MEMORANDUM

Energen Corporation Shareholder Resolution 2015
Report on Goals & Plans to Address Carbon Asset Risk
Filed by Connecticut Retirement Plans and Trust Funds

Energen Corporation  Symbol: EGN

Vote “For”

Resolved: Shareholders request that Energen prepare a report analyzing the consistency of company capital expenditure strategies with policymakers’ goals to limit climate change, including analysis of long- and short-term financial risks to the company associated with high-cost projects in low-demand scenarios, as well as analysis of options to mitigate related risk. The report should be overseen by a committee of independent directors, omit proprietary information, and be prepared at reasonable cost by September 2015.

The resolution’s supporting statement requests that the report include discussion of:

• Assumptions regarding breakeven costs of production for the company’s highest cost projects.
• Consideration of a range of lower demand scenarios accounting for more rapid than expected policy and or technology developments, including the 2-degree scenario as outlined by the IEA.
• An assessment of different capital allocation strategies in the face of low-demand Scenarios.
• How the company will manage risks under these scenarios, such as reducing the carbon intensity of its assets or returning capital to shareholders.
• The Board of Directors role in overseeing climate risk reduction strategies and related capital allocation.

We believe that investors should vote FOR this resolution for the following reasons, each of which is discussed in more detail later in the memo:

1. **Energen is uniquely exposed to Carbon Asset Risk.**

   a. According to Carbon Tracker staff, approximately 67 percent of Energen’s possible future liquids project portfolio requires a price of $80 per barrel to break even.\(^1\) With oil trading around $50 per barrel, investors are concerned that action on climate change, along with other

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\(^1\) Based on data sourced from Rystad Energy’s database as of March 17, 2015.
factors, makes a return to such high prices (for sustained periods) unlikely.

2. **Energen has poor disclosure on this issue**, meaning that investors don’t have the ability to properly evaluate the company’s exposure to Carbon Asset Risk.
   a. As the company demonstrates in its opposition statement, its disclosure on Carbon Asset Risk consists almost entirely of generic boilerplate, devoid of the sort of specific details that would let investors properly understand the risks at play.

3. **The disclosure requested in the resolution is reasonable** and would be of use to investors. The disclosure request is based on a blueprint\(^2\) developed by the Global Investor Coalition, a group of investors representing over $23 trillion in assets, and similar disclosure requests are being made of dozens of companies in the oil and gas sector. Most of these requests are being put forward as part of cooperative dialogue. Where companies have not been open to dialogue, as is the case at Energen, investors have been forced to put forward shareholder proposals.

**Energen is uniquely exposed to Carbon Asset Risk**

- Research by Carbon Tracker\(^3\) makes clear that, as costs have risen, the oil and gas industry is now highly vulnerable to any drop in oil prices driven by a drop in demand. The industry has affirmed this view. According to Statoil, roughly half of the world’s largest oil projects require prices higher than $120/barrel to breakeven, more than double the current price, demonstrating just how vulnerable the industry is to decreases in demand.\(^4\)
- Even absent aggressive global action on climate change, a variety of existing trends—from increased transportation efficiency in North America, to clean air regulation in China,\(^5\) to fuel switching in the petrochemical sector—are eroding demand in a significant way. Global action on climate change would simply exacerbate this demand destruction.
- Despite these trends, fossil fuel companies continue to spend hundreds of billions of dollars each year on finding and developing even more high-cost fossil fuel resources than we can safely burn if we are to avoid catastrophic levels of climate change. At current emission rates, the global carbon budget linked to the 2 degree goal will be exhausted within 19 years, according to

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PricewaterhouseCoopers.⁶

- Even compared to an industry that is levered to high-cost resources, Energen stands out for its bet on high-cost projects, as described above by Carbon Tracker above.

**Energen has poor disclosure on this issue**

Energen has not responded to the CDP disclosure survey, whereas many oil & gas companies do. Nor could we find meaningful discussion of climate change on Energen’s web pages devoted to environmental issues.⁷

The company’s opposition statement to the resolution is comprised primarily of boilerplate regulatory risk language from the 2013 annual report as well as two short paragraphs making the following points:

1) “Energen has commodity price exposure but does not generally participate in the ‘high-cost projects’ referenced in the proposal.”
   But management does not define high-cost projects or provide useful information about production costs or future oil price estimates in its statement.

2) “Energen’s history demonstrates an ability to weather market volatility and, within relatively short time frames, successfully adjust drilling and development programs and capital investment plans in response to changing circumstances and opportunities...”
   This is a backward-looking risk assessment and therefore does not take into account the existential risk that climate change poses to the oil and gas industry.

3) *We have no particular expertise in predicting future governmental policies and actions with respect to climate change or other matters and do not believe that preparation of the requested report is a wise use of management time and corporate funds or likely to generate beneficial information beyond what the Company already provides.*
   Predicting the future is always difficult, and this one reason why the resolution requests analysis of “a range of lower demand scenarios.”

Energen’s climate-related risk was magnified in 2014 by the sale of its natural gas utility, creating a pure-play oil and gas exploration and production company. Oil prices collapsed by more than 50% during the second half of the year, and Energen suffered 28% decline in its share price during the second half of 2014, and significantly reduced its dividend, highlighting the risks of its new pure-play oil & gas production strategy.⁸

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⁶ [http://www.pwc.co.uk/assets/pdf/low-carbon-economy-index-2014.pdf](http://www.pwc.co.uk/assets/pdf/low-carbon-economy-index-2014.pdf)


The disclosure requested in the resolution is reasonable and would be of use to investors

The rest of the memo covers the specific requests made in the supporting statement of the resolution.

