March 19, 2015

Shareowner Rebuttal to Kinder Morgan Statement in Opposition of Shareholder Resolution Requesting Report on Plans to Address Climate Change

Lead filer: First Affirmative Financial Network

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Kinder Morgan shareholders are encouraged to vote FOR the following resolution filed on behalf of Waterglass LLC:

Shareholders request that KMI 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 transporting high production-cost fossil fuels in low-demand scenarios, as well as analysis of options to mitigate related risk and harm to society. The report should be overseen by a committee of independent directors, omit proprietary information, and be prepared at reasonable cost by December, 2015.

The supporting statement specifically requests that the report include discussion of:

- 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.
- How the company will manage risks under these scenarios, such as redeploying capital to lower carbon fuel servicing assets or returning capital to shareholders.
- The Board of Directors’ role in overseeing climate risk reduction strategies and related capital allocation.

A similar resolution filed by First Affirmative last year received 27% of the vote (using simple majority voting of FOR / FOR+AGAINST). This represents over $6 billion in assets. Insider ownership in excess of 30% at the time of the vote indicates that outside owner support was substantially higher than 27%.

Kinder Morgan discloses some climate change risks, but fails to disclose how those risks are evaluated and managed

The company continues to acknowledge the importance of some climate related risks in their 10K, and the risks that they could pose to the company and to shareholder value, and yet the Board’s opposition
statement indicates that “... preparing a report analyzing the consistence of the company capital expenditure strategies with policymakers’ goals to limit climate change is not in the best interest of our stockholders at this time.” Their statement also indicates that the information requested in this proposal “…would not cause us to modify our disciplined approach to allocating capital or our commitment to positioning ourselves for the future, and that preparation of such a report would be unduly burdensome and unnecessary.” The company’s January 28, 2015 corporate overview presentation\(^1\) makes no mention of climate change risk at all when summarizing key business risks.

Shareholders are entitled to know how their company has evaluated the risks they identify in their 10K SEC filing, and how they came to the conclusion that they do not need to analyze company capital expenditures in light of policymakers goals to limit climate change. The company has not disclosed information that will help shareholders to determine if the company is \textit{sufficiently managing financial risks associated with transporting high production cost fuels in a low demand scenario}. The company also fails to provide an analysis of \textit{options to mitigate (climate) related risk and harm to society.}

\textbf{Oil Sands}

A major cornerstone of planned capital expenditure plans is the Trans Mountain Expansion Project\(^2\), designed to increase the nominal capacity of the system from 300,000 bpd to 890,000 bpd for transporting Canadian oil sands to world markets via British Columbia and the Pacific Northwest. As another high carbon fuel it, like coal, is likely to be more vulnerable to regulatory action to limit climate change. Its production cost also makes it particularly vulnerable to scenarios involving reduced demand and/or lower prices; capital expenditure decisions should be considered within the context of this risk. According to the International Energy Agency’s 2015 Medium-Term Oil Market Report “Renewables and natural gas are increasingly price-competitive against oil and coal in emerging markets and will continue to encroach—whether directly or indirectly—on oil consumption. Non-OECD oil demand is only expected to grow by 1.19 mb/d annually in the years to 2020, far less than its historical rate of growth.”\(^3\)

This investment is also of concern due to strong, organized community opposition to this project that is likely to significantly delay the project and increase costs.\(^4\) The recent steep decline in oil prices, if persistent, may threaten the future profitability of oil sands production and the development of higher cost projects, constraining the future need for the substantial increase capacity that this expansion represents.

\textbf{Natural Gas}

Kinder Morgan points out that over half of their earnings are generated from transportation processing and storage of natural gas. While natural gas will certainly be in the energy mix for years to come and the company will no doubt continue to benefit from continued development of this business segment, the assumption that this resource is “clean” when compared to coal is an open question, mainly due to

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\item http://ir.kindermorgan.com/sites/kindermorgan.investorhq.businesswire.com/files/event/additional/KM1-01AnalystConfCorpOverview2015RK-SK-KD.pdf
\item http://www.kindermorgan.com/business/canada/tmx_expansion.aspx
\item http://www.iea.org/Textbase/npsum/MTOMR2015sum.pdf
\item http://www.reuters.com/article/2014/10/21/us-canada-pipeline-kinder-morgn-eng-idUSKCN0IA15N20141021
\end{itemize}
uncertainty about levels of fugitive methane emissions from the well head to delivery.\(^5\) Research is in flux, but should it be determined that the differential between natural gas and coal is less than assumed in terms of climate impact, this bridge fuel will potentially be under pressure, particularly as nonfossil fuel sources become more affordable and as storage issues are addressed.

