

# **The Case of the Exxon Valdez: Reporting Contingent Liabilities for Potential Damage Awards**

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## **Abstract**

In March of 1989 the oil tanker Exxon Valdez ran aground and ruptured spilling thousands of barrels of oil into Prince William Sound. That oil spill created a large contingent liability for Exxon. The final adjudication of lawsuits relative to the oil spill did not happen until 2008. Thus, Exxon had a contingent liability relative to the Exxon Valdez incident for nineteen reporting years. Students will read about the spill, Exxon's attempts to contain it, fines, settlements, court cases, damage awards, and the changing nature of the law regarding punitive damages. They will be asked at key points over the nineteen years of the story to comment on the proper reporting and disclosure of the contingent liability. Making these judgments and discussing them in class will deepen their understanding of contingent liabilities and punitive damage awards and enhance their critical-thinking and oral-communication skills. The case also includes suggestions for a written out-of-class assignment as an alternative approach. This out of class approach will help students develop writing and research skills.

## **The Story of the Exxon Valdez and Related Supreme Court Opinions**

On March 24, 1989, the oil tanker Exxon Valdez ran aground and ruptured 25 miles from the southern end of the Trans-Alaska Pipeline. More than 240,000 barrels of oil spilled from the tanker into the Prince William Sound, waters rich in marine life, vital to local fishing industry, and responsible for much of the area's tourism (Shabehoff 1989). The spill was the largest to date in North American waters. By the evening of March 24, the spill was five miles long and five hundred feet wide. The following day the oil slick was eight miles long and three and a half miles wide (Mauer, 1989). It eventually covered 1,500 square miles of the sound's 2,500 square miles and spoiled hundreds of miles of shoreline (Schneider 1989).

Many parties were injured by the oil spill and, based on United States court decisions, were entitled to sue Exxon for losses suffered. The law provides two basic remedies. Compensatory damages are meant to compensate the plaintiff for losses incurred by the actions of the defendant. Punitive damages are meant to punish the defendant for its conduct and deter the defendant and others from engaging in that conduct in the future. Since punitive damages are awarded in excess of provable injuries, they are normally awarded only when defendant conduct is egregious or reprehensible. Punitive damage awards must be large enough relative to the defendant's wealth to provide the deterrent effect.

Both the circumstances leading to the spill and Exxon's immediate efforts at containment left the company vulnerable to large damage claims. The captain had been drinking. His blood alcohol level tested nine hours after the accident was 0.061, in excess of Coast Guard limits (Schneider 1989). Exxon knew the captain had had a drinking problem but failed to monitor him. After the captain went below deck, an officer not licensed by the Coast Guard to pilot in Prince William Sound took control of the tanker and was in control when it ran aground (Egan 1989).

Exxon's initial response to the spill was slow and did not proceed according to the contingency plan (Mauer 1989). The plan called for booms to be in the water within five hours of a spill. They did not begin putting booms in the water for ten hours. The plan specified seven oil-skimming vessels, but only two were at work a day after the spill. The contingency plan specified chemical dispersants as the chief method to break up a spill of this size, but the company was not prepared to apply chemicals until it was too late for them to be effective. By March 29, Exxon acknowledged it had lost the opportunity to contain the spill and would turn its attention and resources to cleaning it up (Egan 1989).

On July 24, Exxon estimated the cost of the cleanup to be \$1.28 billion. These costs did not include damage awards from the 150 suits that had been filed against Exxon by that date (Wald 1989).

### *Pause for Questions*

1. Describe the sources of Exxon's contingent liability relative to the Exxon Valdez oil spill?
2. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 1989, and what is the minimum amount that you think should be reported?

### *Continuing the Story*

In early 1991 the governor of Alaska proposed dropping all state and federal lawsuits against Exxon in exchange for \$1.2 billion dollars to restore the sound (Egan 1991). A settlement was negotiated for approximately that amount, including \$125 million in criminal penalties. The settlement further gave legal assurances to other plaintiffs that the agreement would not prevent them from collecting damages from Exxon in their pending lawsuits. Those lawsuits numbered 252 by 1991 (Schneider 1991).

The possibility for punitive damages loomed large for Exxon. However, in 1991 the Supreme Court of the United States (hereinafter Supreme Court) for the first time imposed restrictions on the size of punitive damages that can be awarded in any case. In *Pacific Mutual Life Insurance v. Haslip*, the Supreme Court acknowledged that the Due Process Clause to the United States Constitution imposes substantial substantive constraints on the amount of punitive damages that can be awarded. In that case, the Court approved the criteria established by the Alabama Supreme Court (*Pacific Mutual Life Insurance v. Haslip* 1991, VI 3):

It was announced that the following could be taken into consideration in determining whether the award was excessive or inadequate: (a) whether there is a reasonable relationship between the punitive damages award and the harm likely to result from the defendant's conduct as well as the harm that actually has occurred; (b) the degree of reprehensibility of the defendant's conduct, the duration of that conduct, the defendant's awareness, any concealment, and the existence and frequency of similar past conduct; (c) the profitability to the defendant of the wrongful conduct and the desirability of removing that profit and of having the defendant also sustain a loss; (d) the "financial position" of the defendant; (e) all the costs of litigation; (f) the imposition of criminal sanctions on the defendant for its conduct, these to be taken in mitigation; and (g) the existence of other civil awards against the defendant for the same conduct, these also to be taken in mitigation.

