DOMINION (D)
EXECUTIVE INCENTIVE FOR CARBON REDUCTION

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SUMMARY

Research has verified the need to “align corporate executive compensation with long-term goals and strategies and with long-term shareowner interests.”¹ The U.S. electric power sector is an excellent example of the troubling dichotomy between misaligned shareholder and executive best interests.

This misalignment has occurred as a result of the power sector’s decarbonization in response to climate change. Carbon intensity is now a key performance indicator for power companies, with carbon reduction driving value, and carbon assets increasing risk. Companies are more frequently incentivizing named executive officers to deliver on climate goals. For example, Alcoa, Intel, and National Grid have all adopted climate metrics in executive pay packages, and carbon emissions at all three of companies are falling. The focus on climate is as much financial as environmental; research indicates that corporate carbon management results in a range of improved financial outcomes, including increased efficiency, improved branding and competitiveness, reduce regulatory and stranded asset risk.

Yet Dominion’s incentive structure rewards executives for continuing carbon intense activities, which explains its devotion to the controversial “Cove Point” natural gas export facility project, branded by activists as the next Keystone XL.² Dominion would benefit from a carbon reduction incentive in order to shift the company away from an uncertain, dangerous future in natural gas, and instead towards competitiveness in the low carbon economy.

RESOLVE CLAUSE

RESOLVED: Dominion shareholders request that the Board’s Compensation Committee, when setting senior executive compensation, include metrics for reduction of Dominion’s carbon output as one of the annual performance metrics for senior executives under the Company’s “Executive Incentive Plan” (“EIP”).
Please see Appendix A for the full resolution.

² Fuel Fix. Stakes are High for LNG Export Plan. (March, 2014). http://fuelfix.com/blog/2014/03/09/stakes-are-high-for-lng-export-plan/
RATIONALE FOR A YES VOTE

CURRENT INCENTIVES ENCOURAGE EXECUTIVES TO PURSUE RISKY PROJECTS PURSUING RETURNS

Dominion’s annual incentive program, representing a larger proportion of annual pay than salary, is focused on earnings per share (EPS). However, this focus on earnings fails to incentivize executives to pivot the company to respond to escalating risk: market risk, disaster risk, stranded asset risk. Most significant and short sighted is Dominion’s massive investments in natural gas and new nuclear with little diversification into renewables. Dominion plans to bring on a remarkable amount of natural gas in the next 15 years:

![Figure ES-2: New Supply Side Capacity to be Added under Dominion's Preferred Resource Plan by Fuel, 2015-2027](image)

While natural gas has emerged as a new source of baseload power, the domestic oversupply, which is what causes price parity with coal, is uncertain in the future. Many natural gas plays have peaked sooner than expected, and reserve estimates have been dramatically revised downward. Natural gas prices are historically volatile, and price uncertainty is high. Perhaps seeing this trend, Dominion is attempting to

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capitalize on natural gas through its supply chain instead. The company is making a $3.8 billion investment to transition their liquefied natural gas (LNG) terminal, Cove Point, from an import to export facility. Exporting natural gas to international markets has become one of the only ways to recovery breakeven natural gas prices. Yet, the project has been rushed, oversight reduced through political spending, and many aspects of project risk have not been addressed. This insufficient due diligence exposes investors to substantial charges should a disaster occur at the facility, which is a credible possibility, as below.

- **NATURAL GAS & LNG INFRASTRUCTURE OFTEN EXPLODES.**

Numerous natural gas explosions have occurred in North America in recent years in proportion to the growth of domestic fracking. There were three explosions in March 2015, two in January 2015, and one at a Washington terminal similar to Cove Point. In the footnote, please find a partial list of explosions from 2014. Though explosions are a risk for natural gas facilities; Dominion has thus far mostly denied that it is a risk at this facility.

- **DOMINION HAS NOT MADE A DISASTER RESPONSE PLAN PUBLIC.**

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In addition to deemphasizing explosion risk, Dominion has gone to lengths to keep its disaster response plan for Cove Point from the public and investors.\(^\text{10}\) In FERC filings however, it is described: “Dominion’s Emergency Response Plan relies on existing local response agencies and evacuation plans.”\(^\text{11}\) It is unknown whether Dominion has proactively managed any disaster risk related to this project, whether it plans to add resources to local agencies, or whether delegation to local agencies –including a volunteer fire department- is appropriate. Disasters that could befall the Cove Point facility include chemical fires, explosions as noted above, chemical or gas spills, or a nuclear accident with neighboring Exelon-owned Calvert Cliffs nuclear plant.

