Introduction

In July 2012, after a 19 year long fiercely-fought and expensive lawsuit about the dumping of toxic waste in Ecuador, a USD $19.04 billion judgement was executed on Chevron Corporation (Chevron). Despite having agreed to abide by the decision of the Ecuador courts when successfully applying for the transfer of the case from New York - where it was originally filed - Chevron has, under the leadership of CEO and Chairman John Watson, refused to comply with the judgement.

Chevron’s continued refusal to comply with the judgement and John Watson’s emotive statement at the 2012 AGM that the company will resist the judgement “until hell freezes over” together with the company’s antagonistic labelling of the Ecuadorian claimants as “criminals” has resulted in Chevron facing sustained media and civil society criticism and reputation damage.

The Ecuadorian claimants have now commenced enforcement actions in overseas jurisdictions, a move which a representative of Chevron acknowledged would, if successful, “cause significant, irreparable damage to Chevron.”

Chevron’s aggressive and much criticised management of the Ecuadorian case together with allegations of inadequate disclosure of the risks stemming from the case has highlighted a number of long-standing governance issues at the company which many believe are contributing to an unwise refusal to re-evaluate strategy. These include a lack of environmental expertise among independent directors, the combined role of CEO and Chairman, and restrictions on shareholders calling special meetings.

This investor briefing provides an overview of the Ecuadorian litigation and the current enforcement actions against Chevron in Brazil and Canada. It outlines the steps being taken by a significant number of the company’s shareholders (in light of the continuing financial and reputation impacts of the litigation), with regards to board membership and the need for an independent chair. Finally, it proposes suggestions for investor engagement.

The Ecuadorian Judgement: Background

- 1993: lawsuit filed against Texaco in New York on behalf of 30,000 Ecuadorians for environmental destruction and adverse health effects.
- 2001: Chevron Corporation merges with Texaco.
- 2003: Ecuadorians refile lawsuit in Ecuador after sustained campaigning by Texaco and Chevron to move it from New York and promises to abide by the decision of the Ecuador court.
- 2011: Chevron is found liable for USD 8.646 million in damages with an additional 100% of the aggregate damages in a punitive fine should it fail to publicly apologise to the claimants. Court found “sufficient evidence to demonstrate the existence of an excessive number of cancer deaths.”
- 2012: The judgement against Chevron is upheld in an Ecuadorean appellate court.
Ecuadorean Judgement

On 14 February 2011, the Superior Court of Nueva Loja in Ecuador found against Chevron in a long-running and contentious lawsuit relating to the dumping of toxic waste. The court ordered Chevron to pay $8.646 billion in actual damages to be used solely for costs associated with remediating the extensive environmental contamination and damages caused by Chevron; an additional $8.646 billion in punitive damages; and an additional amount equal to ten percent (10%) of the actual damages ($864.6 million) to be paid to the claimants’ representative group, for a total of $18.1 billion. The judgement provided that the punitive damages would be waived if Chevron made a public apology within 15 days. Chevron did not issue an apology and the punitive damages were imposed. Both parties appealed the decision to the relevant provincial appeals court in Ecuador. On January 3, 2012, the appeals court confirmed the lower court ruling and upheld the entirety of the judgement. In July 2012 the judgement was executed on Chevron when the claimants’ compensation was increased to $19.04 billion after the court applied the 10% award to the punitive damages.5

Despite earlier promises Chevron has refused to comply with the judgement, instead launching an aggressive counterattack on the claimants and their lawyers. In February 2011, Chevron filed a civil suit under the Racketeer Influenced and Corrupt Organisations Act (RICO) seeking a court declaration that the Ecuadorian judgement is the result of fraud and therefore unenforceable.6 While a civil trial on the RICO charges is not expected until 2014, the US Court of Appeals for the Second Circuit has already ruled that the claimants can commence enforcement actions on the Ecuadorian judgement despite the ongoing RICO suit.7

Overseas enforcement actions

Representatives of the claimants have stated their intention to commence recognition and enforcement actions in the near term in multiple countries, some of which have mutual enforcement treaties with Ecuador. Enforcement actions have now been filed against Chevron in two jurisdictions.

Canada

On 30 May 2012, claimants filed suit in the Superior Court of Justice in Ontario, Canada, targeting significant assets of Chevron.10 These assets include a non-operator interest in Canada’s largest offshore drilling project and important investments in oil sands in the province of Alberta. Under Canadian law, interest may accrue on a foreign judgement during the enforcement process, potentially adding a significant amount to the judgement against the oil giant.

Brazil

On 27 June 2012, the Ecuadorian claimants filed a similar suit in the Superior Tribunal of Justice of Brazil.11 This suit targets Chevron operations that produce a daily average of 33,000 barrels of crude oil and 13 million cubic feet of natural gas. Brazil, which has the sixth largest economy in the world, is considered a major strategic player for Chevron’s long-term growth.12

Chevron’s Deputy Comptroller Rex Mitchell in sworn testimony in Chevron’s RICO suit acknowledged that if the claimants were successful in their attempts to seize assets of the company through overseas enforcement actions this “is likely to cause irreparable injury to Chevron’s business reputation and business relationships.”13

“Defendants’ campaign to seek seizures anywhere around the world and generate maximum publicity for such acts would cause significant, irreparable damage to Chevron”

Rex Mitchell - Chevron Deputy Comptroller 9

“The Presidency considers this conduct of the defense by the defendant to be proof of procedural bad faith.”