The application of these standards, we conclude, imposes a sufficiently definite and meaningful

constraint on the discretion of Alabama fact finders in awarding punitive damages. The Alabama Supreme Court's post-verdict review ensures that punitive damages awards are not grossly out of proportion to the severity of the offense and have some understandable relationship to compensatory damages. While punitive damages in Alabama may embrace such factors as the heinousness of the civil wrong, its effect upon the victim, the likelihood of its recurrence, and the extent of the defendant's wrongful gain, *the fact finder must be guided by more than the defendant's net worth*. Alabama plaintiffs do not enjoy a windfall because they have the good fortune to have a defendant with a deep pocket. (Emphasis added.)

The Supreme Court found that the 4:1 ratio of punitive damages to compensatory damages was close to the line of constitutional propriety.

### *Pause for Questions*

1. Assuming Exxon had paid the fine levied by the federal and state governments and had finished its cleanup effort, what is the nature of any remaining contingent liability related to the Exxon Valdez oil spill?
2. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 1991, and what is the minimum amount that you think should be reported?

### *Continuing the Story*

The largest lawsuit against Exxon was not concluded until June of 1994. On June 13, in the first phase of the case, the jury ruled that Exxon had been reckless when it permitted a captain with a history of alcoholism to command the supertanker (Schneider 1994a). On August 11, in the second phase of the case, the jury awarded plaintiffs \$286.8 million in compensatory damages (Schneider 1994b).

The third phase of the case involved the determination of punitive damages. The jury was given specific instructions to consider defendant's financial condition (In re the Exxon Valdez 1995). Jury Instruction No. 25 reads in part:

the amount of punitive damages may not be determined arbitrarily. You must use reason in setting the amount...the award may not be larger than what is necessary to achieve society's goals of punishment and deterrence.

Jury Instruction No. 27 reads in part:

In determining the amount of punitive damages to award, if any, you may consider, among other factors:

- (a) the degree of reprehensibility of the defendants' conduct,
- (b) the magnitude of the harm likely to result from the defendants' conduct,
- (c) *the financial condition of the defendants*. (Emphasis added.)

On September 16, in the third phase of the case, the jury awarded plaintiffs \$5 billion dollars in punitive damages (Schneider 1994c). Exxon appealed the punitive damage award.

### *Pause for Questions*

1. Since the court has set the amount of compensatory and punitive damages, does Exxon have a contingent liability related to the Exxon Valdez oil spill? Why or why not?

2. Does the Supreme Court's opinion in *Pacific Mutual Life Insurance v. Haslip*, that a 4 to 1 ratio of punitive to compensatory damages is about the limit of constitutional propriety, affect your judgment of contingent liability reporting for the Exxon Valdez case?

3. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 1994, and what is the minimum amount that you think should be reported?

### *Continuing the Story*

In appealing the size of the punitive damage award, Exxon submitted a research study of punitive damage awards upheld in federal court in the years 1984 through 1994 (Rustad 1998). Exxon calculated the percentage of income and net worth represented by each damage award. The mean and median percentage of income was 7.4 percent and 3.0 percent respectively, and the mean and median percentage of net worth were 1.9 percent and 0.3 percent respectively. They argued that, based on these numbers, the punitive damage award in the Exxon Valdez case was excessive. For reference, table 1 provides income, assets, and liabilities reported by Exxon from 1988 through 1994 as reported on Form 10-K filed with the United States Securities and Exchange Commission.

In reviewing the amount of punitive damages, Judge Holland, the trial judge, noted that the \$5 billion is approximately equal to one year's net income for Exxon, and therefore, not excessive (In re the Exxon Valdez 1995).

### *Pause for Questions*

1. Assuming Exxon had made no payments relative to punitive damages, and considering the Supreme Court opinion in *Pacific Mutual Life Insurance v. Haslip*, and considering Exxon's own analysis of what represents a reasonable award of punitive damages, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill?

2. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 1995, and what is the minimum amount that you think should be reported?

### *Continuing the Story*

In November of 2001, a federal appeals court ruled that the punitive damage award was excessive and ordered the trial judge to reduce it (In re the Exxon Valdez 2001). In 2002, the trial judge reduced the punitive damage award to \$4 billion (In re the Exxon Valdez 2004, 1076).

### *Pause for Questions*

1. Does the trial judge's action change your analysis of this case? Why or why not?

2. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 2002, and what is the minimum amount that you think should be reported?

### *Continuing the Story*

In 2003, the appeals court vacated the \$4 billion award as well and asked the trial judge to reconsider based on *State Farm Mutual Insurance Company v. Campbell* (2003) in which the Supreme Court explained that most cases will warrant no more than a 4:1 ratio between punitive damages and compensatory damages. Due process will rarely be satisfied by ratios in excess of 9:1. A ratio higher than 9:1 might be justified where a particularly egregious act resulted in a small amount of economic damages, where the injury is hard to detect, or where monetary value of non-economic harm might have been difficult to determine. Substantial compensatory damages may dictate a 1:1

ratio for punitive damages. The court also noted that compensatory awards may already contain a punitive element. For example, the portion of a compensatory award for pain and suffering above economic damages may be considered to have a punitive element and would thus warrant a lower ratio of punitive damages to compensatory damages or no punitive damages at all.

We have admonished that “punitive damages pose an acute danger of arbitrary deprivation of property. Jury instructions typically leave the jury with wide discretion in choosing amounts, and *the presentation of evidence of a defendant’s net worth creates the potential that juries will use their verdicts to express biases against big businesses*, particularly those without strong local presences” (*State Farm Mutual Insurance Company v. Campbell* 2003, 417). (Emphasis added.)

