

AN ANALYSIS OF THE FINANCIAL AND OPERATIONAL RISKS TO CHEVRON CORPORATION FROM *AGUINDA V. CHEVRONTEXACO*

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EXECUTIVE SUMMARY

- **Chevron is facing significant financial and operational risks stemming from enforcement of an \$18 billion adverse judgment in Ecuador.** On March 12, 2012, an Ecuadorian appellate court declared the \$18 billion judgment for the company's contamination of soil and water final and enforceable, giving the plaintiffs the right for the first time to collect on the judgment. Chevron itself has admitted in a sworn legal statement that the company is at risk of "irreparable injury to [its] business reputation and business relationships" that "would not be remediable by money damages" from potential enforcement of the Ecuadorian court judgment.
- **The enormous breadth of Chevron's global business operations makes the company particularly vulnerable to enforcement.** There are many jurisdictions around the world in which the plaintiffs could seek court recognition and enforcement of the judgment, including many where Chevron has substantial reserves and that of strategic importance.
- **Chevron's defenses to enforcement actions have greatly narrowed.** The U.S. Second Circuit vacated in its entirety a preliminary injunction from a U.S. District Court that purported to bar the Ecuadorian plaintiffs from enforcing the judgment against Chevron's assets anywhere in the world. The Ecuadorian courts have rejected awards by an arbitral panel seeking a halt to enforcement of the \$18 billion judgment against Chevron.
- **Shareholders of Chevron are increasingly demanding more transparency of the risks and an alternative to the company's litigation strategy.** In May, 2011, shareholders of Chevron – representing \$156 billion of assets under management - called upon Chevron "to fully disclose to shareholders the risks to its operations and business from the potential enforcement of the *Aguinda* verdict" and "reevaluate whether endless litigation in the *Aguinda* case is the best strategy for the Company and its shareholders..." Separately, Trillium Asset Management formally requested the Securities and Exchange Commission "to review whether Chevron has appropriately disclosed to shareholders the scope and magnitude of the financial and operational risk" from the judgment.
- **Chevron shareholders are demanding better corporate governance.** Citing management's handling of the case in Ecuador, shareholders are questioning Chevron's generous executive compensation packages and have proposed overhauls of the company's corporate governance. Despite losing the landmark \$18 billion judgment in Ecuador, Chevron awarded its General Counsel R. Hewitt Pate a 75% raise in 2012 to a staggering \$7.8 million salary and even went so far as to praise "his outstanding management of Ecuador" ahead of the company's annual "say on pay" vote. In 2010 and 2011, a significantly large percentage of Chevron's shareholders supported a resolution calling for the appointment of a director with expertise in environmental liabilities. In addition to re-filing this resolution, shareholders have filed two additional new resolutions for Chevron's 2012 annual meeting calling for corporate governance reforms, one asking that Chevron separate the positions of Chief Executive Officer and Chair of the Board and the other asking that Chevron lower the thresholds for calling a special meeting of shareholders."

1. INTRODUCTION

A decade after Chevron's acquisition of Texaco in 2001, it is now ever more clear that the purchase brought with it significant legal, financial, and reputational liabilities stemming from Texaco's pollution of water and soil in Ecuador.

From 1964 to 1992, Texaco had been the operator of oil extraction facilities in the remote northern region of the Ecuadorian Amazon. The oil fields were operated by Texaco on behalf of a business consortium that also included Ecuadorian state-owned oil company Petroecuador.

In 1993, a group of Ecuadorian citizens living around Texaco's production sites filed a class-action lawsuit against Texaco in New York, alleging that the company had knowingly used substandard environmental practices that led to massive soil and water contamination. Over the ensuing decade, Texaco successfully petitioned to have the case transferred to Ecuador. The case, *Aguinda v. ChevronTexaco*, was re-filed against Chevron in Ecuador in 2003.

After nearly two decades of litigation, on February 14, 2011, the Ecuadorian Provincial Court issued its final judgment in which it found Chevron liable for just over \$18 billion in compensatory and punitive damages. This award constitutes one of the largest court judgments for environmental damage in history. On January 3, 2012, the Ecuadorian appeals court affirmed the \$18 billion judgment in its entirety, and, on March 1, 2012, the court declared that the judgment was final and enforceable. Chevron has appealed the ruling to the National Court of Justice, Ecuador's highest court. However, Chevron refused to post the bond that is required to stop international enforceability of the judgment, and the National Court has not yet indicated whether it will

accept the case on appeal. In the meantime, the plaintiffs now have an internationally valid judgment that they can seek to enforce against Chevron's assets outside of Ecuador. Already, lawyers for the plaintiffs have been reported to be considering enforcement proceedings against Chevron's key assets in Panama and Venezuela, as well as other countries.

