory compliance in one jurisdiction can anchor a securities class action for violations of section 10b of the Securities and Exchange Act.

Supply chain requirements may create additional conflicts for companies that work with suppliers across jurisdictions. California’s S.B. 253 scope 3 emissions reporting mandates data collection from suppliers about their greenhouse gas emissions. But in states deploying anti-ESG policies, requesting such information from suppliers could theoretically constitute discrimination against higher-emission vendors, potentially triggering boycott prohibitions like the one in Texas’s S.B. 13. The result is that companies

that serve both government and commercial markets across jurisdictions may face incompatible data collection obligations.

Moreover, as a result of the increasing divergence in state regulatory policy around ESG, companies face compounding and costly compliance infrastructure requirements. Such requirements may include multi-jurisdiction tracking systems, parallel reporting frameworks for pro- and anti-ESG states, enhanced documentation establishing financial rationales for decisions that may be construed as pro-ESG, and third-party verification costs.

The current trajectory of state and national policies suggests prolonged fragmentation and confusion, leaving companies to navigate an increasingly complex patchwork of state-level regulations. In the absence of clear and focused guidance from the executive branch, federal preemption appears unlikely given persistent congressional gridlock. The gridlock can and likely will expose companies to additional litigation, including class actions. For companies that previously announced forward-looking ESG investments and goals, continued investments and reporting progress toward those goals could result in enforcement actions in certain states. Conversely, an abandonment of those investments or reporting progress could result in a class action asserting that those goals were deceptive, exposing a company to a costly litigation with potentially huge damages.

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