Judge Holland, as requested by the Court of Appeals, reviewed the *State Farm* case and stated that: *State Farm* adds no new, free-standing factor to the constitutional analysis of punitive damages that the court might “tie onto” its previous order. It is the Court’s view that *State Farm*...does not change the analysis (*In re the Exxon Valdez* 2004, 1076).

The award was changed to \$4.5 billion, nine times the amount of all relevant compensatory damages, the outer limit of non-rare punitive damage cases. The Ninth Circuit Court of Appeals then reduced the award to \$2.5 billion. Exxon appealed to the Supreme Court.

### ***Pause for Questions***

1. Based on the facts presented, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill?
2. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 2004, and what is the minimum amount that you think should be reported?

### ***Ending the Story***

On June 25, 2008, the U.S. Supreme Court (*Exxon Shipping, et al., Petitioners v. Grant Baker, et al.* 2008) further reduced the amount of punitive damages to \$500 million, or a one to one ratio with compensatory damages.

### **Learning Objectives**

As implemented by the authors, the case has the following objectives:

1. To gain a better understanding of the reporting and disclosure of contingent liabilities, especially those related to potential damage awards.
2. To practice using accounting judgment.
3. To develop critical thinking skills.
4. To develop oral communication skills.

We also offer suggestions for implementing the case in a written out-of-class assignment before the in-class discussion. In that format the case has additional learning objectives.

5. To develop written communication skills.
6. To develop research skills.

### **Implementation Guidance**

This reading is intended for a senior level or graduate financial accounting or auditing course. It provides a vehicle for instructors to stimulate classroom discussion, helps students gain a better understanding of the uncertainties surrounding contingent liabilities, and motivates students to think more deeply and critically about an important accounting topic. The topic is of such general interest that it motivates class discussion and oral communication. We also offer some suggestions on implementing the case as a written out-of-class assignment that could be used in intermediate accounting.

The reading can be assigned as a whole or in parts. Assigned as a whole, the students read the story and come to class ready to discuss how their judgment of the contingent liability and its reporting or disclosure changed as the story unfolded. Presented in parts, the class discusses the implications of each bit of new information together. In the authors' experience, the discussion tends to be livelier when the students are prepared by reading the first part of the story, but are presented with updates to the story in class.

Students will need some preparation to make the reading meaningful. They will not only need to know the reporting and disclosure requirements for contingent liabilities but will need an understanding of the awarding of compensatory and punitive damages in the United States, i.e., that compensatory damages are intended to make the injured party whole and that punitive damages are meant to punish and deter wrongdoing.

This reading has been used in intermediate accounting and in an undergraduate auditing class. Our experience in both classes is documented below. Objectives were assessed informally through faculty observations of the student groups. Some changes were made to the case in response to editorial suggestions, but the case remains in all material respects the same as what was presented in class.

#### ***Usage in Intermediate Accounting***

Students were introduced to the concept of contingent liabilities early in the course during a discussion of liabilities as one of the elements of financial reporting. Later in the course, in a unit on current liabilities, about fifteen minutes of class time were used to teach the concepts and rules related to contingent liabilities. At the end of that discussion students were given the initial portion of reading and a primer on the nature of punitive damages, i.e., that punitive damages are a part of the common law in the United States, that they are intended to have both a punitive and deterrent effect, and that the size of the award needed to punish and deter wrongdoing depends in part on the size and profitability of the defendant.

In the following class meeting, the students were split into groups of four to five students to discuss their answers to the initial questions. Groups were called on at random to give their answers. Class discussion ensued. Students were then given the next set of materials and questions and the process was repeated.

In general, it seems that the reading was difficult for most of our students. Answers had to be coaxed, were short, and didn't reflect much understanding of the issues. The case took too much time for the amount of learning evidenced. If we use it again in intermediate accounting, we will need to use a different approach; either giving more preparation or having the students read the whole paper in advance.

#### ***Usage in Undergraduate Auditing***

The case was used in an auditing class as part of the unit on the audit of current liabilities. The students were given a brief review of the rules for contingent liabilities and a brief primer on punitive damages before being given the paper up through the first set of questions. In the following class meeting the students were put into groups of 4 or 5 students to discuss their answers. Groups were chosen at random to give answers. Class discussion ensued. Students were then given the next set of materials and questions and

the process was repeated until we reached the end of the paper. The discussion took up an entire 75 minute class.

The discussions were lively, turning into debate at some points. Students spoke of the meaning of the term 'probable,' the uncertainty and unpredictability of the outcome of appeals, the role of the defendants' attorneys in determining probability, what full disclosure would entail, etc.

The case was also used in the auditing class in the following semester. The only change made was that students were given the entire reading all at once. Discussing the reading this way, students have the entire 19 year history of the case. While the groups discussed each segment of the case and then discussed it with the class, discussions in this format included the evolution in their thinking as the court case progressed. The discussion was shorter in this format, but was also more muted. It seems that knowing the outcome in advance left little interest in discussing alternatives for reporting the liability in the intervening years.

Based on the authors' experiences, we conclude that senior and graduate students will find this reading to be instructive as implemented. The in class discussion format of the case has greater benefit when its sections are introduced sequentially. Junior level students didn't do well with the case as presented in class. However, since the topic is most often introduced in Intermediate Accounting, we offer guidance on a written out-of-class approach to implementing the case that may work better with junior level students. Table 2 contains that guidance. The written assignment has the additional advantage of making a formal assessment of objectives easier to implement.