During the course of this complicated, high-stakes and unprecedented legal case, it has been hard to forecast Chevron's ultimate liability. However, stock analysts are beginning to incorporate Chevron's legal liability into their investment analysis. Recent analyst reports have referenced the \$18 billion judgment and the "legal battle in Ecuador hanging over Chevron."¹ Fadel Gheit, an energy analyst at Oppenheimer in New York, told the Financial Times in January 2012 that he expected Chevron to agree to pay between \$2 billion and \$3 billion to bring the dispute to an end.²

This report highlights the weaknesses of Chevron's defenses – in U.S. courts and in international arbitration – against enforcement of the \$18 billion judgment. Drawing on the unusually rich and revealing publicly available legal filings in this case, this report also examines the potential damage and disruption to Chevron's operations should lawyers for the Ecuadorian plaintiffs seek to enforce the \$18 billion *Aguinda* court judgment against Chevron's assets worldwide. Finally, this report analyzes the extent to which Chevron has disclosed these risks to its own shareholders.

This report is based upon review of Chevron's public filings with the Securities and Exchange Commission, public domain legal filings in the U.S. and Ecuador, and interviews with legal experts and members of the legal team of the plaintiffs. The analysis and judgments are entirely those of the author.

1. Seeking Alpha, "3 Oil And Gas Stocks To Consider Now," Ry Frank, 15 March 2012, seekingalpha.com/article/437551-3-oil-and-gas-stocks-to-consider-now

2. Financial Times, "Chevron's Ecuador case takes new Twist," Ed Crooks and Naomi Mapstone, 4 January 2012

2. ANALYSIS OF CHEVRON'S DEFENSE STRATEGY

Chevron has chosen to pursue an aggressive global litigation and public relations strategy to defend itself in the Ecuador case. In the past three years, it has brought allegations of fraud and extortion against the Ecuadorian plaintiffs and their legal team to U.S. courts, seeking to block enforcement of the Ecuadorian judgment. Simultaneously, Chevron has sought to use international arbitration to force the government of Ecuador to assume all liability from any judgment against the company. In both arenas, Chevron has suffered certain setbacks that have caused legal observers to question the company's purported defenses to enforcement of the judgment against Chevron's assets.

United States District Court

In the United States, in the Second District Court of New York, Chevron has sued the Ecuadorian plaintiffs, their lawyers, and certain consultants under the RICO (Racketeering Influence and Corrupt Organizations) law. The RICO suit alleges that plaintiffs' lawyers colluded with Ecuadorian officials to extort a judgment from Chevron. The suit is currently before Judge Lewis Kaplan. On March 7, 2011, as part of the RICO case, Judge Kaplan issued a preliminary injunction in U.S. District Court that purported to bar the Ecuadorian plaintiffs and their legal representatives from pursuing enforcement of any Ecuadorian court judgment outside the country of Ecuador. However, the U.S. Second Circuit struck down the injunction in its entirety on September 19, 2011. The court noted in its opinion of January 26, 2012, that the New York law did not intend for its courts to serve "as a transnational arbiter to dictate to the entire world which judgments are entitled to respect and which countries' courts are to be treated as international pariahs."³

Chevron's International Arbitration Claim

In September 2009, Chevron initiated international arbitration proceedings against the government of Ecuador

at the Permanent Court of Arbitration in The Hague under the provisions of the Bilateral Investment Treaty (BIT) between the U.S. and Ecuador. Among other requests for relief, Chevron asked that the arbitral panel issue a "declaration that Ecuador or Petroecuador is exclusively liable for any judgment that may be issued in the Lago Agrio Litigation."⁴

Although Chevron could, if successful, conceivably obtain money damages from the Ecuadorian government from this process, the arbitral panel has no jurisdiction over the *Aguinda* plaintiffs. In recent rulings, Ecuadorian courts have rejected and refused to enforce interim awards of the arbitral panel that sought to halt the Ecuadorian judicial proceedings. Ecuador's courts have concluded that the panel's orders seeking to suspend enforcement of the Ecuador judgment violate the country's separation of powers doctrine, are not authorized by the terms of the treaty, and violate the fundamental human rights of Ecuadorian citizens.

