Sustainable Investments Institute

Action Report

Environment: Natural Resource Management

Chevron

May 5, 2011

Ticker	Exchange	Meeting Date	Record Date	Annual Meeting Location
CVX	NYSE	5-25-11	4-1-11	San Ramon, California

Agenda

Item	Proposal
1	MGT: Elect directors
2	MGT: Ratify selection of auditors
3	MGT: Advisory vote on executive compensation
4	MGT: Advisory vote on frequency of future advisory vote on executive compensation
5	**SH: Nominate independent environmental expert to board**
6	SH: Establish board committee on human rights
7	SH: Include sustainability as executive performance measure
8	SH: Report on host country selection criteria
9	SH: Report on climate change risks
10	SH: Report on hydraulic fracturing
11	SH: Report on offshore oil well risks

Si2 Briefing Environment: Natural Resource Management

Si2 Special Report Chevron and Investor Pressures on Sustainability Issues

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Links Proxy Statement

Resolved Clause THEREFORE, BE IT RESOLVED: Shareholders request that, as the terms in office of elected board directors 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, in each case as reasonably determined by the company's board, and
- will qualify, subject to limited 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.

Lead Proponent New York State Common Retirement Fund

Vote History This same proposal received 26.7 percent support in 2010.

Summary

Given the environmental challenges confronting Chevron and the oil and gas industry, the proponent believes that Chevron should nominate a candidate to its board with clear environmental expertise that is widely recognized by industry leaders and civil society organizations. The proponent believes such expertise will offer the board better guidance and management improved oversight of the company's environmental practices. The proponent points out several large potential environmental liabilities facing the company, including a major lawsuit pending in Ecuador, and contends that with such high stakes for Chevron and its shareholders, a board director with deep environmental credentials is much needed.

Chevron opposes the proposal. It notes that its Corporate Governance Guidelines already recognize environmental expertise as a valuable attribute to look for in board candidates, and it also highlights for shareholders that its board already has several independent directors with in-depth experience in navigating a wide range of public policy issues. Chevron says its environmental policies, management system and reporting practices offer further proof that it is effectively managing environmental issues. Furthermore, it says, it does not believe the allegations the proponent raises in its proposals hold merit.

I. Chevron and Environment: Natural Resource Management

For a summary of the company's operations and financials, see Si2's special supplement to this report: Chevron and Investor Pressures on Sustainability Issues. Key takeaways from the supplement are:

- Chevron's board Public Policy Committee includes oversight of environmental issues, among others, and the range of expertise held by members of this committee.
- Chevron's director qualification standards, which include environmental expertise among the qualities it seeks in director nominees.
- Chevron's corporate officer dedicated to health, environment and safety.
- Executive pay links to several, broad policies related to management of sustainability issues.
- The risks related to environmental issues it lists in its 10-K statement.
- Chevron's environmental policies, management systems and reporting practices.
- Si2's review of the trial in Ecuador, cited in the proponent's supporting statement.
- Si2's overview of Chevron's operations in Nigeria and an associated lawsuit from these operations, as well as information on oil spills in the Niger Delta.
- Si2's overview of Chevron's operations in Kazakhstan.

II. Proponent Position

Given the challenges and scrutiny the industry receives from shareholders, lenders, host country governments and regulators, and affected communities on environmental impacts, The New York State Common Retirement Fund (NYSCRF) points out that "environmental expertise is critical to the success of companies in the energy industry." It argues, "A company's inability to demonstrate that its environmental policies and practices are in line with internationally accepted standards can lead to difficulties in raising new capital and obtaining the necessary licenses from regulators."

Furthermore, the proponent notes, Chevron has "been cited for allegedly harmful environmental practices," including:

- **Ecuador—**widespread contamination of Amazonian land and water resources related to legacy operations from Texaco in the 1970s. The proponent points to a pending lawsuit that is challenging the adequacy of a remediation effort Texaco completed in 1998, and it highlights that a "court-appointed expert in the Ecuadorian litigation has recommended that Chevron be held liable for up to $27.3 billion in damages."
- **Nigeria—**polluting land and water resources and damaging local fishing through dredging activities in the Niger Delta. The proponent notes, "These practices have fueled civil unrest, protests, and a related lawsuit alleging Chevron's complicity in security forces' killing of two protestors."
- **Kazakhstan—**environmental and health damages to local communities. The proponent points out that Chevron has a 50 percent interest in a consortium that was "fined approximately $609 million for illegally storing [sulfur]."