### **Teaching Notes**

Table 3 contains Exxon's reporting and disclosure of the relevant contingent loss and liability. It contains Exxon's contingent liability reporting and disclosure for each year the reader is asked to comment. The information can be shared with students at the end of the discussion, or after each set of questions, depending on instructor preference or student responses.

Table 4 contains possible answers for case questions. The questions are organized by year as they appear in the reading. Table 5 contains possible answers for the written out-of-class assignment.

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Table 1  
Financial Statement Highlights  
(in millions of dollars)

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	1988	1989	1990	1991	1992	1993	1994
Revenues	\$87,252	\$95,173	\$115,794	\$115,068	\$117,106	\$111,211	\$113,904
Net Income	5,260	3,510	5,010	5,600	4,770	5,280	5,100
Current Assets	14,846	16,576	18,336	17,102	16,424	14,859	16,460
Total Assets	74,293	83,219	87,707	87,560	85,030	84,145	87,862
Current Liabilities	17,479	21,984	24,025	20,854	19,663	18,590	19,493
Total Liabilities	45,526	83,219	54,652	52,633	51,254	49,353	50,447

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Table 2  
The Case of the Exxon Valdez:  
Reporting Contingent Liabilities for Potential Damage Awards  
Writing Assignment

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1. Find in the FASB Codification of Accounting Standards guidance on the reporting and disclosure of contingent losses. A contingent loss may lead to impairment of an asset or incurrence of a liability. The contingent loss in this case is associated with a contingent liability. Answer the following questions giving the codification reference for your answer.

- a. What is a contingent loss?
  - b. Under what conditions must a contingent loss (liability) be reported in the income statement (balance sheet)?
  - c. How is the amount of the loss (liability) to be reported on the income statement (balance sheet) determined if there are several possibilities?
  - d. If the loss (liability) does not meet the criteria to be reported on the income statement, what disclosure is required in the financial-statement footnotes?
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2. Keeping in mind what you learned in part 1, and referring to the conditions at Exxon at the end of 1989 relative to the Exxon Valdez oil spill, answer the following questions.

- a. What is source of Exxon's contingent loss and liability at the end of 1989? Or, in other words, what obligations or potential obligations does Exxon have as a result of the oil spill?
  - b. Do any of those obligations meet the criteria to be reported as a loss (liability) on Exxon's income statement (balance sheet)? Explain how the obligations meet or do not meet the criteria?
  - c. How should the contingent loss (liabilities) arising from the Exxon Valdez oil spill be reported and disclosed in the 1989 financial statements and accompanying notes?
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3. Now assume that by the end of 1991 Exxon had paid the fine levied by the federal and state governments and had finished its cleanup effort. Consider the conditions existing at Exxon at the end of 2001 relative to the Exxon Valdez oil spill and the Supreme Court guidance in *Pacific Mutual Life Insurance v. Haslip* and answer the following questions.

- a. What is the source of Exxon's contingent liability at the end of 1991?
  - b. What amount of contingent liability should be reported in the balance sheet? Why should that amount be reported?
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4. Answer the following questions relative to the end of 1994.

- a. Since the court has set the amount of compensatory and punitive damages, should the financial statements reflect a liability of that amount? Give an explanation for your answer.
  - b. Does the Supreme Court's opinion in *Pacific Mutual Life Insurance v. Haslip*, that a 4 to 1 ratio of punitive to compensatory damages is about the limit of constitutional propriety, affect your judgment of contingent liability reporting for the Exxon Valdez case?
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5. Answer the following questions relative to 1995.

- a. Assuming Exxon had made no payments relative to punitive damages, and considering the Supreme Court opinion in *Pacific Mutual Life Insurance v. Haslip*, and considering Exxon's own analysis of what represents a reasonable award of punitive damages, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill? Explain your answer.
  - b. What factors should be considered in determining the amount of the contingent liability to be reported and what amount do you think should be reported?
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6. Answer the following questions for 2001.

- a. Does the trial judge's action change your analysis of this case? Why or why not?
  - b. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 2002, and what is the minimum amount that you think should be reported?
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7. Answer the following questions for 2004.

- a. Based on the facts presented, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill?
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b. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 2004, and what is the minimum amount that you think should be reported?

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Table 3  
Exxon Reporting and Disclosure of Contingent Loss and Liability Related to the  
Exxon Valdez Oil Spill

(Disclosure information is quoted from Exxon annual financial statements.)