It is worth noting that in the context of litigation surrounding Chevron's right to invoke the arbitration, a U.S. federal appellate court came down on the side of the plaintiffs in some of the most central and hotly-contested issues in the *Aguinda* case. These include confirming that Chevron is bound by promises made by Texaco, including assurances that Texaco gave to the U.S. district court that it would recognize the binding nature of any judgment issued in Ecuador and submit to Ecuadorian jurisdiction. These promises were found to be "enforceable against Chevron in this action and any future proceedings between the parties, including enforcement actions, contempt proceedings, and attempts to confirm arbitral awards."⁵

In summary, the dispute over the investor arbitration has dealt a blow to some of Chevron's central legal arguments in its defense of the Ecuador litigation. Chevron no doubt

3. Republic of Ecuador v. Chevron Corp., 638 F.3d 384, 399 (2d Cir. 2011)

4. Chevron's Notice of International Arbitration Against Government of Ecuador www.chevron.com/documents/pdf/EcuadorBITEn.pdf

5. March 17, 2011 Decision by the United States Court of Appeals, Second Circuit, Republic of Ecuador v. Chevron Corporation, Texaco Petroleum Company, pg. 21

will continue to pursue the arbitration, but it will take years before a resolution is at hand. Even if said resolution is favorable to Chevron, the arbitral panel has no power to enforce its own judgments against Ecuador and it has no power to bind the *Aguinda* plaintiffs.

3. ANALYSIS OF RISKS FROM CHEVRON'S LITIGATION STRATEGY

The case against Chevron is reaching its most risky phase for the oil company as the Ecuadorian plaintiffs seek to enforce their \$18 billion judgment against Chevron's assets outside of Ecuador. Lawyers for the plaintiffs have been reported to be considering enforcement proceedings against Chevron's key assets, including those in Panama and Venezuela.

"Chevron has investments in more than 50 countries, but two have caught our eye ... Panama because oil ships go through the Panama Canal and in Venezuela because they have important assets there," [plaintiffs' lawyer Pablo] Fajardo said.⁶

In the course of the litigation and counter-litigation in this case, a key legal memo was made public during the discovery process. The memo is titled: "Invictus. Path Forward: Securing and Enforcing Judgment and Reaching Settlement." This memo, drawn up by the law firm Patton Boggs, has yielded significant revelations concerning an aggressive global strategy to obtain enforcement of the Ecuadorian courts' judgment in the United States and other countries in which Chevron has significant operations. Judge Kaplan cites the Patton Boggs memo in his opinion as evidence that Chevron's faces "significant risks" and "irreparable" damage to its assets, supply chain, business reputation, and business relationships from any enforcement of the Ecuadorian judgment.

What makes this risk to Chevron's operations particularly credible is not just the information in the Patton Boggs memo but also Chevron's own sworn testimony. Chevron Deputy Comptroller Rex Mitchell, in a sworn declaration, made clear that efforts by the plaintiffs, outlined in the Patton Boggs memo, 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."⁷

According to Marco Simons, Legal Director of EarthRights International, the extent of Chevron's global operations put the company at great risk from the Ecuadorian plaintiffs' enforcement efforts since "[t]he plaintiffs only need to win once or a few times, while Chevron needs to win everywhere. Even if Chevron wins twenty cases, just one loss could cost the company hundreds of millions or billions of dollars."⁸

Enforcement Strategy

The Patton Boggs memo outlines a legal strategy in the United States for picking the most favorable U.S. state or federal court for enforcement of the Ecuadorian court judgment in the United States.⁹ Under the Full Faith and Credit clause of the U.S. Constitution, the plaintiffs' lawyers need only convince one state or federal court to enforce the judgment against Chevron. The Patton Boggs memo analyzes which U.S. state and federal courts would be the

6. Reuters, "Ecuador plaintiffs eye Chevron assets in Venezuela, Panama", March 2, 2012 www.reuters.com/article/2012/03/02/ecuador-chevron-idUSL2E8E28RT20120302

7. Declaration of Chevron Deputy Comptroller Rex Mitchell in support of Chevron Corporation Motion for a Preliminary Injunction, Filed 2/5/11, p. 4

