Governance (Sustainability Pay Links)

Devon Energy

May 17, 2017

Ticker	Exchange	Meeting Date	Record Date	Annual Meeting Location
DVN	NYSE	6-7-2017	4-10-2017	Oklahoma City, Oklahoma

Agenda	
Item	**Proposal**
1	MGT: Elect directors
2	MGT: Advisory vote on the frequency of future advisory votes on executive compensation
3	MGT: Advisory vote on executive compensation
4	MGT: Ratify selection of auditors
5	MGT: Approve Annual Incentive Compensation Plan
6	MGT: Approve 2017 Long-Term Incentive Plan
7	SH: Review/report on climate change advocacy
8	SH: Report on climate change
9	SH: Report on lobbying
10	**SH: Link executive pay to sustainability metrics**

Si2 Briefing Governance (Sustainability Reporting), Environment (Climate Change) and Environmental Management

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Links 2017 Proxy Statement; 2016 Form 10-K; 2016 Corporate Social Responsibility Report

Resolved Clause Shareholders request that Devon Energy issue a report that assesses, in light of global concerns about climate-change and the resultant pressures to transition to a low carbon economy, the benefits and risks of continuing to use oil and gas reserve additions as a metric in named executives' compensation. The report should be produced at reasonable cost and omit propriety information.

Lead Proponent As You Sow

Vote History A similar proposal in 2016 asked the company not to use "oil and gas reserve addition" metrics to determine the amount of senior executive's incentive compensation. It earned 3.8 percent support.

Summary As You Sow wants Devon Energy to study the use of "oil and gas reserve addition" in its executive compensation incentive metrics, asserting that "creation of sustainable value" requires reevaluation of performance metrics as energy markets transition to a low carbon economy. Management opposes the resolution, asserting that reserve addition is an important metric for its executive compensation program and that the existing structure is appropriate and aligned with the company's long-term strategy.

The proponent believes that Devon Energy's continued use of reserve replacement as a performance metric could lead to a spiral of amassing assets that become stranded as the world moves away from carbon energy and prices drop. Devon Energy maintains notes that as an oil and gas company, the addition of new reserves is an important performance metric. It says that its Compensation Committee considers all elements of executive compensation and to focus on one performance metric out of many would not be an appropriate use of its time or resources.

I. Devon Energy and Climate Change

Financials			
($ millions)	**2014**	**2015**	**% Change**
Total Revenue	$13,145	$12,197	(7.2%)
Net Income	($14,454)	($3,704)	74.4%

Devon Energy is a leading independent energy company engaged primarily in the exploration, development and production of oil, natural gas and natural gas liquids (NGLs). Its operations are concentrated in various North American onshore areas in the United States and Canada. The company produces about 1.4 billion cubic feet of natural gas, 116 MBbls of natural gas liquids and 151 MBbls of oil per day. It has proved reserves of 2 billion barrels of oil equivalent.

Devon Energy also owns natural gas pipelines, plants and treatment facilities in many of its producing areas, making it one of North America's larger processors of natural gas and NGLs. In addition, the company has doubled its onshore North American oil production since 2011 and states that it has a deep inventory of development opportunities.

Devon Energy pioneered the commercial development of natural gas from shale and coalbed formations, and it is a leader in using steam to produce bitumen from Canadian oil sands. The company is the first and only U.S.-based independent energy company to develop and operate a bitumen oil sands project in Canada.

Devon Energy says in its 2016 Form 10-K that its core strategy is "building value per share" by:

- managing a premier asset portfolio;
- delivering top-tier results within the areas that we operate;
- continuing disciplined capital allocation; and
- maintaining significant financial strength.

The company has approximately 5,000 employees, down from 6,600 at the same time last year.