1) Assumptions regarding breakeven costs of production for the company’s highest cost projects

Given the generally high production costs of the newest sources of oil (including those that require hydraulic fracturing), proponents are concerned that the industry in general and Energen in particular is vulnerable to scenarios in which demand for oil declines along with prices.

Demand for fossil fuels is already being affected by policies and technology trends related to climate change including: increased fuel efficiency, use of lower-carbon fuels, the electrification of ground transportation, and rapidly declining costs of renewable energy.10

The risk of reduced demand amplifies concerns among investors about the declining returns of many oil and gas companies and the wisdom of deploying more capital to low-return projects that require high oil prices to break even.

Reductions in demand increase the probability of price declines for Energen’s products. Investors need to know more about assumptions Energen uses to estimate future market prices and break-even costs of production to assess the risk of Energen’s reserves becoming uneconomic to produce over short, medium and long-term time horizons.

2) Consideration of a range of lower demand scenarios accounting for more rapid than expected policy and or technology developments, including the 2-degree scenario as outlined by the IEA.

Nearly every nation agreed in the Copenhagen Accord to limit the average global temperature increase to 2 degrees Celsius. There is widespread agreement that meeting this goal will require a 50% reduction in greenhouse gas emissions globally by 2050 entailing an estimated 80% emissions reduction by 2050 in developed countries.

HSBC reports that: “In its low-carbon 450 PPM scenario, the IEA (International Energy Agency) estimates that demand for fossil fuels would still grow up to 2020. Oil demand, for example, is forecast to grow at 0.4% annually. However, from 2020

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9 http://www.npr.org/2014/11/04/361204786/falling-oil-prices-make-fracking-less-lucrative
onwards, the IEA projects that oil demand would decline, though not as much as coal.... Together, the oil price and the unburnable carbon effects are equivalent to between 34% and 52% of market capitalisation.”

Since carbon capture and storage (CCS) technology seems highly unlikely to be widely deployed for the foreseeable future, a plausible scenario for avoiding a breach of 2 degree temperature increase involves a dramatic reduction in use of fossil fuels. Investors need to know how Energen will be impacted by plausible low-carbon scenarios. For example, under which scenarios will any of the company’s reserves or infrastructure become stranded assets? Which of Energen’s assets are most likely to strand first?

3) An assessment of different capital allocation strategies in the face of low-demand Scenarios

It was reported in February 2015 that Energen plans to spend $1 billion on capital expenditures in 2015 focusing on oil and natural gas liquids. As Carbon Tracker explains, “fossil fuel capex is a key leading indicator of future carbon emissions.”

It is not in the best interest of investors for companies to expend capital on low-return projects, particularly those to develop high-cost, high-carbon reserves that may be ultimately unusable. Given the magnitude of the threat that climate change presents to the oil and gas industry, management should assess which capital allocation strategies make the most sense to prepare for low-demand scenarios. Options include:

- Investing in lower carbon fossil fuel reserves, such as natural gas plays, some of which Energen has recently sold.
- investing in renewable energy
- investing in hydrogen production / distribution
- investing in energy storage / battery businesses (for transport, homes/businesses, or utility scale storage)
- increasing dividends or buying back shares
- offering investors something like royalty trusts. Examples of these include Prudhoe Bay Royalty Trust (NYSE: BPT) and the Sandridge Mississippian Trust II (NYSE: SDR). A royalty trust is a bond-like investment vehicle (although more volatile than many bonds due to commodity price swings),

12 http://www.bloomberg.com/politics/articles/2015-02-14/the-white-house-walks-away-from-clean-coal
with tax advantages and a finite life. It passes income from an oil & gas project through to investors. “Its value slowly declines over time until it’s no longer economically feasible to pull oil and gas from a well…”16 In June of 2014 there were approximately 20 oil and gas royalty trusts traded on U.S. markets according to the Motley Fool.

4) How the company will manage risks under these scenarios, such as reducing the carbon intensity of its assets or returning capital to shareholders.

Management acknowledges certain risks from climate change in the 2015 10-K: “We are unable to predict the timing or manifestation of climate change or reliably estimate the impact to Energen. However, climate change could affect our operations as follows:

• sustained increases or decreases to the supply and demand of oil, natural gas liquids and natural gas
• potential disruption to third-party facilities to which Energen delivers....”

But management provides inadequate information on how these risks will be managed. Risk mitigation options include:

• those listed under number 3 above,
• selling or spinning off high carbon and/or high-cost-to-produce reserves,
• buying lower-carbon reserves and those with lower production costs.

5) The Board of Director’s role in overseeing climate risk reduction strategies and related capital allocation

We were not able to find disclosure about the Board’s role in overseeing risks related to climate change. Given the importance of these risks to Energen’s financial performance and viability, investors need to know what the Board is doing to guide management in addressing these critical issues. Average CEO tenure tends to be rather short for U.S. companies (about 4.6 years),17 and the Board needs to ensure that long-term planning and risk mitigation address key long-term issues such as climate change.

Conclusion
Since climate change creates fundamental risks to Energen, and because Energen’s disclosure on climate risk is inadequate, investors are encouraged to vote “for” this important request for enhanced disclosure.