Memo

Subject: Grounds for a ‘FOR’ vote on Chevron shareholder resolution requesting that the company recommend an independent board candidate with a high level of expertise and experience in environmental matters relevant to oil companies.

Date: May 8, 2013

Contact: Sonia Kowal, Zevin Asset Management
sonia@zevin.com

Shareholders are encouraged to vote FOR the following resolution:

RESOLVED: Shareholders request that, as elected board directors’ terms of office expire, at least one candidate be recommended who:

• has a high level of expertise and experience in environmental matters relevant to hydrocarbon exploration and production and is widely recognized in the business and environmental communities as an authority in such field, as reasonably determined by the company’s board, and

• will qualify, subject to exceptions in extraordinary circumstances explicitly specified by the board, as an independent director under the standards applicable to the company as an NYSE listed company, in order that the board includes at least one director satisfying the foregoing criteria, which director shall have designated responsibility on the board for environmental matters.

This resolution was filed by the New York State Common Retirement Fund. Co-fliers include Amnesty International USA, Trillium Asset Management, and Zevin Asset Management.

Rationale for a ‘FOR’ vote:

Summary:

The purpose of the resolution is to improve the board’s capacity for oversight and management of rapidly growing and profound environmental risks. This memo is organized in three main sections:

1) risk exposure:

• The International Energy Agency recently concluded, “No more than one-third of proven reserves of fossil fuel can be consumed prior to 2050 if the world is to achieve the 2°C goal, unless carbon capture and storage (CCS) is widely deployed.”1. The Copenhagen Agreement between the US, China, India, Brazil and South Africa

---

and recognized by 193 other nations recognizes the need to limit the average global temperature from rising 2C (3.6F) higher than pre-industrial levels.2

- BP's Macondo oil well blowout demonstrates the 'bet the company' environmental risks involved in extracting reserves.
- Chevron has caused environmental damages in several countries, detailed below, and is facing massive legal and reputational risks related to environmental damage in Ecuador.

2) Chevron acknowledges the need for expertise on environmental issues by the company, but lacks such expertise on its board.

3) A number of Chevron's peer companies have board members with the relevant environmental expertise, indicating Chevron's lagging response to this concern of shareholders.

1. **Risk Exposure**

   **A) Financial Risks**

Chevron's core business is production of oil and natural gas, known in the industry as “upstream business.” Over half of Chevron’s value derives from its oil and gas production operations, which typically enjoy much higher profit margins compared to “downstream” businesses such as refined product sales.3

HSBC estimated that 40 - 60% of the market value of oil and gas companies could be lost because, in a carbon-constrained world, a portion of their proven reserves would become stranded assets and reduced demand for oil would drive down the prices for petroleum products.4 According to Standard & Poor's, such a price decline could build pressure on the creditworthiness of oil and gas companies, particularly those with large exposure to high cost unconventional production such as oil sands.5

Chevron faced a $19 billion court judgment covering remediation costs and punitive damages stemming from pollution of land and water in the Ecuadorian Amazon. According to a *New Yorker* article, Chevron was offered a $140 million settlement in 2001, which it declined. It is estimated that Chevron has spent roughly that amount fighting the case every year since then and more than double that amount recently.6

---

2 http://news.bbc.co.uk/2/hi/8422307.stm
3 Trefis, Chevron analysis, 10 February 2011, pp. 1-2
5 Redmond, Simon, and Michael Wilkins, 2013, What a carbon-constrained future could mean for oil companies’ creditworthiness, (Standard & Poors).
Shareholders have repeatedly questioned whether Chevron has properly disclosed the risks to the company stemming from the $19 billion judgment in Ecuador. Most recently, in May 2012, a group of shareholders wrote to the Securities and Exchange Commission concerning Chevron asking the agency to “investigate evidence that the company is violating securities laws by repeatedly making misrepresentations and material omissions regarding its adverse judgment in Ecuador.”

Since the board of directors has oversight of the company’s financial statements, adding a board member with appropriate expertise in environmental issues – and environmental liabilities – would help the board improve its oversight of – and remedy possible deficiencies in – Chevron’s disclosure of its risks from the Ecuadorian litigation and judgment.

Clearly, environmental issues pose a threat both to Chevron’s business model going forward, as well as a threat based on massive potential legal liabilities based on past events.

B) Operational Risks

Chevron faces a variety of environmental operational risks around the globe. Here are some examples.