Public policy and regulation: Devon Energy says in its Form 10-K, "Laws, rules, regulations, taxes, fees and other policy implementation actions affecting our industry have been pervasive and are under constant review for amendment or expansion." Because public policy and laws change frequently, management says it is "unable to predict the future cost or impact of compliance," but it does not expect any such changes to affect its operations "materially differently than they would affect other companies with similar operations, size and financial strength." It goes on to specify different public policy and regulatory matters that may affect its bottom line, including exploration and production regulation, royalties and incentives in Canada, marketing in Canada and environmental, pipeline safety and occupational regulations. On environmental laws and regulations, it includes "the emission of certain gases into the atmosphere" as one of the factors that could affect its performance.

Oil and gas assets: The table below *(next page)* summarizes the company's oil and gas reserves at the end of 2016.

Devon Energy's 2016 Oil and Gas Reserves							
	Proved Reserves			Production			
	MMBoe	*% of Total*	*% Liquids*	*MBoe/d*	*% of Total*	*% Liquids*	*Gross Wells Drilled*
Barnett Shale	895	44%	25%	169	28%	27%	-
Delaware Basin	108	5%	75%	60	10%	74%	58
Eagle Ford	75	4%	76%	76	12%	76%	63
Heavy Oil	504	24%	99%	134	22%	98%	25
Rockies Oil	24	1%	64%	19	3%	79%	19
STACK	393	19%	47%	93	15%	48%	133
Other	59	3%	90%	17	3%	81%	28
Total	**2,058**	**100%**	**54%**	**568**	**100%**	**62%**	**326**

"MMBoe" means million barrel of oil equivalent.
Source: Devon Energy 2016 Form 10-K

In addition, Devon Energy provides the following description of its oil and gas positions:

- **Barnett Shale—**This is the company's largest property in terms of production and proved reserves; its leases are located primarily in Denton, Johnson, Parker, Tarrant and Wise counties in north Texas. Given the low commodity pricing environment, the company shifted its focus to enhancing existing well performance through re-fracturing, artificial lift and line pressure reduction projects. It plans on minimal development activity in the Barnett in 2017.
- **Delaware Basin—**The Delaware Basin is a legacy asset for the company and includes the Bone Spring, Delaware, Wolfcamp and Leonard formations. Devon Energy plans to invest $700 million of capital in the Delaware Basin in 2017, primarily focused on the second Bone Spring opportunity in the basin of southeast New Mexico.
- **STACK—**In early January 2016, Devon Energy acquired 80,000 net acres in the Woodford Shale and Meramec plays. The STACK development is located primarily in Oklahoma's Canadian, Kingfisher and Blaine counties and named for the stacked play in the area. The company says that its Woodford Shale position is the largest and one of the best in the industry; it plans to invest about $750 million in 2017.
- **Eagle Ford—**It acquired the Eagle Ford position in early 2014 from GeoSouthern and has about 66,000 net acres located in DeWitt and Lavaca counties in south Texas. It plans to invest $175 million in 2017.
- **Rockies Oil—**Devon Energy's operations here are focused on emerging oil opportunities in the Powder River Basin and the Wind River Basin. In the Powder River, it is currently targeting several Cretaceous oil objectives, including the Turner, Parkman and Teapot formations. In December 2015, it acquired 253,000 net acres in the "core" of the oil fairway in the Powder River. It plans to invest $175 million in 2017.
- **Heavy Oil—**Its operations in Canada are focused on heavy oil assets in Alberta, Canada, especially in its Jackfish complex, a thermal heavy oil operation in the non-conventional oil sands of east central Alberta. It uses a recovery method known as steam-assisted gravity drainage at Jackfish; it expects to maintain a reasonably flat production profile for greater than 20 years with only $200 million in annual maintenance.

  Its Pike oil sands acreage is situated directly to the southeast of its Jackfish acreage in east central Alberta and has similar reservoir characteristics to Jackfish. The Pike leasehold is currently undeveloped and had no proved reserves or production at the end of 2016. It is evaluating its development timeline for Pike. In 2016, Devon Energy plans to invest $1,300 million in its Canadian Heavy Oil business.

During 2016, the company sold non-core assets in Mississippi, east Texas, the Anadarko Basin and the Midland basin for approximately $1.9 billion. Estimated proved reserves associated with these assets were approximately 157 MMBoe, or approximately 10 percent of total U.S. proved reserves.