Year	Reporting and Disclosure
1989	<p>Reporting: Loss of \$1.68 billion, net of tax. In 1990, the loss was reclassified as \$2.454 billion before tax. No separate balance sheet disclosure.</p> <p>Disclosure: On March 24, 1989, the Exxon Valdez, a tanker owned by Exxon Shipping Company, a subsidiary of Exxon Corporation, ran aground on Bligh Reef in Prince William Sound off the port of Valdez, Alaska, and released approximately 260,000 barrels of crude oil. More than one hundred and seventy lawsuits including class actions have been brought in various courts against Exxon Corporation and certain of its consolidated subsidiaries. Most of these lawsuits seek unspecified compensatory and punitive damages; several lawsuits seek damages in varying specified amounts. Certain of the lawsuits seek injunctive relief.</p> <p>The State of Alaska has filed a suit in Superior Court in Alaska against Exxon Shipping Company, Exxon Corporation and others seeking substantial civil penalties and unspecified damages arising from the oil spill. On February 27, 1990, an indictment was returned in the United States District Court in Anchorage, Alaska, charging Exxon Shipping Company and Exxon Corporation with violation of the Refuse Act, the Migratory Bird Treaty Act, the Clean Water Act, the Ports and Waterways Safety Act and the Dangerous Cargo Act.</p> <p>The potential total costs relating to the matters described above are difficult to predict and are not expected to be resolved for a number of years. It is believed that the ultimate outcome, net of reserves already provided, will not have a materially adverse effect upon the corporation's operations or financial condition.</p>
1991	<p>Reporting: None</p> <p>Disclosure: On March 24, 1989, the Exxon Valdez, a tanker owned by Exxon Shipping Company, a subsidiary of Exxon Corporation, ran aground on Bligh Reef in Prince William Sound off the port of Valdez, Alaska, and released approximately 260,000 barrels of crude oil. More than 315 lawsuits, including class actions, have been brought in various courts against Exxon Corporation and certain of its subsidiaries. Most of these lawsuits seek unspecified compensatory and punitive damages; several lawsuits seek damages in varying specified amounts. Certain of the lawsuits seek injunctive relief. Of these lawsuits, more than 55 have been dismissed or settled.</p> <p>In August 1989, the State of Alaska filed a suit in Superior Court in Alaska against Exxon Shipping Company, Exxon Corporation, and others, seeking substantial civil penalties and unspecified damages arising from the oil spill. On February 27, 1990, an indictment was returned in the United States District Court in Anchorage, Alaska, charging Exxon Shipping Company and Exxon Corporation with violation of the Refuse Act, the Migratory Bird Treaty Act, the Clean Water Act, the Ports and Waterways Safety Act, and the Dangerous Cargo Act. In March 1991, the United States filed a civil suit against Exxon Shipping Company, Exxon Corporation, and others, and the State of Alaska filed a separate civil suit against Exxon Shipping Company and Exxon Corporation. These suits, seeking unspecified damages from the oil spill, were filed in the United States District Court for the District of Alaska.</p> <p>On October 8, 1991, the United States District Court for the District of Alaska approved a civil agreement and consent decree executed by Exxon Corporation, Exxon Shipping Company, Exxon Pipeline Company, the United States, and the State of Alaska and accepted a plea agreement executed by Exxon Corporation, Exxon Shipping Company, and the United States. These agreements provided for guilty pleas to certain misdemeanors, the dismissal of all felony charges and the remaining misdemeanor charges by the United States, and the release of all civil claims against Exxon Corporation, Exxon Shipping Company, and Exxon</p>

Pipeline Company (except certain claims by the State under the Fisheries Business Act) by the United States and the State of Alaska. The agreements also released all claims related to or arising from the oil spill by Exxon Corporation, Exxon Shipping Company, and Exxon Pipeline Company against the governments.

Payments under the plea agreement totaled \$125 million--\$25 million in fines and \$100 million in payments to the United States and Alaska for restoration projects in Alaska. Payments under the civil agreement and consent decree will total \$900 million over a ten year period. The civil agreement also provides for the possible payment, between September 1, 2002 and September 1, 2006, of up to \$100 million for substantial loss or decline in populations, habitats or species in areas affected by the oil spill which could not have been reasonably anticipated on September 25, 1991.

The remaining cost to the corporation from the Valdez accident is difficult to predict and cannot be determined at this time. It is believed the final outcome, net of reserves already provided, will not have a materially adverse effect upon the corporation's operations or financial condition.

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1994 Reporting: None

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Disclosure:

A number of lawsuits, including class actions, have been brought in various courts against Exxon Corporation and certain of its subsidiaries relating to the accidental release of crude oil from the tanker Exxon Valdez in 1989. Most of these lawsuits seek unspecified compensatory and punitive damages; several lawsuits seek damages in varying specified amounts. The claims of many individuals have been dismissed or settled. A civil trial in the United States District Court for the District of Alaska commenced on May 2, 1994 on punitive damage claims made by a class composed of all persons and entities seeking punitive damages from the corporation as a result of the Exxon Valdez grounding. On September 16, 1994, the jury returned a verdict awarding the class punitive damages of \$5 billion. The District Court has denied the corporation's motions to overturn or reduce this verdict, and the corporation plans to appeal this verdict following entry of a final judgment by the District Court. The corporation believes that this verdict is unjustified and should be set aside or substantially reduced by appellate courts.

With respect to the remaining compensatory damage claims against the corporation arising from the grounding, many of these claims have been or will be addressed in the same federal civil trial, which is still ongoing. On August 11, 1994, the jury returned a verdict finding that fisher plaintiffs were damaged in the amount of \$286.8 million. This award is subject to a number of adjustments by the District Court, including a reduction to reflect payments already made by the corporation to many of these plaintiffs, and is subject to appeal. A later phase of the trial will be a separate proceeding or series of proceedings to deal with certain claims for compensatory damages not addressed or settled in prior phases. The timing and scope of this later phase have yet to be determined. At present, the specified claims in this later phase total approximately \$200 million, which the corporation believes is far in excess of their value. There are a number of additional cases pending in federal and instate court in Alaska where the compensatory damages claimed have not been fully specified.

The ultimate cost to the corporation from the lawsuits arising from the Exxon Valdez grounding is not possible to predict and may not be resolved for a number of years.

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1995 Reporting: None

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Disclosure:

A number of lawsuits, including class actions, have been brought in various courts against Exxon Corporation and certain of its subsidiaries relating to the accidental release of crude oil from the tanker Exxon Valdez in 1989. Most of these lawsuits seek unspecified compensatory and punitive damages. Several lawsuits seek damages in varying specified amounts.