Chevron Deputy Comptroller Rex Mitchell, in a sworn declaration, made clear that efforts by the plaintiffs to enforce the Ecuadorian court judgment in any one of the countries where Chevron operates would be “disruptive” and cause “irreparable” damage to Chevron:

“...The seizure of Chevron assets, such as oil tankers, wells, or pipelines, in any one of these countries, would disrupt Chevron’s supply chain and operations; and seizures in multiple jurisdictions would be more disruptive...[The] Defendants’ campaign to seek seizures anywhere around the world and generate maximum publicity for such acts would cause significant, irreparable damage to Chevron. Unless it is stopped, Defendants’ announced plan to cause disruption to Chevron’s supply chain is likely to cause irreparable injury to Chevron’s business reputation and business relationships that would not be remediable by money damages.”

To date, the Ecuadorian plaintiffs have filed recognition and enforcement actions in three countries where Chevron has significant – and strategic - assets: Canada, Brazil, and Argentina.

7 “Chevron’s Misrepresentations in Public Filings Regarding its $18.1 Billion Environmental Liability in Ecuador,” By Graham Erion, April 2012.
8 Declaration of Chevron Deputy Comptroller Rex Mitchell in support of Chevron Corporation Motion for a Preliminary Injunction, Filed 2/5/11, p. 4
On November 7, 2012, an Argentine court ordered the immediate freeze of all of Chevron’s assets in the country pending enforcement of the judgment following an Ecuador court order and in conjunction with an enforcement treaty between Argentina and Ecuador. The court also ordered 40% of the revenue stream from those assets to be paid into an escrow account, which will be awarded to the Ecuadorian defense if the judgment is enforced. This has interfered with Chevron’s ability to do business in Argentina: a $1 billion deal with Argentina’s YPF SA is in jeopardy without liquidity of Argentinian assets. In a recent investor conference, CEO John Watson indicated without “access to [the] cash”, the shale exploration deal cannot move forward.

Apart from Ecuador-related costs and risks, Chevron has a record of pollution and litigation in other countries, including Brazil, Nigeria, Kazakhstan, and the United States. Better board oversight of the management of these environmental liabilities is required to protect shareholder value.

Brazil

A drilling accident in November 2011 in Brazil caused 3000 barrels of crude oil to seep into the Atlantic Ocean from the seabed.

Following the spill, which occurred in the Frade Field off the coast of Brazil, a suspension of offshore exploration was imposed on Chevron, and the oil workers union in Brazil is asking for Chevron’s offshore drilling contract to be revoked entirely. The company has already been charged $110 million in fines due to the incident, and an additional $11 billion civil lawsuit was filed by Brazilian prosecutors in November 2011. After further leaks were found in March 2012, the suit increased to $20 billion.

Criminal charges against the company were dropped in late February of this year, though the civil suit, Brazil’s largest-ever environmental case, remains open.

Nigeria

Operations in the Niger Delta have caused ongoing pollution, as well as environmental incidents.

A fire of unknown causes broke out on a natural gas rig in Nigeria on January 16, 2012. It burned for 46 days, causing two deaths, local evacuations, and polluting water, killing fish, and increasing health issues in the meantime. Although the company began to drill a

---

12 “Chevron, Transocean say Brazil drops criminal oil spill charges”, available at http://uk.reuters.com/article/2013/02/21/business-us-chevron-brazil-charges-idUKBRE91J17Z20130221
Chevron has been operating in Nigeria for almost 50 years, and during that time has used flaring practices and caused environmental pollution. The long-term pollution in the Niger delta area has prompted Chevron and USAID to set up a $50 million fund to make reparations for damages. Over the years environmental incidents have caused civil unrest and prompted protests. For example, a high-profile lawsuit alleging Chevron’s compliance in the killings of two protesters in 1998 by Nigerian security forces was only recently settled.

**Kazakhstan**

Chevron’s Kazakhstan operations, which represent 22% of net proved reserves, have been fined millions of dollars for different environmental malpractices.

- In 2007, the company was fined $609 million, largely because the company had not properly dealt with a large amount of stored solid sulfur that was being kept in the open air and was causing pollution concerns.
- In 2010, Chevron was fined $1.4 million in Kazakhstan for the unauthorized flaring of natural gas.
- In 2012, the special interregional economic court of the Western Kazakhstan Region fined the Karachaganak Petroleum Operating (KPO) consortium $52 million for environmental pollution related to its hydrochloric treatment operations. Chevron Corporation owns 20% of the KPO consortium.

