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ASTM Releases a New Standard Regarding Disclosure of Financial Impacts Related to Climate Change

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In March 2010, ASTM International, one of the world's largest voluntary standards development organizations, released a standard guide, ASTM Standard E2718-10, *Standard Guide for Financial Disclosures Attributed to Climate Change* (the Guide), suggesting processes for the identification, evaluation, and disclosure of financial impacts attributable to climate change. The Guide is intended for use on a voluntary basis by companies and public agencies (collectively, "reporting entities") as a supplement to, rather than a replacement for, any applicable regulatory pronouncements, such as the interpretive guidance issued in February 2010 by the U.S. Securities and Exchange Commission (SEC) related to disclosure by public companies about the impacts of climate change.[1]

The Guide is the result of a consensus development process, spanning over two years, which involved a wide variety of stakeholders. A key benefit of the Guide is the discussion of *processes* for identifying and evaluating financial impacts attributable to climate change, a topic some stakeholders felt was lacking in the SEC's interpretive guidance. While the degree of Guide use and acceptance remains to be seen, ASTM has already received requests for a Guide appendix providing a model disclosure.

It is important to note that while the ASTM and SEC guidance documents both identify similar areas of risk that should be considered when drafting disclosures, the Guide states that disclosure about material financial impacts may be presented either in the financial statements or outside the financial statements, whereas the SEC's interpretation discusses disclosures outside the financial statements. We recommend that public companies consider providing forward-looking statements about climate change outside the financial statements so that such disclosures have the benefit of the safe harbor for forward-looking statements under the federal securities laws.[2]

Identifying Financial Impacts

[1] For more information about the SEC interpretive guidance, see the February 4, 2010 Morgan Lewis LawFlash, "SEC Interpretive Guidance Addresses Climate Change Disclosure Requirements," available at http://www.morganlewis.com/pubs/ClimateChangeAlert_SECInterpGuidanceAddressesDisclosure_4feb10.pdf.

[2] Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, protect a public company from liability in private lawsuits for a forward-looking statement disclosed outside the financial statements as long as, among other things, the forward-looking statement is "accompanied by meaningful cautionary statements identifying important factors that could cause actual results to differ materially from those in the forward-looking statement." Additional disclosures about the financial impacts of climate change may be required in the footnotes to the financial statements, however, as a result of the decision by the Financial Accounting Standards Board on April 14, 2010 to propose expanded disclosures about loss contingencies.

The Guide identifies various possible financial impacts from climate change.[3] To facilitate their identification, the Guide describes major categories of circumstances that might give rise to such impacts. The categories include the following:

- **Regulatory –** The enforcement of laws or regulations regarding greenhouse gas emission levels, investigations, controls, and reporting. This includes predicted changes in federal, state, and local regulations as well as statutory and common law developments.

- **Resources –** Predicted changes/trends in the costs or availability of natural resources that may change a reporting entity's products, processes, and/or markets or services. This includes both positive and negative impacts.

- **Physical Risks** – Predicted changes in a reporting entity's assets and operations resulting from climate changes.

- **Contractual Assumption of Risk –** Insurance contracts, hold harmless agreements, and indemnity agreements.

- **Litigation** – The commencement of litigation or assertion of a claim or assessment by a party alleging legal liability related to climate change on the part of the reporting entity.

Evaluating Financial Impacts

Once potential financial impacts have been identified, the Guide states that a reporting entity should determine whether the impacts (1) have a likelihood that is more than remote; (2) could have a severe impact that would disrupt the normal functioning of the entity or its financial position, cash flows, or operations; and (3) are near-term, likely to occur during the next year. If these three criteria are met, the reporting entity should proceed to estimate the likelihood, magnitude, and timing of the potential impacts to the entity's financial position. This evaluation is important because it informs the ultimate decision by the reporting entity about whether or not to disclose particular impacts.

Disclosing Financial Impacts

The Guide provides that a reporting entity should disclose financial impacts attributable to climate change when it believes that those impacts, in the aggregate, are material. While noting there is no "bright line" test for materiality, the Guide identifies statements made by the U.S. Supreme Court[4] and the Financial Accounting Standards Board[5] concerning the meaning of "materiality."

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[3] These are "damages attributed to the entity's products or processes, regulatory compliance costs (including changes in resource costs, technology costs, distribution and transportation costs), physical costs (including asset impairments), changes in income due to changes in markets for products and services, and litigation and management costs [as well as] both initial response costs as well as long-term costs (for example, operations and maintenance costs, changing energy costs)."

[4] *TSC Industries, Inc. v. Northway, Inc.*, 426 U.S. 438 (1976) (a disclosure is material if there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available" or if there is "a substantial likelihood that a reasonable shareholder would consider it important in deciding how to vote").

[5] The FASB states in Statement of Accounting Concepts No. 2 that an item is material if "the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement."

Once financial impacts are determined to be material, the Guide directs reporting entities to make a variety of disclosures, including:

- Information about the analysis performed by the reporting entity, which would include consideration of the major circumstances identified above, a discussion about both risks and opportunities considered and a discussion about management's position on and strategic activities related to climate change, as well identification of who within the reporting entity's corporate governance structure is responsible for addressing these issues.[6]
- Relevant regulatory requirements and their resulting financial impacts.
- The likelihood, magnitude, and timing of the financial impacts, including disclosure of the techniques used for data measurement.
- Estimated insurance or other recoveries or, if not available, an affirmative statement of that fact.

If a reporting entity believes that financial impacts attributable to climate change are so uncertain and speculative that no quantitative financial analysis can be performed, the Guide suggests that the reporting entity include a description of the types of financial impacts it foresees and its reasoning for determining that further quantitative analysis and disclosure is not currently feasible. The Guide notes that while uncertainty cannot be eliminated, it is likely that at least some financial impacts can be assessed and quantified.

Conclusion

ASTM Standard E2718-10 provides needed guidance on the processes that can be used in the assessment of the financial impact of climate change and the determination of whether and how to disclose any such financial impact. Although the standard is voluntary and independent of any particular regulatory scheme, it provides a helpful framework for reporting entities to use to assess the need for disclosure.

If you have any questions or would like more information on any of the topics discussed in this LawFlash, please contact any of the following Morgan Lewis attorneys:

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[6] The severe economic problems during the last couple of years led to suggestions, which also have been reflected in draft legislation, that companies' boards of directors strengthen their oversight of the management of risk. Risk management includes the appropriate identification of risks, which, for many reporting entities, include the impact of climate change.

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