Accounting Forum 37 (2013) 110–123

Contents lists available at SciVerse ScienceDirect

Accounting Forum

journal homepage: www.elsevier.com/locate/accfor

Accounting for the environmental impacts of Texaco's operations in Ecuador: Chevron's contingent environmental liability disclosures☆

Stacie Buccina[a], Douglas Chene[a,*], Jeffrey Gramlich[a,b]

[a] University of Southern Maine, United States
[b] Copenhagen Business School, Denmark

ARTICLE INFO

Keywords:
Environmental liability
Chevron
Texaco
ChevronTexaco
Financial disclosure
Ecuador
Environmental remediation
Legitimacy theory
Stakeholder theory

ABSTRACT

This paper examines the disclosure of a contingent legal obligation that arose as a result of Texaco Inc.'s oil drilling and extraction activities in Ecuador. We examine Texaco's and, after Texaco's acquisition by Chevron in 2001, Chevron's, financial reporting and SEC disclosures pertaining to a lawsuit claiming damages related to the environmental effects of Texaco's 30 years of operations in Ecuador. After an historical review of Texaco's drilling and extraction activities in Ecuador, and the ensuing litigation that began in 1993, we consider U.S. accounting and reporting rules as they apply to Texaco and Chevron. Given these rules, we analyze the appropriateness and timing of Chevron's disclosures related to the heretofore-unresolved litigation. The discussion employs legitimacy and stakeholder theories to explain Chevron's disclosures.

1. Introduction

This case study of financial disclosures pertains to lawsuits brought by residents of Ecuador against Chevron (formerly Texaco). From 1964 to 1992, Texaco conducted oil drilling and extraction activities in Ecuador using techniques that allegedly produced severe and lethal environmental degradation. In 1993 Texaco became the defendant in a civil lawsuit, *Aguinda v. Texaco Inc.* (hereafter, *Aguinda*, "the lawsuit" or "the suit") pertaining to asserted environmental damages from its operations in Ecuador. With the 2001 merger of Texaco and Chevron, the lawsuits apply to the surviving company, Chevron. By 2007, perhaps earlier, it appeared reasonably possible, maybe even probable, that Chevron would be forced to pay a substantial monetary award for cleanup and compensation costs (see Table 1 for a summary of the key events in the case).

Memorable ugly oil spills by BP in 2010 and Exxon's Valdez in 1989, along with greater expectations for corporate social responsibility (GlobeScan, 2009) and increasingly interconnected social media have combined to spur demand for, and scrutiny of, corporate transparency and accountability. One study finds that 85% of informed working-age Americans expect business to create shareholder value in a way that aligns with society's interests even if this means sacrificing shareholder value (Edelman, 2011). Yet only 46% of the same Americans trust business to do what is right. But the energy industry may be unique. Despite the highly publicized environmental accidents of the recent past, Americans' thirst for low-cost petroleum appears to reign and Edelman's survey finds that 60% of the sampled adults trust the energy business to do what is right.

☆ The authors thank the editor, Robin Roberts, and the two referees for their helpful comments and suggestions.

* Corresponding author at: University of Southern Maine, School of Business, 96 Falmouth, Portland, ME 04104 9300, United States. Tel.: +1 207 780 4328; fax: +1 207 780 4644.
E-mail addresses: stacie.buccina@maine.edu (S. Buccina), dchene@usm.maine.edu (D. Chene), gramlich@maine.edu (J. Gramlich).

0155-9982/$ – see front matter
http://dx.doi.org/10.1016/j.accfor.2013.04.003

Table 1
Chronology of major events.