**United States**

Chevron has had several civil penalties imposed against them by the California Air Resources Board in 2008, 2009, and 2011 for issues relating to the company’s gasoline not meeting regulations. Chevron is expected to pay hundreds of thousands in fines for these penalties. Chevron is also involved in ongoing disputes with the Hawaii Department of

---


Health and the EPA about similar violations. The company recently paid the state of Utah a $550,000 penalty, in addition to $4 million in damages and restoration projects, for two spills that occurred in 2010.21

In September 2012, the U.S. Environmental Protection Agency (EPA) opened a criminal investigation into Chevron’s Richmond refinery in California. The EPA began the investigation after learning that the refinery had installed a pipe that detoured pollutants around monitoring equipment and burned them into the atmosphere. John Gioa, chairman of the Bay Area Air Quality Board, said “[Chevron’s] credibility at this point is at one of the lowest points I’ve seen” after the investigation was announced.22

The company also faces nearly $1 million in penalties relating to a fire at this same refinery in August of 2012. The fine is the largest in Cal-OSHA history.23

These numerous environmental accidents and controversies, and the fines that result, suggest that Chevron’s board provides inadequate oversight of Chevron’s policies, procedures, incentives, risk management and accountability mechanisms relating to environmental issues. Proper board oversight of management would be greatly enhanced by having an independent board member with environmental expertise. This person would provide knowledge and experience, and add an environmental focus to decision making at the highest level of the company, helping to restore the trust of both shareholders and the public.

C) Reputational Risks

A fossil fuel divestment campaign has spread to well over 300 college campuses, with four colleges committing to divest. Additionally, 10 US cities have pledged to divest, and petitions are active in 100 other cities and states.24 The campaign has garnered significant media attention, and we believe has put serious pressure on religious, social and certain other intuitional investors to divest from oil and gas companies and / or significantly increase their efforts to engage fossil fuel companies to modify their business models to reduce emissions dramatically – an often cited goal is an 80% reduction in emissions by 2050.

Divestment campaign leaders are seeking to reduce the political influence of the oil and gas industry by persuading the public that fossil fuel companies threaten the global economy, ecosystems, and the quality of life of hundreds of millions of people – and that fossil fuel company managers are enriching themselves at the expense of society.

21 Chevron 2012 10-K Report, p 32
24 http://www.sustainablebusiness.com/index.cfm/go/news.display/id/24815
We believe the divestment campaign presents serious reputational risk to Chevron among the public and may make it more difficult for Chevron to recruit, retain and motivate employees.

The unburnable carbon analysis is a serious threat to Chevron’s reputation amongst investors who may lose faith in the value of Chevron’s reserves and its plans to spend significant sums finding and producing new reserves.

The Ecuador case has brought much negative attention to Chevron over the years and continues to threaten the company’s reputation. In the course of the Ecuadorian case, the plaintiffs have painted a picture in the courts and the international media of a company responsible for destroying a portion of the Ecuadorian Amazon. Moreover, Chevron’s legal strategy of suing the Ecuadorian plaintiffs in a RICO suit and taking the government of Ecuador to trade arbitration risks reducing willingness among governments and local communities worldwide to do business with the company in the future.

In 2009, 60 Minutes aired a story called “Amazon Crude” about the damage that has been caused in the Ecuadorian rainforest. An independent film documentary on the same topic called “Crude” was also made that year. Chevron has stated that the company will “fight this [case] until Hell freezes over.”

To succeed and grow in its core business, Chevron has to compete against other oil companies for access to new projects around the world. To win these projects, Chevron needs both permission from governments and “social license to operate” from local communities where the company is bidding to exploit new oil and gas fields. The company’s unwillingness to consider a settlement with the communities in the Ecuadorian Amazon and its countersuits against the communities and the Ecuadorian government can be reasonably expected to detract from Chevron’s reputation as a trustworthy business partner, thereby increasing unwillingness by governments and local communities to grant Chevron legal and social license to operate in new areas.

2. **Chevron acknowledges the need for expertise in environmental issues by the company but lacks such expertise on its board.**

Good environmental management is crucial for the oil majors because of the magnitude of the environmental risks inherent to the industry.

BP’s Macondo well blowout in the Gulf of Mexico proves the ‘bet the company’ level of environmental risk endemic to the industry.

Chevron is aware of scope environmental risks it faces, stating in its most recent 10-K form that its “operations also produce byproducts, which may be considered pollutants... Any of these activities could result in liability or significant delays in operations arising from

---

private litigation or government action, either as a result of an accidental, unlawful discharge or as a result of new conclusions about the effects of the company’s operations on human health or the environment...”