8. "Chevron fights justice in Ecuador on two fronts, but needs to win everywhere," EarthRights International blog, by Marco Simons, 4 May 2011 <http://www.earthrights.org/blog/chevron-fights-justice-ecuador-two-fronts-needs-win-everywhere>

9. Patton Boggs, "Invictus. Path Forward: Securing and Enforcing Judgment and Reaching Settlement," undated, pp.12-16

most favorable to both plaintiffs and the enforcement of judgments in foreign courts.¹⁰

Outside the United States, the memo envisions a similar “keystone nation” strategy for global enforcement of the judgment. Under this strategy, lawyers for the Ecuadorian plaintiffs will identify certain “keystone” nations that both promise the best potential for recognizing the validity of the Ecuadoran court judgment and also enjoy reciprocity or even a judgment recognition treaty with countries that serve as the locus for greater Chevron assets.¹¹

The Patton Boggs memo assesses several countries as possible “keystone nations” in enforcing the judgment internationally and anticipates “serious, early consideration” of enforcement in Argentina, Brazil, Colombia, and Venezuela. All four of these countries have ratified the Organization of American States’ Inter-American Convention on Extraterritorial Validity of Foreign Judgments and Arbitral Awards, a fact that should have the effect of significantly streamlining any enforcement process in those countries. In addition, Patton Boggs has represented the governments of Colombia and Venezuela and maintains long-standing relationships with law firms and public affairs firms in all four countries.¹²

Chevron has significant operations in all four countries. In 2011, operations in Argentina, Brazil and Colombia produced 101,000 equivalent barrels per day of production of crude oil, natural gas liquids, and natural gas.¹³ The company’s share of daily production in Venezuela in 2011 was 65,000 barrels.¹⁴ Chevron is investing heavily in future production in the region. Brazil is the site of Chevron’s majority-owned and operated Frade Field where development drilling is planned to continue through 2013.¹⁵ In addition to South American countries, the Patton Boggs

memo also looks to strong enforcement possibilities in both Singapore (home to Chevron’s Asia-Pacific headquarters for downstream operations and key refineries and chemical plants)¹⁶ and the Philippines (where Chevron produces 25,000 barrels of oil-equivalent production per day and has interest in significant geothermal power facilities.)¹⁷

Risks to Chevron’s Future Operations

Chevron’s core oil and gas production business faces two risks from the *Aguinda* case. Firstly, Chevron’s legal strategy of suing the Ecuadorian plaintiffs in a RICO suit and taking the government of Ecuador to trade arbitration risks building resistance among governments and local communities worldwide to doing business with the company in the future. Secondly, the legal strategy outlined by Patton Boggs for enforcement of any judgment includes extensive public policy and press work that would further publicize Chevron’s connection to environmental damage in the Amazon and thus heighten Chevron’s notoriety worldwide.

Chevron’s core business is production of oil and natural gas, known in the industry as “upstream business.” According to Trefis, over half of Chevron’s value derives from its oil and gas production operations, which enjoy much higher profit margins compared to “downstream” businesses such as refined product sales.¹⁸

To succeed and grow in this business, Chevron has to win access to a steady stream of new projects around the world in competition with other oil and gas companies. To win the competition for these projects, Chevron needs both legal permission from governments and “social license to operate” from local communities where the company is bidding to exploit new oil and gas fields.

10. *ibid*, pp. 13-14

11. *ibid*, pp. 17-20

12. *ibid*, p.20

13. Chevron Corporation 2011 10-K, 2/23/12, p.5

14. *ibid*, 2/23/12, p.13

15. *ibid*, 2/23/12, p.12

16. Patton Boggs, “Invictus. Path Forward: Securing and Enforcing Judgment and Reaching Settlement,” undated, p.19

17. Chevron Corporation 2011 Annual Report Supplement, 2/23/12, p.31

18. Trefis, Chevron analysis, 10 February 2011, pp. 1-2

In the course of the *Aguinda* case, the plaintiffs and their legal team have been successful in painting a picture in the courts and the media worldwide of a company responsible for pollution and lack of mitigation in the Ecuadorian Amazon. Chevron has reinforced its own reputation as a company that does not deal fairly with governments and local communities with its trade case against the government of Ecuador and the company's inclusion of the Ecuadorian plaintiffs in its RICO suit.