Reserves accounting: Devon Energy says the following on proved oil reserves accounting in its 10-K:

> Proved oil and gas reserves are those quantities of oil, gas and NGLs which, by analysis of geoscience and engineering data, can be estimated with reasonable certainty to be economically producible from known reservoirs under existing economic conditions, operating methods and government regulations. To be considered proved, oil and gas reserves must be economically producible before contracts providing the right to operate expire, unless evidence indicates that renewal is reasonably certain. Also, the project to extract the hydrocarbons must have commenced or the operator must be reasonably certain that it will commence the project within a reasonable time.
>
> The process of estimating oil, gas and NGL reserves is complex and requires significant judgment as discussed in "Item 1A. Risk Factors" of this report. As a result, we have developed internal policies for estimating and recording reserves. Such policies require proved reserves to be in compliance with the SEC definitions and guidance. Our policies assign responsibilities for compliance in reserves bookings to our Reserve Evaluation Group, (the "Group"). These same policies also require that reserve estimates be made by professionally qualified reserves estimators, as defined by the Society of Petroleum Engineers' standards.

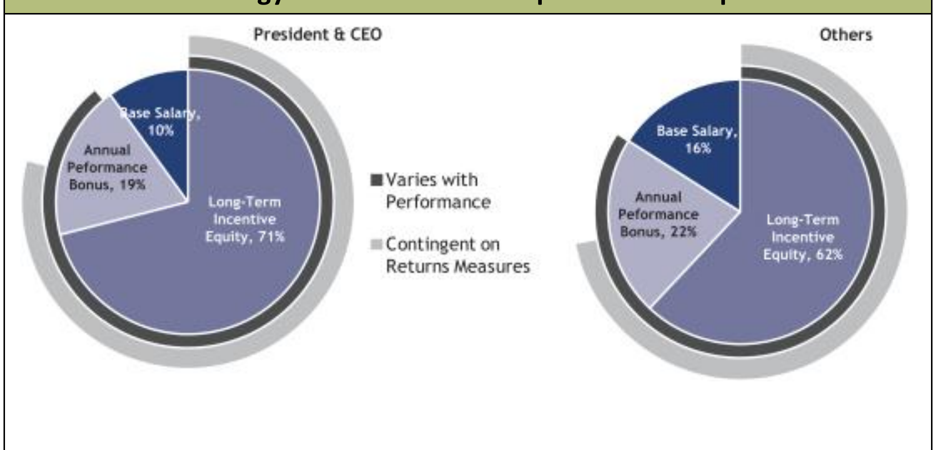
Executive Compensation

According to Devon Energy's 2017 Proxy Statement, the company's goal is to deliver "consistent top-tier stockholder returns through a highly engaged culture focused on innovation, safety, operational excellence, environmental stewardship and social responsibility." It says that its executive compensation program aims to:

- attract and retain highly trained, experienced, and committed executives who have the skills, education, business acumen, and background to lead a large and diversified oil and gas business;
- motivate and reward executives to drive and achieve our goal of increasing stockholder value;
- provide balanced incentives for the achievement of near-term and long-term objectives, without motivating executives to take excessive risk; and
- track and respond to developments, such as changes in competitive pay practices.

Devon Energy's 2016 executive compensation program included base salary, an annual performance cash bonus and long-term equity incentive awards (which included performance restricted stocks and performance share units).

Devon Energy 2015 Executive Compensation Components



Source: Devon Energy 2017 Proxy Statement

The performance metric of oil and gas reserves addition, the topic of Item 10 on the proxy ballot, is part of the cash bonus program. The table at the bottom of the previous page illustrates the company's executive compensation components in 2016.

Cash incentive compensation: Devon Energy's annual performance cash bonus is linked to pre-determined performance goals, as illustrated in the table below. According to the proxy statement, the Compensation Committee assigned a separate weighting to each performance measure to reflect the relative importance of those areas for the year in January 2016. It then assigned a performance score of between 0 percent to 200 percent for each performance measure, with a score of 100 percent indicating performance that met expectations. The weighed score, then, was multiplied by the executive's predetermined base salary, which set the amount of performance cash bonus for the year.