Chevron also recognizes the need to deal with some of these risks in the most strategic way possible. The company acknowledges: “Chevron’s results depend on its ability to identify and mitigate the risks and hazards inherent to operating in the crude oil and natural gas industry...failure to manage these risks effectively could result in unexpected incidents, including releases, explosions or mechanical failures resulting in personal injury, loss of life, environmental damage, loss of revenues, legal liability and/or disruption to operations.”

Among the most effective ways to identify and mitigate environmental risks is to have a board member with environmental background and expertise who ensures, on an on-going basis, that all appropriate governance structures are in place. If a company is unable to show that its environmental policies and practices align with nationally and internationally accepted standards, it is likely to experience difficulty raising new capital and obtaining regulatory licenses. Climate change and environmental issues continue to garner political attention and related laws and regulations are constantly changing. As Chevron states in its most recent 10-K report,

“International agreements and national or regional legislation and regulatory measures to limit greenhouse emissions are currently in various stages of discussion or implementation. These and other greenhouse gas emissions-related laws, policies and regulations may result in substantial capital, compliance, operating and maintenance costs....Greenhouse gas emissions that could be regulated include those arising from the company’s exploration and production of crude oil and natural gas; the upgrading of production from oil sands into synthetic oil; power generation; the conversion of crude oil and natural gas into refined products; the processing, liquefaction and regasification of natural gas; the transportation of crude oil, natural gas and related products and consumers’ or customers’ use of the company’s products.”

Regulations affect nearly all aspects of Chevron’s business and the costs of complying with them, along with the costs for environmental protection and remediation, can be substantial. In 2012, the company's environmental costs totaled $2.8 billion, an increase from the prior year. These excessive costs demonstrate the importance of carefully considering environmental issues in every top company decision.

A well-qualified board member with environmental expertise will help to hold management accountable for the mitigation of environmental risks. Many companies take

---

27 Chevron 2013 10-K Report, p 28
28 Chevron 2013 10-K Report, p 28
29 Chevron 2013 10-K Report, p 29
30 Chevron 2013 10-K Report, p FS-16
into consideration or actively seek out, among other things, environmental knowledge and experience when nominating directors for this reason.

The perspective provided by a person with environmental skills and experience included in his or her background is, according to ConocoPhillips, “valued as [companies] implement policies and conduct operations in order to ensure that our actions today will not only provide the energy needed to drive economic growth and social well-being, but also secure a stable and healthy environment for tomorrow.”31 There is also, according to experts in the field, an “expectation that these board members will guide corporate decisions in ways that will have a positive environmental impact...[and] stakeholder theorists would view their inclusion as a positive move.”32

**Chevron’s current board members do not demonstrate adequate environmental expertise.**

None of Chevron’s current thirteen board members have the necessary background and experience in the environmental field to be able to best educate the company on and mitigate environmental risk and preserve shareholder value and a positive reputation.

- Even the current Vice President of Health, Environment, and Safety has no apparent environmental background, having “held a number of positions of increasing responsibility in drilling, production engineering, operations, human resources, asset management and business development.” but nothing that would indicate environmental expertise.33

In a 2011 opposition statement to a similar shareholder resolution, Chevron states, “Your Board agrees that its membership should include broad experience or expertise in environmental issues”34 and perhaps to follow through on this statement, it has recently been announced that Charles Moorman has been nominated and elected to Chevron’s Board of Directors. Mr. Moorman is the President and CEO of Norfolk Southern Company, and serves on the boards of five different groups already, including the Nature Conservancy of Virginia.35 While his involvement with the Nature Conservancy is admirable, serving on the trustee board of an environmental organization does not constitute environmental expertise as contemplated in the resolution, and we don’t believe that Mr. Moorman can provide Chevron with the environmental focus, guidance and oversight that is important for the company’s success. His background is in engineering, with experience in transportation, technology, telecommunications, and corporate services.36 In addition his Chairmanship37 of the American Coalition For Clean Coal Electricity concerns us, since the

31 ConocoPhillips 2011 Proxy Statement, p 13
33 http://www.chevron.com/about/leadership/corporateofficers/lohec/
34 Chevron 2011 Proxy Statement, p 75
35http://www.chevron.com/chevron/pressreleases/article/03282012_charleswwickmoormanominatedtochevronboardofdirectors.ne ws
37 http://investing.businessweek.com/research/stocks/people/person.asp?personId=1098665&ticker=NSC
idea of ‘clean coal’ has been widely discredited by environmental experts and climate scientists given the lack of commercial-scale deployment of carbon capture and storage technologies, and because of ACCCE’s lobbying activities, detailed on the web site provided in the footnote. The source of environmental expertise on Chevron’s board should be someone who has, among other knowledge and experience, studied and worked in the environmental field for a significant time.