In its memo, Patton Boggs outlines an enforcement strategy involving the vigorous use of the media and public policy work that would continue to underscore these themes.¹⁹ All of these factors can be reasonably expected to detract from Chevron's reputation as a responsible operator and thereby increase opposition by governments and local communities to granting Chevron legal and social license to operate in new areas.

19. Patton Boggs, "Invictus. Path Forward: Securing and Enforcing Judgment and Reaching Settlement," undated, p.24

4. HOW HAS CHEVRON DISCLOSED AND MANAGED ITS RISK?

It should be of growing concern to the company's shareholders how Chevron's board of directors and management are managing and disclosing risks related to the Ecuadorian case. In its 2011 10-K report, Chevron neglects to disclose one of its own assessments of the severity of risk to its operations, specifically the sworn testimony of Deputy Comptroller Rex Mitchell to the U.S. District Court. Chevron also makes statements about the Ecuadorian litigation that are a one-sided interpretation of the case and which could be misleading to some investors in the absence of additional disclosures. Given these disclosure lapses, shareholders may also reasonably question whether Chevron's board of directors is failing in its fiduciary duties to oversee this material issue facing the company.

Shareholder Concerns About Management And Disclosure of Ecuador Risk

Concerned shareholders have long questioned Chevron's management and disclosure of the risks to the company from the Ecuadorian case. As early as 2003, shareholders led by Trillium Asset Management filed the first in a series of shareholder resolutions on the issue. In the resolution, the shareholders asked the company to remediate the damage from its pollution in Ecuador in order to reduce the risk to Chevron's reputation and business:

"In our view, Texaco's cleanup efforts were inadequate and our company has a continuing ethical obligation to redress the outstanding environment and health consequences of its activities in Ecuador. Negative publicity generated by this situation damages our credibility as an environmentally responsible corporate citizen and jeopardizes our ability to compete in the global marketplace."²⁰

Shareholders have continued to question Chevron's disclosure and management by filing resolutions each year

since 2003. In May 2009, the then New York State Attorney General Andrew Cuomo joined concerned shareholders by writing Chevron on two issues. One was that the company had not disclosed its assessment of the probable outcome of the Ecuadorian litigation or its estimated financial liability. The other was that in public filings with the SEC, Chevron had asserted its belief that the Ecuadorian court lacked jurisdiction over Chevron, which appeared to be contradicted by the Company's own filings from *Aguinda v. ChevronTexaco* in which Chevron consented to be subject to any duly obtained judgments of that court as a condition of the case's removal to Ecuador.

In April 2010, Trillium Asset Management, Amnesty International USA, and the Commonwealth of Pennsylvania Treasury Department in a letter to Chevron shareholders cited concerns over Chevron's liability in Ecuador as one reason why shareholders should support their resolution asking the board of directors to nominate one board candidate with "a high level of expertise and experience in environmental matters relevant to hydrocarbon exploration and production." That resolution received the votes of approximately 25% of Chevron outstanding shares in 2010 and 2011. The shareholders, led by the New York State Comptroller Thomas DiNapoli, have subsequently re-filed the shareholder resolution for a vote at Chevron's annual shareholder meeting in May 2012.

In May, 2011, shareholders of Chevron – representing \$156 billion of assets under management - called upon Chevron "to fully disclose to shareholders the risks to its operations and business from the potential enforcement of the *Aguinda* verdict" and "reevaluate whether endless litigation in the *Aguinda* case is the best strategy for the Company and its shareholders, or whether a more productive approach, such as reaching an equitable negotiated settlement, could be employed to protect shareholder investments and prevent any further reputational harm due to protracted litigation."²¹

20. Trillium website (accessed 4/18/11): trilliuminvest.com/resolutions/environmental-health-2/

21. "Investor Statement on Chevron and *Aguinda v. Texaco*," May 2011 trilliuminvest.com/wp-content/uploads/2011/05/CVX-investor-statement-with-Signatories-May-25-2011.pdf

Chevron shareholders are demanding better corporate governance. Citing management's handling of the case in Ecuador, shareholders are questioning Chevron's generous executive compensation packages and have proposed overhauls of the company's corporate governance. Despite losing the landmark \$18 billion judgment in Ecuador, Chevron awarded its General Counsel R. Hewitt Pate a 75% raise in 2012 to a staggering \$7.8 million salary and even went so far as to praise "his outstanding management of Ecuador" ahead of the company's annual "say on pay" vote.²² In 2010 and 2011, a significantly large percentage of Chevron's shareholders supported a resolution calling for the appointment of a director with expertise in environmental liabilities. In addition to re-filing this resolution, shareholders have filed two additional new resolutions for Chevron's 2012 annual meeting calling for corporate governance reforms, one asking that Chevron separate the positions of Chief Executive Officer and Chair of the Board and the other asking that Chevron lower the thresholds for calling a special meeting of shareholders."