NYSCRF believes "that these controversies have the potential to damage shareholder value and that the company must respond to environmental challenges in an effective, strategic and transparent manner in order to restore trust and minimize the adverse impact of its operations." The most effective way to do so is "at the most strategic level—by appointing a specialist to the board," the pension fund contends. The fund argues, "An authoritative figure with acknowledged environmental expertise and standing could perform a valuable and strategic role for the company by enabling Chevron to more effectively address the environmental issues inherent in its business," and "it would also help ensure that the highest levels of attention focus on the development of environmental standards for new projects." NYSCRF also says that the nomination of an environmental expert to the board would send a strong message that the company is taking its environmental management responsibilities seriously.

Therefore, NYSCRF is asking that the next time the term of an elected board member expires, the company should nominate a candidate with environmental expertise relevant to the oil and gas industry and "widely recognized in the business and environmental communities as an authority in such field…" The proponent also asks that the candidate be identified as independent by NYSE listing standards.

III. Management Position

Chevron recommends a vote against the proposal, because it believes it already has "strong environmental practices"; that its present board "membership qualification standards adequately recognize the importance of environmental expertise"; and that board candidates "should possess a broad range of skills, qualifications and attributes rather than a single expertise." Chevron notes, however, that it already seeks experience with environmental issues among the qualities it seeks in board members, as outlined in its Corporate Governance Guidelines and proxy statement. Furthermore, it says its present board includes several independent directors, "whose professional activities have brought them experience with environmental matters relating to world trade, manufacturing, technology and public policy," and it notes its board has access to internal and external environmental experts to keep it apprised of important environmental issues.

Chevron underscores that its policies, environmental management system and practices—including its Operational Excellence Management System and Environmental, Social and Health Impact Assessment process—all demonstrate a clear commitment "to seeing that all projects and products are developed in an environmentally sound manner and that operations and products continue to reduce their environmental impacts." It points out that it backs up these claims by reporting on its sustainability performance in its annual sustainability report, and that the data systems built to generate metrics for this report are assured by an independent third party, Lloyd's Register Quality Assurance.

Furthermore, Chevron says, it "disagrees with the allegations on which the proposal is premised." It notes on its website and in its 10-K statement that it is vigorously defending itself against the allegations stemming from Texaco's legacy operations in Ecuador.

In sum, Chevron and its board believe "having a special purpose director is not a good corporate governance practice." Chevron explains:

> Boards make decisions as a group, with collective responsibility that is inconsistent with delegating responsibility for areas as important as the environment to a single specialist director. All of your Directors owe Chevron and its stockholders fiduciary duties that oblige them to educate themselves and make decisions on an informed and deliberative basis. Your Board needs directors who can integrate knowledge about a variety of subjects, often at the same time and affecting the same issue.

It concludes, "Your Board agrees that its membership should include broad experience or expertise in environmental issues but does not believe that it would be appropriate to select a director exclusively on the basis of a single criterion or area of expertise." Chevron therefore urges a vote against the proposal.

IV. Analysis

Key Points at Issue

- Would Chevron's board benefit from a director with environmental expertise?
- Do the allegations the proponent notes raise serious questions about Chevron's environmental management practices and board oversight of these issues?

Board composition: Chevron argues that its board already has plenty of environmental experts. It notes that many of its board members have broad experience with public policy issues. Furthermore, it says, where the board is lacking expertise, it has access to Chevron managers and outside experts to help it navigate the many environmental issues it must assess. As reviewed in the Special Report supplement to this Action Report, Chevron has a Public Policy Committee of its board with two former U.S. Senators, a former Deputy U.S. Trade Representative and U.S. Ambassador to the World Trade Organization, and a retired chairman of an independent research, technology development and commercialization organization that has done extensive work in the energy sector. However, none would be considered an environmental professional or expert in environmental management, as called for by the proponent's proposal, although they all have had considerable experience in grappling with thorny environmental issues in many capacities.