3. **A number of Chevron’s industry peer companies have board directors with the relevant environmental expertise indicating Chevron’s lagging response to this concern of shareholders.**

Other companies in the energy sector have taken the lead on this matter and Chevron risks falling behind the competition by not nominating a director with environmental expertise.

1. Victoria Tschinkel has been a member of the Board of Directors at ConocoPhillips since 2002. She also served as the Secretary of the Florida Department of Environmental Regulation from 1981 to 1987, was the Senior Environmental Consultant to Landers & Parsons from 1987 to 2002, and was the Director of the Florida Nature Conservancy from 2003 to 2006. The 2011 Proxy Statement discusses the value she adds to the company as a director, saying, “Ms. Tschinkel’s extensive environmental regulatory experience...[and]...her relationships and experience working within the environmental community position her to advise the Board on the impact of our operations in sensitive areas. The Board believes her experience and expertise in these matters make her well qualified to serve as a member of the Board.”

2. John F. Turner is a member of U.S. Peabody Energy Corporation’s Board of Directors. His diverse resume includes serving as the Director of U.S. Fish and Wildlife Service from 1989 to 1993, and the Assistant Secretary of State for the Bureau of Oceans and International Environmental and Scientific Affairs from 2001 to 2005. Mr. Turner was also the President and CEO of The Conservation Fund, is a Chairman of the University of Wyoming, Ruckelshaus Institute of Environment and Natural Resources, and a member of U.S. Peabody Health, Safety and Environmental Committee.

3. Kathryn Fuller is member of the Board of Directors for Alcoa Corporation. In addition to her involvement in many other organizations, she was the U.S. Department of Justice Chief for the Wildlife and Marine Resources Section from 1981 to 1982, was involved with The Conservation Foundation from 1982 to 1989, and served as President and CEO of World Wildlife Fund U.S. from 1989 to 2005.

---

39 ConocoPhillips 2013 Proxy Statement, p 19
40 U.S. Peabody 2013 Proxy Statement, p 9
4. Diamond Offshore Drilling has among its independent directors Vice Admiral Paul Gaffney, U.S. Navy (Ret.), currently President of Monmouth University. From 1996 to 2000, Vice Admiral Gaffney was the Chief of Naval Research. He was also the senior uniformed oceanography specialist in the Navy, having served as commander of the Navy Meteorology and Oceanography Command from 1994 to 1997. He has been the Naval Research Laboratory commander and worked in a number of other science and oceanography administration assignments. Gaffney served as a commissioner on the U.S. Ocean Policy Commission from 2001 to 2004 and is a public trustee for the New Jersey Sea Grant Consortium. He graduated from the U.S. Naval Academy in 1968. He has a master’s in mechanical engineering (ocean) from Catholic University and a master’s in business administration from Jacksonville University.42

Each of these board members who have demonstrated extensive experience and expertise in environmental matters are helping their companies best manage environmental, financial, and reputational risk, and are upholding shareholder value with the valuable environmental focus they bring to high level company strategy.

**Conclusion:**

Chevron, as an international energy company with operations across five continents, is exposed to environmental risk and opportunity in nearly every part of its business—many of these risks are of ‘bet the company’ magnitude. The ‘unburnable carbon’ thesis and the fossil fuel divestment movement represent fundamental new threats to Chevron’s business model going forward. A related threat is the rapidly decreasing cost of renewable energy sources.

Despite the dramatically elevated importance of environmental concerns, Chevron’s environmental track record, controversies, and fines indicate that the company is not dealing with environmental issues at the most strategic level. An independent director who holds relevant environmental skills and experience, along with other qualifications, would allow Chevron to most effectively address environmental issues and would demonstrate the company’s seriousness to do so. Shareholders should vote ‘FOR’ the resolution.

42 [http://investing.businessweek.com/research/stocks/people/person.asp?personId=12169607&ticker=DO:US&previousCapId=338612&previousTitle=Diamond%20Offshore%20Drilling](http://investing.businessweek.com/research/stocks/people/person.asp?personId=12169607&ticker=DO:US&previousCapId=338612&previousTitle=Diamond%20Offshore%20Drilling)