As illustrated in the first table below, Devon Energy's named executives were rewarded for the addition of oil and gas reserves in 2016 as the company exceeded its BOE addition target by 157 percent. As a result, the Oil and Gas Reserve Additions metric was paid out at the maximum 200 percent of target, trailing only Lease Operating Expenses. The final cash incentive bonuses for the named executive officer are summarized in the second table *(next page)*.

2016 Devon Energy Performance Scorecard

Measure	Goal	Outcome	Weight	Score	Weighed Score
Oil and Gas Production	213.5 million BOE	223.5 million BOE	15%	125%	18.75%
Total Stockholder Return	Top half of the peer group on a 1-year basis	1-year TSR ranked 6th out of 15-member peer group	15%	125%	18.75%
Lease Operating Expenses per BOE	$8.44 per BOE	$7.08 per BOE	15%	150%	22.5%
Oil and Gas Reserves Additions	102 million BOE added	262.5 million BOE added	10%	200%	20%
Improve the Overall Value of Devon's Risked Resource Portfolio	Achieve successes in acquisitions and divestitures, exploration, appraisal of prospects and technical areas	Exceeded top end of range of expected asset divestiture proceeds; progressed to commerciality a portion of the risked resource equal to 125% of 2016 production; evaluated >20% of overall amount of sub-commercial resource; evaluated material additions equivalent to 90% of total Devon risked resource	10%	125%	12.5%
Environmental, Health and Safety	Continuous improvement on various measures	Improved SIF rate, recordable incident rate, SIF vehicle rate, spill rate compliance to protocols*	10%	125%	12.5%
Total Capital Expenditures	$1.676 billion	$1.560 billion	10%	100%	10%
Pre-Tax Cash Margin per BOE,	$3.66 per BOE	$3.85 per BOE	5%	100%	5%

2016 Devon Energy Performance Scorecard					
Measure	**Goal**	**Outcome**	**Weight**	**Score**	**Weighed Score**
Normalized					
Learning and People	Hold health care cost inflation below the national average; promote improved execution	Held health care cost inflation below the national average; aligned team leadership and communication to promote improved execution	5%	100%	5%
Improve Business Environment	Increase stakeholder alignment to improve public policy and business operating environment for Devon	Engaged stakeholders, legislators and associations on local, state and federal ordinances and regulations	5%	100%	5%
				2016 Company Performance Score	**130%**

Source: Devon Energy 2017 Proxy Statement
*SIF rate measures serious incidents or fatalities.

2015 Devon Energy Executive Performance Cash Bonus					
Executive	**2016 Base Salary ($000)**	**Performance Bonus Target**	**Company Performance Score**	**Process Determined Bonus Amount ($000)**	**Actual Award Amount ($000)**
David A. Hager, President and CEO	$1,275	135%	130%	$2,238	$2,238
Thomas L. Mitchell, Executive Vice President and Chief Financial Officer	$610	100%	130%	$793	$793
Tony D. Vaughn, Chief Operating Officer	$740	100%	130%	$962	$962
Lyndon C. Taylor Executive President and General Counsel	$625	80%	130%	$650	$650
R. Alan Marcum, Executive Vice President, Administration	$550	80%	130%	$572	$572

Source: Devon Energy 2017 Proxy Statement

Long-term incentive compensation: The company does not discuss in detail how it determined its long-term incentive (LTI) equity pay, which accounted for the largest portion of 2016 executive pay. Rather, the company's proxy statement simply says that its Compensation Committee "reviewed market data for LTI granted to executives at peer companies." The committee determined that grants targeting the

50th market percentile would be appropriate in most years but, because of Devon Energy's negative total shareholder return (TSR) in 2015 and its desire to preserve shares in the long-term incentive plan, it approved grants valued at 1/3rd less than the targeted value for each executive.