A civil trial in the United States District Court for the District of Alaska commenced on May 2, 1994 on punitive damage claims made by a class composed of all persons and entities seeking punitive damages from the corporation as a result of the Exxon Valdez grounding. On September 16, 1994, the jury returned a verdict awarding the class punitive damages of \$5 billion. The verdict is not final. The corporation plans to appeal this verdict following entry of a final judgment by the District Court. The corporation believes that this verdict is unjustified and should be set aside or substantially reduced by the District Court or appellate courts.

Many of the claims of individuals have been dismissed by the courts but have been appealed. A number of claims have been settled. With respect to the remaining compensatory damage claims against the corporation arising from the grounding, many of these claims have been or will be addressed in the same federal civil trial proceeding, which is still ongoing. On August 11, 1994, the jury returned a verdict finding that fisher plaintiffs were damaged in the amount of \$286.8 million. On August 31, 1995, the District Court issued an order that reduced this verdict to about \$70 million to reflect payments already made to the plaintiffs by the corporation and others. The corporation expects this lesser amount to be further reduced. Additional claims for compensatory damages, scheduled for determination in the final phase of the trial, have been settled. The remaining class action claims are included in \$3a.5 million settlement of this final phase. The class settlement is subject to approval by the court. The total amount of the settlement will be satisfied by recognition of prior payments made to the plaintiffs by the corporation and others. If the settlement is approved, the federal trial will be concluded. There are a number of additional cases pending in state court in Alaska where the compensatory damages claimed have not been fully specified.

The ultimate cost to the corporation from the lawsuits arising from the Exxon Valdez grounding is not possible to predict and may not be resolved for a number of years.

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2002 Reporting: None

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Disclosure:

A number of lawsuits, including class actions, were brought in various courts against Exxon Mobil Corporation and certain of its subsidiaries relating to the accidental release of crude oil from the tanker Exxon Valdez in 1989. The vast majority of the claims have been resolved leaving a few compensatory damages cases to be tried. All of the punitive damage claims were consolidated in the civil trial that began in May 1994.

In that trial, on September 24, 1996, the United States District Court for the District of Alaska entered a judgment in the amount of \$5.058 billion. The District Court awarded approximately \$19.6 million in compensatory damages to fisher plaintiffs, \$38 million in prejudgment interest on the compensatory damages and \$5 billion in punitive damages to a class composed of all persons and entities who asserted claims for punitive damages from the corporation as a result of the Exxon Valdez grounding. The District Court also ordered that these awards shall bear interest from and after entry of the judgment. The District Court stayed execution on the judgment pending appeal based on a \$6.75 billion letter of credit posted by the corporation. ExxonMobil appealed the judgment. On November 7, 2001, the United States Court of Appeals for the Ninth Circuit vacated the punitive damage award as being excessive under the Constitution and remanded the case to the District Court for it to determine the amount of the punitive damage award consistent with the Ninth Circuit's holding. The Ninth Circuit upheld the compensatory damage award which has been paid. The letter of credit was terminated on February 1, 2002.

On January 29, 1997, a settlement agreement was concluded resolving all remaining matters between the corporation and various insurers arising from the Valdez accident. Under terms of this settlement, ExxonMobil received \$480 million. Final income statement recognition of this settlement continues to be deferred in view of uncertainty regarding the ultimate cost to the corporation of the Valdez accident. The ultimate cost to ExxonMobil from the lawsuits arising from the Exxon Valdez grounding is not possible to predict and may not be resolved for a number of years.

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2004	<p>Reporting: None</p> <hr/> <p>Disclosure</p> <p>A variety of claims have been made against ExxonMobil and certain of its consolidated subsidiaries in a number of pending lawsuits and tax disputes. The Corporation accrues an undiscounted liability for those contingencies where the incurrence of a loss is probable and the amount can be reasonably estimated. The Corporation does not record liabilities when the likelihood that the liability has been incurred is probable but the amount cannot be reasonably estimated, or when the liability is believed to be only reasonably possible or remote. ExxonMobil will continue to defend itself vigorously in these matters. Based on a consideration of all relevant facts and circumstances, the Corporation does not believe the ultimate outcome of any currently pending lawsuit against ExxonMobil will have a materially adverse effect upon the Corporation's operations or financial condition.</p> <p>A number of lawsuits, including class actions, were brought in various courts against Exxon Mobil Corporation and certain of its subsidiaries relating to the accidental release of crude oil from the tanker Exxon Valdez in 1989. The vast majority of the compensatory claims have been resolved. All of the punitive damage claims were consolidated in the civil trial that began in May 1994.</p> <p>In that trial, on September 24, 1996, the United States District Court for the District of Alaska entered a judgment in the amount of \$5 billion in punitive damages to a class composed of all persons and entities who asserted claims for punitive damages from the Corporation as a result of the Exxon Valdez grounding. ExxonMobil appealed the judgment. On November 7, 2001, the United States Court of Appeals for the Ninth Circuit vacated the punitive damage award as being excessive under the Constitution and remanded the case to the District Court for it to determine the amount of the punitive damage award consistent with the Ninth Circuit's holding. The Ninth Circuit upheld the compensatory damage award, which has been paid. On December 6, 2002, the District Court reduced the punitive damage award from \$5 billion to \$4 billion. Both the plaintiffs and ExxonMobil appealed that decision to the Ninth Circuit. The Ninth Circuit panel vacated the District Court's \$4 billion punitive damage award without argument and sent the case back for the District Court to reconsider in light of the recent U.S. Supreme Court decision in <i>Campbell v. State Farm</i>.</p> <p>On January 28, 2004, the District Court reinstated the punitive damage award at \$4.5 billion plus interest. ExxonMobil and the plaintiffs have appealed the decision to the Ninth Circuit. The Corporation has posted a \$5.4 billion letter of credit.</p> <p>On January 29, 1997, a settlement agreement was concluded resolving all remaining matters between the Corporation and various insurers arising from the Valdez accident. Under terms of this settlement, ExxonMobil received \$480 million. Final income statement recognition of this settlement continues to be deferred in view of uncertainty regarding the ultimate cost to the Corporation of the Valdez accident. Management believes that the likelihood of the judgment being upheld is remote. While it is reasonably possible that a liability may have been incurred arising from the Exxon Valdez grounding, it is not possible to predict the ultimate outcome or to reasonably estimate any such potential liability.</p>
2008	<p>Reporting: Loss of</p> <hr/> <p>Disclosure:</p> <p>A number of lawsuits, including class actions, were brought in various courts against Exxon Mobil Corporation and certain of its subsidiaries relating to the accidental release of crude oil from the tanker Exxon Valdez in 1989. All the compensatory claims have been resolved and paid. All of the punitive damage claims were consolidated in the civil trial that began in 1994. On June 25, 2008, the U.S. Supreme Court vacated the \$2.5 billion punitive damage award previously entered by the Ninth Circuit Court of Appeals and remanded the case to the Circuit Court with an instruction that punitive damages in the case may not exceed a maximum amount of \$507.5 million. Exxon Mobil Corporation recorded an after-tax charge of \$290 million in the second quarter of 2008, reflecting the maximum amount of the punitive</p>