**Coal**

The statement in opposition indicates that “coal continues to play a vital role in providing jobs and economically disadvantaged communities in the US in providing affordable sources of energy for Americans and people around the world.” The company’s 2015 analyst conference Terminals presentation predicts an increase in export coal volumes of 13\%.\(^6\) However, current and potential climate impacts on the demand for coal going forward presents a substantial risk to the company.

Coal is being challenged on many fronts by a host of cleaner, increasingly affordable sources of energy. Low natural gas prices will continue to challenge the possibility of a rebound in coal prices. Solar power’s rapid progress towards price parity further erodes coal’s place as the most affordable source of energy. An evaluation\(^7\) by Deutsche Bank indicates that “The ratio of coal based wholesale electricity to solar electricity cost was 7:1 four years ago. This ratio is now less than 2:1 and could likely approach 1:1 over the next 12 to 18 months.” Several companies such as SolarCity now offer on-site solar services (primarily leasing) for residential and business customers in numerous states that promise to lower customers’ total electric bills as soon as the system is turned on.

As the implementation of carbon pollution standards\(^8\) for existing power plants progresses and China acts on its pledges to reduce its reliance on coal\(^9\), domestic coal companies that make up KM I’s customer base are seeing their financial positions deteriorate markedly\(^10\). China’s coal imports dropped substantially last year, and the trend has continued this year with a 33% decline in 2015 as of the end of February compared to 2014.\(^11\) January numbers for this year show a 50% decline compared to last year. If company projections are based on the assumption that there will be an export market turnaround, we believe the company may waste capital to support a rapidly declining industry.

Management states that they “seek to mitigate our exposure to market and regulatory risks related to a project by entering into long-term contracts with reputable customers to ensure stable cash flow.” However, it is not clear that these reputable customers will be able to ensure stable cash flow into the future.

**Carbon Capture and Storage**

The company identifies its CO\(_2\) business as benefiting from deployment of CCS technology and the board’s statement in opposition indicates ongoing “discussions with several customers regarding potential carbon capture and storage (CCS) projects…”

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\(^8\) [https://www.whitehouse.gov/climate-change](https://www.whitehouse.gov/climate-change)
\(^11\) [http://www.reuters.com/article/2015/03/09/china-trade-coal-idUSL4N0W71QN20150309](http://www.reuters.com/article/2015/03/09/china-trade-coal-idUSL4N0W71QN20150309)
However, assumptions made by Kinder Morgan regarding the viability and necessary investment commitment for successful wide-spread deployment of CCS technology are not disclosed. This information is important, particularly within the context of the company’s investment in infrastructure supporting coal customers, given the central role CCS is likely to have to pay for coal-burning customers such as electric utilities, the current nascent state of CCS technology development, and the high uncertainty of when or even if the technology will be an environmentally and economically viable option.

**Conclusion**

A central risk to expanding and maintaining KMI’s capital intensive, long-lived, fossil fuel transportation businesses is the possibility of stranded assets and/or reduced profits resulting from a wide variety of efforts to reduce greenhouse gas emissions. These efforts include everything from international treaties to pending U.S. regulations on new and existing power plants, to the rapidly growing market share and falling price of renewable energy. The scientific community, the IEA, and many governments around the world have clearly stated that greenhouse gas emissions must fall by something on the order of 80% by 2050, and that the longer it takes the reduce emissions the higher the price will be to act in the future. Actions to reduce both the present and future impacts of climate change pose a serious threat to the vast majority of Kinder Morgan’s customers—and to Kinder Morgan’s businesses that rely on those customers. Shareholder need to know how the company and its board are evaluating climate change impacts and what steps Kinder Morgan is taking to reduce the risks.

*NOTE: This is not a solicitation of authority to vote your proxy. Please DO NOT send us your proxy card; the proponent is not able to vote your proxies, nor does this communication contemplate such an event. The proponent urges shareholders to vote FOR this resolution following the instructions provided on the management's proxy mailing.*

*Mention of a specific company or security should not be considered an endorsement or a recommendation to buy or sell that security. Past performance is no guarantee of future investment results.*