LTI awards were granted 50 percent in performance share units tied to TSR and 50 percent in performance restricted stock tied to cash flow before balance sheet changes of at least $700 million in 2017. Neither award uses the reserve replacement ratio as a performance metric. Performance Share Units will vest after a three-year performance period, while performance restricted stock will vest over four years if the metric is achieved.

Advisory vote on pay: In 2016 and 2015, 95.1 percent and 93.6 percent of voting shareholders approved Devon Energy's executive compensation program, respectively.

II. Proponents' Position

As You Sow wants Devon to assess the risks and benefits of using "oil and gas reserve addition" in its executive compensation incentive metrics, asserting that "standards for sustainable value" requires moving towards a low carbon economy.

The proponent notes that the 2015 Paris Climate Agreement "underscores the challenges faced by the oil and gas industry in this changing environment." In addition, government policies on fuel efficiency, carbon pricing and emissions create the need for new metrics, while low carbon market forces are forcing companies to come up with new answers. The need for energy companies to plan for "radical change" was also a point of emphasis for Fitch Ratings in October 2016.

The proponent believes that linking executive compensation to increases in oil and gas reserves will incentivize a continued focus on reserve growth while the company should be exploring options for a changing energy economy. Such incentivization could lead to the "addition of reserves which are likely to become stranded in a low carbon economy" and discourage management from pursuing more innovative solutions, like diversification, according to As You Sow.

Climate change has prompted some investors to ask oil and gas companies to consider stress scenarios for the industry, the resolution notes, with Standard and Poor's analysis saying that "the speed with which companies react and modify their strategies, including their investments, would be an important potential rating consideration." The resolution adds that the recent volatility in oil and gas prices "heightened the importance of management evaluating the costs and benefits of developing new oil and gas reserves, rather than simply amassing additional reserves in response to compensation incentives."

The proponent believes that "severing the link between reserves growth and executive compensation would better reflect increasing uncertainty over climate regulation and future oil and gas demand," which, it asserts, would be more in line with long-term shareholder interests.

III. Management Position

Devon Energy opposes the resolution, asserting that reserve addition is an important metric for its executive compensation program and that the existing structure is appropriate and aligned with the company's long-term strategy.

Devon Energy says that it already produces a Compensation Discussion & Analysis that "provides significant information about executive compensation and the various factors considered in making compensation decisions" and that production of a report on the benefits and risks of one particular metric is unnecessary and unlikely to yield useful information to either the committee or to shareholders.

The compensation committee of the board is responsible for determining appropriate compensation metrics for the company and reviews those metrics annually. The company believes that chosen goals are critical to near-term performance as well as sustainable future growth. It also believes that the committee ensures a balanced approach weighting performance goals so that they are not too heavily skewed towards one particular metric.

"Exploring for and developing undiscovered oil and natural gas reserves is fundamental to the Company's business and critical to its ability to build and sustain value for its stockholders," management asserts, noting that other metrics in the 2016 compensation program included "oil and gas production, total stockholder return, pre-tax cash margin per BOE (normalized), overall value of Devon's asset portfolio, environmental, health and safety, total capital expenditures, lease operating expenses, learning and people, and improvement of the Company's business environment." These metrics, taken together as a whole, "appropriately measure" the company's performance and align the interests of executives with long-term shareholder value, it says.

Devon Energy also says that it carefully measures and reports oil and gas reserves within established SEC definitions as well as company policies and that these "include only those quantities that can be estimated with reasonable certainty to be economically producible from known reservoirs under existing economic conditions, operating methods and government regulations." It notes that the Reserves Evaluation Group is responsible for compliance in reserves bookings and oversees audits and reserve estimates performed by third-party firms; Devon also has a Reserves Committee, it points out, which consists of three independent directors and provides additional oversight.

Devon Energy says that the compensation committee believes in the use of reserve addition metric in the company's compensation program, which, it asserts, is "appropriate and well-aligned" with its long-term strategy. Asserting that the study of reserve addition in executive compensation metrics is unnecessary and not in the best interests of the company, management recommends a vote against the proposal.