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damages. The parties have filed briefs in the Ninth Circuit Court of Appeals on the issue of post-judgment interest and recovery of costs. Exxon Mobil Corporation recorded an after-tax charge of \$170 million in the third quarter of 2008, reflecting its estimate of the resolution of those issues.

Table 4  
Possible Answers to Questions

Year	Questions and Possible Answers
1989	<p>1. Describe the sources of Exxon's contingent liability relative to the Exxon Valdez oil spill?</p> <p>The sources of Exxon's contingent liability are clean-up costs, legal fines and penalties, settlement costs for those suffering economic harm, and possible compensatory and punitive damages from lawsuits.</p>
	<p>2. What factors should be considered in determining the amount of the contingent liability that Exxon should report on its balance sheet in 1989, and what is the minimum amount that you think should be reported?</p> <p>There are several potential costs here for Exxon. For each, the student should consider whether it is probable Exxon will have to pay it, and if the amount can be reasonably estimated. Students focus on the \$1.28 billion dollars of estimated cleanup costs. That would seem to be the proper focus, but we would need to subtract any cleanup costs expended prior to year-end. Some students will ask about fines, penalties and legal damages, but there is little information to estimate them.</p>
1991	<p>1. Assuming Exxon had paid the fine levied by the federal and state governments and had finished its cleanup effort, what is the nature of any remaining contingent liability related to the Exxon Valdez oil spill?</p> <p>Since cleanup has been completed and fines and penalties have been paid, the nature of the remaining liability is any remaining settlements and possible compensatory and punitive damages.</p>
	<p>2. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 1991?</p> <p>There is not enough information to estimate any liability.</p>
1994	<p>1. Since the court has set the amount of compensatory and punitive damages, does Exxon have a contingent liability related to the Exxon Valdez oil spill? Why or why not?</p> <p>Some students will argue that, since the liability is now known, it is no longer contingent. However, since damages are often changed on appeal, the actual liability is still dependent on a future event, and thus Exxon has a contingent liability.</p>
	<p>2. Does the Supreme Court's opinion in <i>Pacific Mutual Life Insurance v. Haslip</i>, that a four to one ratio of punitive to compensatory damages is about the limit of constitutional propriety, affect your judgment of contingent liability reporting for the Exxon Valdez case?</p> <p>Students like having the concrete numbers to work with that are provided by these damage awards. Most will agree that the four to one ratio set by the court is relevant to the analysis.</p>
	<p>3. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 1994?</p> <p>Some students will do the math (<math>\\$286 \text{ million} \times 4 = \\$1.144 \text{ billion}</math> of punitive damages + <math>\\$286 \text{ million}</math> compensatory damages = <math>\\$1.43 \text{ billion}</math>) and want to report a contingent liability of <math>\\$1.43 \text{ billion}</math>. These students miss the point that this is a maximum set by the court and contingent liabilities should be reported at the lower end of the range of probable outcomes. At this point, because of some payments already made to plaintiffs, Exxon still judges the bottom end of the range of the probable contingent liability to be zero.</p>
1995	<p>1. Assuming Exxon had made no payments relative to punitive damages, and considering the Supreme Court opinion in <i>Pacific Mutual Life Insurance v. Haslip</i>, and considering Exxon's own analysis of what represents a reasonable award of punitive damages, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill?</p> <p>Students choose to use either the trial court judge's \$5 billion award, the four to one ratio of punitive to compensatory damages, or an award based on Exxon's research study. Using the percentages from the Exxon study produces estimates of a liability from \$100 million to \$700 million.</p>
	<p>2. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 1995?</p> <p>Most students will agree that Exxon should not report a liability equal to the \$5 billion dollars awarded. Many will want to book a liability based on Exxon's own calculations.</p>