Competitive comparisons: As noted earlier, Chevron says in its Corporate Governance Guidelines that it seeks environmental expertise, among other attributes, in board members. However, do its competitors assess environmental credentials in selecting board nominees? Chevron's principal competitors in the United States are **ConocoPhillips** and **ExxonMobil**. ConocoPhillips does not mention environmental expertise in its Corporate Governance Guidelines, and ExxonMobil also does not state such criteria in its guidelines. At the same time, both companies, like Chevron, have been challenged by shareholders on a wide range of actual and potential environmental liabilities and issues.

Environmental liabilities: Among the most serious of allegations confronting Chevron is the pending lawsuit related to allegations and potential liabilities from Texaco's legacy operations in Ecuador. It is important to point out that the environmental damage and allegedly insufficient remediation all occurred before Chevron purchased Texaco. Nonetheless, the potential penalties are substantial. The plaintiffs are asking for damages ranging from $21 billion to in excess of $100 billion, and a recent judgment by an Ecuadorian court has levied damages of more than $18 billion. Still, other factors are at play. First, Chevron has been successful in U.S. courts to win a ruling that it cannot be forced to pay a judgment from a court in Ecuador. Chevron no longer has assets in Ecuador, so the plaintiffs need to seek relief in other jurisdictions where Chevron holds assets. In addition, the case is still on appeal, and Chevron is defending itself vigorously. The company contends in its 2010 10-K filing that the lawsuit is without merit, and it offers shareholders no clear guidance on potential liabilities given the high stakes and uncertainties in the case. At the same time, Chevron has argued in U.S. courts that enforcement of the Ecuadorian judgment would cause "irreparable injury to the Company's business reputation and business relationships." If the $18 billion judgment were to be enforced, it would be equal to almost 95 percent of Chevron's total net income for 2010. In addition, as noted in the supplement to this report, stock analysts have pegged the potential downside on Chevron's stock price at 5 percent.

Beyond Ecuador, the $609 million fine of Chevron's 50-50 joint venture for illegally storing sulfur in Kazakhstan is much smaller but still noteworthy. If Chevron is put on the hook for paying half of that amount, it also would be equivalent to 1.6 percent of its 2010 total net income. Also still not insignificant are the allegations related to the Niger Delta. A report compiled by WWF UK, the World Conservation Union and representatives from the Nigerian federal government and the Nigerian Conservation Foundation calculated in 2006 that up to 1.5 million tons of oil—about 50 times the pollution unleashed in the *Exxon Valdez* tanker disaster in Alaska and close to twice as much as the amount released in the BP Deepwater Horizon spill in the Gulf of Mexico—has been spilled in the Niger Delta since the 1970s. Chevron is not alone as a major operator in the Niger Delta, and it and other oil companies have pointed to a long list of mitigating circumstances in the spills, including theft and sabotage. Still, the legacy could hold liabilities for Chevron and its shareholders down the road. Considering the $20 billion-plus price tag for the BP spill in the Gulf of Mexico last year, the cleanup costs could be considerable. Kazakhstan, also cited by the proponent, should be another area of concern, given that 25 percent of Chevron's net proved reserves were in Kazakhstan as of the end of 2010.

Voting Considerations

Central to voting on this issue for shareholders is whether they believe Chevron needs a board nominee with in-depth expertise in environmental science and management. But investors also may want to consider other factors such as competitive comparisons and the lawsuits noted by the proponent.

Voting in favor: Shareholders who believe a dedicated environmental expert on Chevron's board would help the company better navigate the many environmental issues confronting the company, from environmental remediation to climate change, will want to vote for this proposal. While its competitors do not offer comparable director qualification standards, the industry as a whole has been placed under far greater scrutiny, especially in the wake of the BP spill last year, and has been found lacking in several areas related to emergency preparedness and safety. With several major environmental liabilities looming, some shareholders may believe that Chevron's board and shareholders would benefit from a board member with greater environmental expertise and they will vote for this proposal.

Voting against: Others may feel that the proponent is splitting hairs with the company over the degree of environmental expertise that already exists on the board and accordingly vote against this proposal. After all, even if board members do not have in-depth expertise on a particular environmental issue, the board can request assistance from management or outside experts. Others also might feel that Chevron's policies and environmental management system offer enough evidence that its board and management are doing a good enough job overseeing the company's environmental practices and will vote against this proposal. Given the uncertainties attached to the litigation cited by the proponents, and the company's vigorous defense of its position, some investors also may agree with the company that the litigation has no merit and side with management in voting against the resolution.