- **AN EXPLOSION AT COVE POINT LNG TERMINAL COULD CAUSE A NUCLEAR DISASTER AFFECTING THE WASHINGTON, DC METRO AREA.**

  Troublingly, the plant is located five minutes from the Calvert Cliffs Nuclear Plant.\(^\text{12}\) Should the Cove Point Plant explode and cause or worsen a nuclear disaster at Calvert Cliffs, it could affect the DC Metro area.\(^\text{13}\) The Federal Energy Regulatory Commission (FERC) accepted as sufficient Dominion’s assurance that the two facilities “have agreed to coordinate in the event of an incident”.\(^\text{14}\) This should not satisfy investors; voluntary coordination does not reduce the risk of a hurricane, storm surge, or similar weather event of unexpected intensity from hitting either facility and triggering a cascading effect at the other. The disaster risks of the plants are amplified due to their close proximity.

  Further even under normal conditions, Calvert Cliffs is a vulnerable plant. For example, the Fukushima disaster of 2011 occurred partly because the plant’s reactors could not be shut down once flooding disabled electrical systems.\(^\text{15}\) This inability to shut down reactors led to

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\(^{12}\) Google Maps. *Dominion Cove Point LNG & Calvert Cliffs State Park.* [https://www.google.com/maps/dir/Dominion+Cove+Point+LNG,+2100+Cove+Point+Road,+Lusby,+MD+20657/Calvert+Cliffs+State+Park,+10540+Hg+Trueman+Road,+Lusby,+MD+20657/@38.3903172,76.4409376,14z/data=!3m1!4b1!4m13!4m12!1m5!1m1!1s0x89b9d70a5ae5aa87:0x32aa99b73734d706!2m2!1d76.40948312d38.38787771m51l1m11s0x89b9d7ad9f1cf87b0xa807be178550df7212m21d-76.43008512d38.397015](https://www.google.com/maps/dir/Dominion+Cove+Point+LNG,+2100+Cove+Point+Road,+Lusby,+MD+20657/Calvert+Cliffs+State+Park,+10540+Hg+Trueman+Road,+Lusby,+MD+20657/@38.3903172,76.4409376,14z/data=!3m1!4b1!4m13!4m12!1m5!1m1!1s0x89b9d70a5ae5aa87:0x32aa99b73734d706!2m2!1d76.40948312d38.38787771m51l1m11s0x89b9d7ad9f1cf87b0xa807be178550df7212m21d-76.43008512d38.397015)


uncontrolled meltdowns and chain reactions.\textsuperscript{16} A similar problem nearly occurred in 2014 at Calvert Cliffs when wind blew snow into the plant, the snow melted and short circuited emergency automatic shut-off equipment.\textsuperscript{17} Calvert Cliff’s workers union described the event as a “near miss”.\textsuperscript{18}

• **DOMINION’S POLITICAL SPENDING CAUSED INADEQUATE ENVIRONMENTAL, SAFETY and FINANCIAL REVIEW OF COVE POINT.**

Investors should not ignore the similarities between the safety problems at Fukushima and at Cove Point. Findings from the independent investigation debriefing Fukushima described it as “a profoundly man-made disaster — that could and should have been foreseen and prevented”, caused by “collusion between the company, the government and regulators”, saying they had “betrayed the nation’s right to safety from nuclear accidents.” [and that Fukushima’s owner] Tepco “manipulated its cozy relationship with regulators to take the teeth out of regulations,”.\textsuperscript{19}

The same thing is occurring at Dominion with Cove Point. Dominion spent significant sums on regulators at all levels of government to usher the project through, with success.\textsuperscript{20} The Board of Directors of Calvert County, the body tasked with deciding whether to recommend the project to FERC, signed a Non-Disclosure Agreement with Dominion.\textsuperscript{21} The Board then attempted to waive zoning laws related to the project (later overturned), granted Dominion a major tax credit for the project, and informed the public ahead of a public meeting on the plant that the board