English Translation of 2011 Judgement 8
Investor engagement questions

• In light of the enforcement actions filed in Canada and Brazil, what is Chevron’s contingency to avoid its own internal assessment of ‘irreparable injuries to the company’s operations and business relationships’ from enforcement of the judgement?
• Will Chevron disclose in detail the exact nature of this ‘irreparable injury’ to allow shareholders to fully assess the risks to its operations and business from the potential enforcement of the Ecuador judgement?

Investor engagement question

• What is Chevron’s response to the recent petitions filed to the SEC by shareholders and a member of Congress over the company’s record of disclosure of the Ecuador lawsuit?

Allegations of misleading and inadequate disclosure

There have been calls for the SEC to investigate whether Chevron is failing to meet disclosure requirements under the Securities Exchange Acts of 1933 and 1934.

Public companies, including Chevron, who misrepresent or fail to disclose such material information can be criminally or civilly sanctioned by the Securities and Exchange Commission or the Department of Justice and face potential individual, class, or derivative civil litigation by private investors.

It has been alleged that Chevron’s SEC filings are inadequate in a number of respects including:

• Refusal to disclose material impact of enforcement actions against Chevron assets in multiple countries.
• Refusal to disclose possible loss or range of loss in financial statements, despite specificity of $19.04 billion judgement.
• Selective disclosure of court rulings.

The SEC was twice petitioned in May 2012 to independently review whether Chevron has complied with its legal obligations in disclosing risk to investors; by Congresswoman Jan Schakowsky\(^{19}\) and shareholders, the Unitarian Universalist Association, Newground Social Investment, and Zevin Asset Management.\(^{20}\)

Investor engagement question

• What is Chevron’s response to the recent petitions filed to the SEC by shareholders and a member of Congress over the company’s record of disclosure of the Ecuador lawsuit?
Poor corporate governance

Investor concerns around Chevron’s governance have been directed at two key issues: a lack of environmental expertise at board level and the combined role of CEO and chair.

Lack of relevant expertise at board level

Despite the occurrence of a number of environmental incidents including the Ecuadorian judgement, a spill off the coast of Brazil\(^2^1\), fines at its Kazakhstani operations\(^2^2\), penalties imposed by US regulators\(^2^3\) and pollution in Nigeria\(^2^4\), Chevron has not, despite repeated shareholder requests, appointed to its board an independent director with significant expertise and experience in environmental matters relevant to the energy sector.

In this respect Chevron lags behind many of its peers including ConocoPhillips, Alcoa and Peabody Energy Corporation.

Shareholder action

In 2012, a shareholder resolution calling on Chevron to appoint an independent board member with environmental expertise filed by the New York State Common Retirement Fund - which manages $150 billion of state government pensions - received a vote in favour of 21.5%.\(^2^6\)

Combined role of CEO and Chair

John Watson currently serves as both Chairman and CEO. The separation of these roles is widely considered best practice, both in accordance with the UK Corporate Governance Code and in the US.\(^2^7\) Globally, it is now typical for companies to separate these roles: in 2009 less than 12% of incoming CEOs were also made chairs, compared with 48% in 2002.\(^2^8\) John Watson’s emotive defense of Chevron’s controversial and expensive legal strategy with regards to the Ecuadorian judgement has contributed significantly to shareholder support for independent board leadership.

Shareholder action

A shareholder resolution requesting an independent chair was filed in 2008 when both positions were held by David O’Reilly and received 14% support.\(^3^0\) No policy change was made and in 2010 John Watson was appointed to the dual role of Chairman and CEO. A resolution again requesting the separation of the roles was filed in 2012, which heavily referenced the mismanagement of the Ecuador lawsuit, and received a vote of over 38% in favour.\(^3^1\)

Investor engagement suggestion

- Support shareholder requests for the appointment of a non-executive director with a high level of expertise and experience in environmental matters.
- Support shareholder requests for the separation of the roles of Chairman and CEO in accordance with corporate governance best practice.
Conclusion

Chevron faces a range of environmental, legal, and governance issues, the most pressing of which is ongoing litigation regarding the Ecuadorian judgement. Concern has been expressed by shareholders and others that the company’s board of directors and management is displaying poor judgement in refusing to reevaluate both board composition and the company’s expensive and reputation damaging legal strategy with respect to the Ecuadorian judgement.

Chevron has, to date, ignored both significant minority votes in favour of resolutions seeking to address governance failures and requests by shareholders for meetings to discuss the company’s controversial legal strategies. It is important therefore that international shareholders engage with Chevron specifically on the issues set out in this investor briefing and support shareholder proposals aimed at improving governance at the company.
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