IV. Analysis

- Is addition of new reserves an important performance metric for the company?
- Should Devon Energy move away from its oil and gas portfolio and invest in renewables?

Si2's Briefing Paper, Environment (Climate Change), contains a general analysis of issues investors may want to consider. The following information is specific to Devon Energy.

Importance of new reserves: The proponent asserts that the new reserve addition metric for Devon Energy's executive compensation program may not represent the long-term interests of the company and shareholders, because climate change means a more sustainable strategy would move away from fossil fuels. Management disagrees and says that, as an oil and gas company, the addition of new reserves is an important factor for company's health and therefore the metric should remain in the compensation program.

As illustrated earlier in the report, the metric, "Oil and Gas Reserves Additions" made up about 10 percent of Devon Energy's targeted annual cash incentive bonus, which in turn accounted for about 20 percent of each named executive's entire pay packages. The company exceeded the Oil and Gas Reserves Additions goal in 2016 and the executives were rewarded with a payout for that metric that was 200 percent of the targeted amount. The metric was one out of 10 performance metrics for the cash incentive bonus, with three other metrics weighted more heavily. Oil and Gas Reserves Additions was not used as a performance metric for long-term equity incentives granted in 2016.

Not much information is disclosed on how the committee determined the company's equity pay and how it was linked to the executives' performance. The importance of oil and gas reserves additions as a performance metric becomes blurred, therefore, since it is unclear exactly how much weight the company gives to this measure as part of each executive's total annual pay package.

In addition, the question comes down to whether Devon Energy should remain an oil and gas company or should, in light of climate change and increasing regulatory pressures, invest in renewable energy and transform itself into another sort of company altogether. If the company was to diversify its product portfolio with renewables then it would seem appropriate that the company either drop the new reserves metric from its executive compensation program, or add another that measures growth of renewables. But, if it will remain an oil and gas company as it has been in the past, and as its leadership now intends, the addition of new reserves may remain an important performance metric for its executive compensation.

Strategic choice: The proponents are concerned about the impact of increasing climate change regulation on Devon Energy and want the company to start planning for a transition to a low carbon economy. The point of contention between the proponents and the company is that Devon Energy sees itself entirely as an oil and gas company and is not interested in diversifying its portfolio, at least right now. The company has said so in its corporate social responsibility reports for a number of years:

> At Devon, we support a consistent, reliable regulatory framework; society depends on measures that are both effective and economically viable. As 55 percent of the world's energy comes from oil and natural gas, curtailing these resources could hurt economic growth and diminish the quality of life for millions of people….
>
> We expect development of new energy sources to continue. Meanwhile, it's our job to produce the energy the world needs now, and to do so thoughtfully and responsibly. We execute our plans based on rigorous analysis of the global outlook for energy, including the prospects for new regulations. We are confident that oil and natural gas will remain the world's most affordable and accessible forms of energy for many years to come.

Shareholders voting on this resolution will have to decide if they want the company to become an energy company, as opposed to an oil and gas company, and start investing in new directions, or if they believe that there is no need for the company to distract itself from its current focus. Some investors may consider it a bad time to move away from its core strategy, given the company's recent losses, although others may believe that it is all the more reason to diversify its product portfolio.

Voting Considerations

Votes in favor: Investors who believe that Devon Energy should move away from oil and gas given climate change risks and want to align executive interest with this new focus will want to vote for this resolution.

Votes against: Investors who agree with the company that its focus should remain on oil and gas, and that additions to oil and gas reserves should be an important performance consideration for named executives, will want to vote against the proposal.

Resources

- Devon Energy's 2017 Proxy Statement
  https://www.sec.gov/Archives/edgar/data/1090012/000119312517137053/d335277ddef14a.htm
- Devon Energy's 2016 Form 10-K
  https://www.sec.gov/Archives/edgar/data/1090012/000119312517137053/d335277ddef14a.htm
- Devon Energy's *2016 Corporate Responsibility Report*
  http://www.devonenergy.com/documents/Social-Responsibility/2016-CSR-Report/DVN-2016-CSR_FINAL_Updated.3.7.17.pdf