\textsuperscript{20} League of Women Voters Calvert County. *Appendix A: Official Calvert County Government Support for Expanding the Dominion Cove Point LNG Plant for Export and Agreement for Tax Relief* [http://leagueofwomenvoterscalvertcounty.wildapricot.org/Resources/Documents/TransparencyStudy_Appendices.pdf](http://leagueofwomenvoterscalvertcounty.wildapricot.org/Resources/Documents/TransparencyStudy_Appendices.pdf)

had already decided to approve it.\textsuperscript{22} In early March 2015, Virginia’s legislature passed a law exempting Dominion from financial audits for five years.\textsuperscript{23}

This political spending should raise alarm to investors. Minimizing review of project’s environmental, safety and financial liability only masks such liability, stymies investors’ ability to evaluate the financial value of the project and Dominion as a whole, and increases the likelihood of problems in the future that could have been addressed and mitigated had a thorough review occurred.

- **REGULATORS MAY NOT RAISE RATES TO ALLOW DOMINION TO RECOVER COSTS.**
  Dominion shareholders may have to absorb losses from project costs, should they exceed the original estimate, if regulators do not approve future cost recovery. Regulators have nationally been reluctant to allow ongoing rate hikes for fossil fuel infrastructure. In Hawaii, regulators rejected utility planning that committed too heavily to fossil fuels.\textsuperscript{24} In Ohio, regulators rejected a plan to pass coal plant costs onto customers.\textsuperscript{25} In Mississippi, regulators have been unwilling to approve costs for Southern Company’s Kemper plant, a coal to gas facility of similar cost to the Dominion project, until the company can prove value in operation.\textsuperscript{26}

For these reasons, Cove Point is a problematic direction for Dominion to take its business. Yet with executives focused solely on near term earnings, which do not encourage accounting for the risks noted above, it makes some sense that the company might move forward despite these risks. By the time problems arise at Cove Point, executives are likely to be onto new pursuits, bonuses in hand.

A. **FOSSIL FUEL ASSETS LIKELY TO BE STRANDED**
Beyond the risks noted above, Cove Point project could end up a stranded asset. Dominion’s incentives encourage executives to continue investing in fossil fuel assets whose operation is cheap, maximizing near term earnings, but which could be made illegal in the next 10-20 years as regulatory risk becomes more severe in response to deteriorating climate conditions. Natural gas has approximately half the

\textsuperscript{22} Huffington Post. *Is The Cove Point Liquified Natural Gas Terminal The Next Keystone XL?* (Feb, 2014).


\textsuperscript{24} KHON 2. *State orders Hawaiian Electric Companies to lower rates, connect more solar.* (June, 2014). http://khon2.com/2014/04/29/state-orders-hawaiian-electric-companies-to-lower-costs-address-challenges/

\textsuperscript{25} Cleveland. *PUCO rejects deal to have ratepayers subsidize a coal-fired power plant.* (Feb, 2015). http://www.cleveland.com/business/index.ssf/2015/02/puco_rejects_deal_to_have_rate.html

carbon impact as coal not accounting for fugitive methane, but as such it is still vulnerable to being stranded by climate regulation.

As the 14th greatest coal user with the 14th greatest carbon emissions in the US, Dominion has substantial carbon exposure from coal alone. 27 The Company has suffered from flagging coal investments, which in some cases it has tried to dump, such as its New England Brayton Point station. Brayton Point was stranded, and shareholders absorbed the losses; Dominion had put a billion dollars of compliance equipment into the plant to prolong its life before ultimately deciding to sell at a loss of approximately $700 million. 28 Dominion is being forced into an additional 800 megawatts of coal plant shut downs due to mounting costs. 29

The company could avoid or reduce stranded assets by moving aggressively into low carbon infrastructure and proactively retiring old plants. A study by the Institute for Energy Economics & Financial Analysis found that “Even a moderately aggressive Clean Energy Investment Plan would produce significant benefits for Dominion’s ratepayers.” 30 These benefits include reduced rates, cleaner air, less corporate emissions, reduced uncertainty from volatile fuel costs, less stress on the grid, and more. However, Dominion’s executive staff is not incentivized to recognize these benefits; instead they are incentivized to maximize short-term net income. Maximizing net income is accomplished at utilities through maximizing costs and energy sales. This results in what we see, Dominion’s wasting ratepayer and shareholder dollars resisting change in favor of prolonging the life of existing coal plants and making massive new fossil fuel investments.