Has Chevron Disclosed Fully to Shareholders the Financial And Operational Risk From the Ecuador Judgment?

In May 2011, Trillium Asset Management wrote the Securities and Exchange Commission (SEC) to express its concerns about disclosures and omissions from Chevron's 2011 annual report concerning the Ecuadorian judgment. In the letter, Trillium requested the SEC staff review "whether Chevron has appropriately disclosed to shareholders the scope and magnitude of financial and operational risk from a recent adverse legal judgment in Ecuador."

One full year since this complaint to the SEC, Chevron has failed to address the concerns around the extent and accuracy of its statements to shareholders on the Ecuador case. This complaint and other concerns around Chevron's disclosure in this case were recently underscored in a report

by Graham Erion, a securities lawyer who concluded that Chevron was materially misleading its shareholders.²³

Chevron did not disclose any risk of its liability from the Ecuador litigation in its Annual Report until as late as February 2009. In its 2011 10-K, Chevron disclosed the judgment against the company that was upheld upon appeal but continues to assert uncertainty as to its ultimate probable financial liability, stating:

"The ultimate outcome of the foregoing matters, including any financial effect on Chevron, remains uncertain. Management does not believe an estimate of a reasonably possible loss (or a range of loss) can be made in this case. ...Moreover, the highly uncertain legal environment surrounding the case provides no basis for management to estimate a reasonably possible loss (or a range of loss)."²⁴

One of the most notable omissions from Chevron's filings is the analysis of the significance, severity, and implications of the risks to its operations from any enforcement of the Ecuadorian court judgment. In this regard, it is instructive to contrast what Chevron's Deputy Comptroller stated in his sworn testimony to Judge Kaplan and what Chevron has publicly disclosed to its shareholders.

In its 2011 10-K report, Chevron does disclose that it expects the Ecuadorian plaintiffs to seek enforcement of any judgment outside Ecuador.

"Because Chevron has no assets in Ecuador and the Lago Agrio plaintiffs' lawyers have stated in press releases and through other media that they will seek to enforce the Ecuadorian judgment in various countries and otherwise disrupt Chevron's operations, Chevron expects enforcement actions as a result of this judgment to be brought in other jurisdictions. Chevron expects to contest and defend against any such actions."²⁵

In striking contrast to this cursory reference, Chevron

22. Chevron Corporation, Notice of the 2012 Annual Meeting and 2012 Proxy Statement, 4/12/12, p.28

23. "Report: Chevron Misleading Investors Over Ecuador Environmental Judgment," 17 April 2012 <http://chevrontoxico.com/news-and-multimedia/2012/0417-chevron-misleading-investors-over-ecuador-environmental-judgment.html>

24. Chevron Corporation, 2011 10-K Report, 2/23/12, p. FS-42

25. *ibid*, p. FS-42

Deputy Comptroller Rex Mitchell has stated in sworn testimony in Chevron's RICO suit that the company faces "irreparable damages" if the Ecuadorian plaintiffs are able to seize or attach Chevron assets in the course of the enforcement of the Ecuadorian judgment. Mitchell stated: "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."

"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.**"²⁶

The fact that Chevron has not disclosed its own alarming assessment of the risk to its operations in its filings with the SEC poses the question of whether the company is being fully transparent to its shareholders. Shareholders reading the annual report disclosure could reasonably want to know the Deputy Comptroller's assessment of the potential for irreparable harm to reputation and relationships that would not even be remedied by monetary damages. For those wanting to know how severe the downside risk of recent adverse rulings in Ecuador, clarifying that "enforcement actions" could mean seizure of oil tankers, wells or pipelines, and "irreparable injury to the company's business reputation and relationships" could be the kind of information that is viewed as "material" to determining the value of stock and prospects for the company.

In analyzing whether these omissions in the company's disclosures are material within the meaning of the securities laws the courts would consider several factors, including the importance of the information to investor decision-making.