Date	Event
1964	Texpet, a fourth-level subsidiary of Texaco drills for oil in the Oriente region of Ecuador.
1965	Texpet begins operations as a concession that drills and operates oil wells for a consortium equally owned by Texpet and Gulf Oil.
1972	Texaco upper management instructs Texpet management to destroy all environmental reports and avoid issuing further routine environmental reports.
1974	Ecuador's state-owned oil company buys 25% of the consortium, leaving Texpet and Gulf Oil each with 37.5% (Texpet continues to operate the concession).
1976	Petroecuador buys Gulf Oil's 37.5%, bringing its total ownership to 62.5% (Texpet continues to operate the concession).
1984	Chevron acquires Gulf Oil through merger.
1990	Petroecuador takes over the operations of the concession from Texpet.
1992	Petroecuador buys Texpet's 37.5% share of the consortium, making Petroecuador sole owner and operator.
1993	Class action files suit against Texaco in U.S. District Court by attorneys representing 30,000 residents of the Oriente region of Ecuador: *Aguinda v. Texaco, Inc.*, Dkt. No. 93 Civ. 7527 (S.D.N.Y. filed Nov. 3, 1993).
1994	Class action files suit against Texaco in U.S. District Court by attorneys representing 25,000 downstream Peruvian residents: *Jota v. Texaco, Inc.*, Dkt. No. 94 Civ. 9266 (S.D.N.Y. filed Dec. 28, 1994).
1996–1997	Judge Jed Rakoff dismisses the *Aguinda* and *Jota* cases.
1998	U.S. Court of Appeals vacates Rakoff decisions and remands them to U.S. District Court for reconsideration.
2001 (February)	Texaco agrees to jurisdiction in Ecuador and the U.S. District Court agrees to dismiss the combined case.
2001 (October)	Chevron acquires Texaco through merger.
2002	Ruling against the class action plaintiffs, the U.S. Court of Appeals affirmed the District Court's 2002 decision to dismiss the case.
2003	Class action plaintiffs file suit against Chevron in Lago Agrio, Ecuador.
2007	Ecuador court appoints Richard Cabrera Vega as the court's independent expert.
2008 (April)	Court expert Cabrera Vega recommends to court that Chevron be required to pay $16.3 billion in damages.
2008 (November)	Court expert Cabrera Vega increases original damages assessment to $27.3 billion.
2009 (August)	Chevron announces that it possesses videotapes that allegedly show plaintiffs' representatives attempting to bribe Ecuadorian Judge Juan Nunez.
2010 (May)	Chevron obtains subpoena to view outtakes of the documentary, *Crude*.
2009 (September)	Ecuadorian Judge Juan Nunez denies impropriety but recuses himself from the case.
2011 (February)	Ecuadorian Judge Nicolas Zambrano orders Chevron to pay $9.46 billion in damages and compensation.
2011 (March)	Chevron obtains injunction preventing attorney Steven Donziger and other members of the plaintiff legal team from seeking to enforce the $9.46 billion judgment outside of Ecuador.

Legitimacy theory argues that a firm's legitimacy depends on its ability to convince the public that its actions are consistent with social values. The 60% approval rate suggests that the energy industry more often than not reflects American social values. A different view of the role of business in society, stakeholder theory, suggests that a firm's actions reflect the values of an amalgamated group of sometimes competing stakeholders (Gray et al., 1995). Relying on a framework developed by Ullmann (1985), Roberts (1992) demonstrates that CSR reporting behavior can be empirically linked to stakeholder power, strategic posture and economic performance (Roberts, 1992; Ullmann, 1985). Given that financial reporting standards largely determine minimum financial disclosures, the focus of stakeholder theory in this setting is on management's allocation of resources between competing stakeholders: shareholders on one hand and harmed people and their attorneys on the other.

Financial reporting of contingent environmental liabilities has been a topic of growing concern for several years (Lee & Hutchinson, 2005). Lee and Hutchinson (2005) reviewed the literature pertaining to disclosures of environmental information in financial reports and determined that these disclosures have increased in relevance to a broad range of stakeholders (Lee & Hutchinson, 2005). Desir, Fanning, and Pfeiffer (2010) reviewed pre-settlement filings for 51 companies that experienced a financial loss from a lawsuit and found that less than half had either (1) disclosed estimates of the possible range of loss or (2) stated that they were unable to make an estimate of the loss, as required by the current accounting standard governing disclosure of contingent liabilities (Desir et al., 2010; FASB, 2009).

The objective of this paper is to utilize legitimacy and stakeholder theories, in concert with applicable accounting and disclosure rules, to explain how and why Texaco, and then Chevron, avoided financial disclosure of the Ecuador lawsuit until Chevron's calendar year 2008 SEC Form 10K was filed in early 2009. Beyond disclosure, the firms' financial statements have not recognized any financial responsibility to the people of Ecuador who have been harmed by the disaster. Chevron's 2009 footnote disclosure came considerably after widespread television, magazine and newspaper reports had highlighted the severity and magnitude of the ongoing environmental damages. We perform our analysis by first evaluating Texaco and Chevron SEC disclosures and financial reports starting with 1993. We consider these reports through the lenses of legitimacy and stakeholder theories, in light of mandatory SEC disclosure rules and U.S. generally accepted accounting principles (GAAP).

In Section 2 we rely on the work of Chen and Roberts (2010) to provide a brief overview of legitimacy and stakeholder theories and review prior research on environmental disclosures (Chen & Roberts, 2010). While there are a number of studies in this area few studies have focused on emerging economies (Mahadeo et al., 2011). In Section 3 we provide a historical overview of Texaco's drilling and extraction activities in Ecuador and the ensuing litigation. In Section 4 we consider the SEC disclosure rules and GAAP reporting requirements related to contingent environmental obligations in order to evaluate the timing and adequacy of Chevron's financial disclosures pertaining to the Ecuador situation. In Section 5 we invoke legitimacy