B. CARBON REDUCTION AND MANAGEMENT RESULTS PROPORTIONALLY IN IMPROVED FINANCIAL PERFORMANCE

Research from the Carbon Disclosure Project and Ceres demonstrates that carbon management yields financial performance. When corporations track, manage, and reduce carbon impacts, various financial indicators improve, including improved return on equity, stronger dividends, lower earnings volatility, reduced emissions and regulatory risk. 31 This report identifies business benefits of carbon reduction including power price certainty, customer demand for low carbon solutions, reduced overhead,

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http://action.clf.org/images/content/reports/brayton_point_report.pdf

29 Dominion.  Integrated Resource Plan.  


https://www.cdp.net/CDPResults/CDP-SP500-leaders-report-2014.pdf
[Note that because utility return on equity is capped by regulation, the ROE trend does not follow in the power sector]
improved leadership and branding. Another analysis confirms that “firms with stronger ESG policies also enjoy increased efficiency and higher valuations than their peers.”

Though the effect of an executive compensation incentive for carbon reduction not yet been formally studied, it is logical that companies managing carbon through low carbon investments better succeed as carbon asset risk increases. Proponents compared data from the largest 28 U.S. investor owned utilities (as per the Ceres Benchmarking Utility Clean Energy Report, 2014) with current stock prices (see Appendix B). The results indicate that utilities with the most renewable energy sales and energy efficiency savings also have the best stock price. Thorough study is needed, but an executive that incentivizes carbon reductions (and thus low carbon investments like renewable energy and energy efficiency) seems likely to result in increased shareholder value.

CONCLUSION

Rather than pursuing a plan for a low carbon business model that would position it for ongoing competitiveness, Dominion has invested in a dangerous LNG terminal that endangers both shareholder value, the safety community in the vicinity of the project, and presents risks of a major catastrophe affecting the nation’s capital. An executive compensation incentive rewarding carbon reductions would help curb this type of irresponsible investment, and help align Dominion’s business planning with fundamental shifts in the energy sector toward low-carbon infrastructure.

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34 Appendix A
Appendices

Appendix A

RESOLVED: Dominion shareholders request that the Board’s Compensation Committee, when setting senior executive compensation, include metrics for reduction of Dominion’s carbon output as one of the annual performance metrics for senior executives under the Company’s “Executive Incentive Plan” (“EIP”).

SUPPORTING STATEMENT: We believe that the long-term interests of Dominion shareholders is best served by encouraging a focus on long-term value creation and risk management.

Dominion says that it “has long recognized the need to address the climate change challenge” (Dominion website) yet no environmental performance is or has been linked with senior executive compensation. Under the current Executive Incentives Plan, Performance Metrics are weighted 90% based on earnings per share and 10% based on safety (lost work days away) performance. No consideration is given to whether or how much the company has reduced its carbon emissions during the preceding year.

The effect of failing to provide such incentives is obvious in Dominion’s ongoing commitment to fossil fuels. Dominion’s power mix is approximately 77% coal (Dominion 2014 CDP); indeed Dominion burns the 7th most coal and generates the 6th most carbon emissions of the top 100 electric power producers in the United States. (Ceres, 2012)

This puts our company in conflict with international findings on climate change that in order to maintain a livable climate below 2 degrees Celsius of warming “fossil fuel power generation ... is phased out almost entirely by 2100.” (UN IPCC Synthesis Report, November 2014). Dominion’s ongoing plans to invest billions of shareholder dollars in maintaining and potentially growing fossil fueled power capacity, and thereby sustaining carbon emissions, appears misaligned with management of these long term risks relating to climate change. Moreover, the focus on coal operations leaves the company vulnerable to environmental compliance costs that Dominion estimates at approximately $5.9 billion in coming years (Dominion 2014 IRP).

While determining specific metrics for executive compensation rests within the discretion of the board and its compensation committee, a senior executive compensation policy incorporating progress on carbon emission reduction would help better align Dominion’s values with its operations, and position the company to thrive in a future impacted by climate change.

Appendix B
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