2001	<p>1. Based on the facts presented, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill? Students are still somewhat undecided on what Exxon will ultimately be required to pay.</p>
	<p>2. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 2001? Most students will now choose Exxon's own calculations as the amount of contingent liability to report.</p>
2002	<p>1. Based on the facts presented, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill? At this point there should be no students left defending the trial judge's award of \$5 billion as the amount of the contingent liability. Students will be split between whether the reduced award, Exxon's own calculations, or the four to one ratio of punitive to compensatory damages is the most likely outcome for the case.</p>
	<p>2. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 2002? Most students will continue to choose Exxon's own calculations as the amount of contingent liability to report.</p>
2003	<p>1. Based on the facts presented, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill? Students now have to grapple with what the appropriate multiple of punitive damages to compensatory ought to be. Was this an egregious act that might warrant a 9:1 ratio? Do the compensatory damages and the \$2 billion already paid out by Exxon in fines and cleanup costs constitute sufficient penalty that the ratio ought to be 1:1? Or should the ratio be somewhere between the two?</p>
	<p>2. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 2003? Students generally agree that any of the three are reasonably possible and choose to accrue a liability for the ratio of 1:1.</p>
2004	<p>1. Based on the facts presented, what is your estimate of the remaining contingent liability related to the Exxon Valdez oil spill? Some students will grapple with what the appropriate multiple of punitive damages to compensatory damages ought to be. Was this an egregious act that might warrant a 9:1 ratio? Do the compensatory damages and the \$2 billion already paid out by Exxon in fines and cleanup costs constitute sufficient penalty that the ratio ought to be 1:1? Or should the ratio be somewhere between the two? Other students think the case is over and estimate a contingent liability of \$2.5 billion.</p>
	<p>2. Based on the facts presented, what is the minimum amount of liability that Exxon should report on its balance sheet in 2004? Some students think the case is over and decide to accrue the \$2.5 billion liability. Others continue to defend using an estimate based on Exxon's analysis prepared for the appeal of punitive damages.</p>

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Table 5  
The Case of the Exxon Valdez:  
Reporting Contingent Liabilities for Potential Damage Awards  
Writing Assignment Answer Key

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1. Find in the FASB Codification of Accounting Standards guidance on the reporting and disclosure of contingent losses. A contingent loss may lead to impairment of an asset or incurrence of a liability. The contingent loss in this case is associated with a contingent liability. Answer the following questions giving the codification reference for your answer.
- a. What is a contingent loss?
  - b. Under what conditions must a contingent loss (liability) be reported in the income statement (balance sheet)?
  - c. How is the amount of the loss (liability) to be reported on the income statement (balance sheet) determined if there are several possibilities?
  - d. If the loss (liability) does not meet the criteria to be reported on the income statement, what disclosure is required in the financial-statement footnotes?
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- a. 450-20-05 An existing condition, situation, or set of circumstances involving uncertainty as to possible loss to an entity that will ultimately be resolved when one or more future events occur or fail to occur.
  - b. 450-20-25-2 An estimated loss from a contingency shall be accrued by a charge to income if both of the following conditions are met:
    - a. Information available indicates that it is probable that an asset had been impaired or a liability incurred at the date of the financial statements.
    - b. The amount of loss can be reasonably estimated.
  - c. 450-20-25-5 When the condition in paragraph 450-20-25-2(a) is met with respect to a particular loss contingency and the reasonable estimate of the loss is a range, the condition in paragraph 450-20-25-2(b) is met and an amount shall be accrued for the loss.
 

450-20-30-1 If some amount within a range of loss appears at the time to be a better estimate than any other amount within the range, that amount shall be accrued. When no amount within the range is a better estimate than any other amount, however, the minimum amount in the range shall be accrued.
  - d. Disclosure of the contingency shall be made if there is at least a reasonable possibility that a loss may have been incurred and either of the following conditions exists:
    - a. An accrual is not made for a loss contingency because any of the conditions in paragraph 450-20-25-2 are not met.
    - b. An exposure to loss exists in excess of the amount accrued pursuant to the provisions of paragraph 450-20-30-1.
- 450-20-50-4 The disclosure shall include both of the following:
- a. The nature of the contingency
  - b. An estimate of the possible loss or range of loss or a statement that such an estimate cannot be made.
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2. Keeping in mind what you learned in part 1, and referring to the conditions at Exxon at the end of 1989 relative to the Exxon Valdez oil spill, answer the following questions.
- a. What is source of Exxon's contingent loss and liability at the end of 1989? Or, in other words, what obligations or potential obligations does Exxon have as a result of the oil spill?
  - b. Do any of those obligations meet the criteria to be reported as a loss (liability) on Exxon's income statement (balance sheet)? Explain how the obligations meet or do not meet the criteria?
  - c. How should the contingent loss (liabilities) arising from the Exxon Valdez oil spill be reported and disclosed in the 1989 financial statements and accompanying notes?
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- a. The sources of Exxon's contingent loss and liability are clean-up costs, legal fines and penalties, settlement costs for those suffering economic harm, and possible compensatory and punitive
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damages from lawsuits.

b. Students focus on the \$1.28 billion dollars of estimated cleanup costs. That would seem to be the proper focus, but we would need to subtract any cleanup costs expended prior to year-end. Some students will ask about fines, penalties and legal damages, but there is little information to estimate them.

c. A loss should be reported on the income statement for the \$1.28 billion of clean-up costs. That amount, less any costs already expended should be accrued as a liability on the balance sheet. A footnote should describe the event of the spill, the resulting clean-up costs that were estimated and reported, and the items that remain contingent on future events but either not probable or not estimable, i.e., the possible fines and penalties, settlement costs, and possible compensatory and punitive damages.

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3-7 Answer for these parts can be found in Table 3.

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