A core inquiry involves whether there is "a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available."²⁷

The company has disclosed that enforcement actions may be anticipated regarding the Ecuador judgment, and that it intends to contest such enforcement actions. However, the company neglected to disclose management's concern about the potential for severe damage to the company's operations, relationships and reputation indicated in the comptroller's testimony.

Many investors might have reasonably expected the company to have disclosed more regarding these risks particularly after the protective injunction by U.S. District Court that purported to bar any enforcement of the \$18 billion judgment outside of Ecuador was struck down by the U.S. Second Circuit and the Ecuadorian courts rejected awards by the arbitral panel also seeking to halt enforcement of the judgment.

Have Chevron's Statements to Shareholders About the Court Case Been Misleading?

Chevron's 2011 10-K includes a number of questionable statements about the court case in Ecuador, a sample of which are addressed below in turn.

Statement 1: "As to matters of law, the company believes first, that the court lacks jurisdiction over Chevron"²⁸

While this may be a true statement of the company's opinion, Chevron's statement is misleading since it omits the fact that Texaco agreed to the binding nature of any judgment issued in Ecuador in 2002 before a U.S. federal court as a condition of the case being transferred to Ecuador.²⁹

26. Declaration of Chevron Deputy Comptroller Rex Mitchell in support of Chevron Corporation Motion for a Preliminary Injunction, Filed 2/5/11, p. 4 [emphasis added]
27. TSC Industries, Inc. v. Northway, Inc., 426 U.S. 438, 96 S.Ct. 2126, 48 L.Ed. 2d 757 (1976); Basic Incorporated v. Levinson, 485 U.S. 224, 108 S.Ct. 978, 99 L.Ed. 2d. 194 (1988).
28. Chevron Corporation, 2011 10-K Report, p. FS-40
29. Opinion and Order of U.S. District Court Judge D.J. Rakoff, 30 May 2001, Item 3. www.texaco.com/sitelets/ecuador/docs/aquinda_v_texaco_oao2.pdf

Moreover, in a recent opinion on Chevron's BIT arbitration, the United States Second Circuit noted that in arguing to remove the case from U.S. District Court in the 1990s, "Texaco assured the district court that it would recognize the binding nature of any judgment issued in Ecuador." It goes on to conclude, "As a result, that promise, along with Texaco's more general promises to submit to Ecuadorian jurisdiction, is enforceable against Chevron in this action and any future proceedings between the parties, including enforcement actions, contempt proceedings, and attempts to confirm arbitral awards."³⁰

Statement 2: "the claims are barred by the statute of limitations in Ecuador"³¹

This statement fails to mention that Chevron waived its defenses under the statute of limitations when company voluntarily submitted itself to jurisdiction in Ecuador in 2002 before a U.S. federal court as a condition of the case being transferred to Ecuador.³²

Statement 3. "the lawsuit is also barred by the releases from liability previously given to Texpet

by the Republic of Ecuador and Petroecuador and by the pertinent provincial and municipal governments."³³

This statement is misleading. Chevron neglects to mention that the company was released from *government* claims only, not the type of third-party claims in the *Aguinda* lawsuit. Notably, Chevron fails to mention that the Ecuadorian courts have ruled against the company's broad interpretation of the scope of this release.³⁴

Chevron is entitled to disagreements with the plaintiffs about points of contention in the lawsuit; indeed, that is why a lawsuit exists. However, some of the preceding statements, taken in aggregate, could create the misleading perception that the Ecuadorian lawsuit is fraudulent and without legal merit. The reality is that these are disputed issues on which Chevron holds a position, which is not the same as the position held by the plaintiffs or, more importantly, that held by the courts in their rulings in this case.

30. March 17, 2011 Decision by the United States Court of Appeals, Second Circuit, Republic of Ecuador v. Chevron Corporation, Texaco Petroleum Company, pg. 6

31. Chevron Corporation, 2011 10-K Report, p. FS-40

32. United States Court of Appeals, Second Circuit. - 303 F.3d 470, Item. 31
law.justia.com/cases/federal/appellate-courts/F3/303/470/505740/

33. Chevron Corporation, 2011 10-K Report, p. FS-41

34. Ruling of Presiding Judge Nicolas Zambrano Lozada, Provincial Court of Sucumbios, 14 February 2011, p.34 and p.176
chevrontoxico.com/assets/docs/2011-02-14-judgment-Aguinda-v-ChevronTexaco.pdf

