Hess Corporation

Vote Yes: Carbon Asset Risk Disclosure

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SUMMARY

This proposal asks Hess Corporation to estimate and disclose to shareowners the potential for its oil and gas assets to lose partial or total financial value, i.e., to become stranded, due to climate change driven regulatory and market changes. This carbon asset risk is widely recognized as a growing risk for oil and gas companies and their shareholders. HSBC's analysis of carbon asset risk shows that 40%-60% of oil and gas companies' market capitalization could be lost if oil demand falls.[1] Falling oil demand may result from changing market forces including lower-cost, competing products and/or substitutes; increasing efficiency; and regulatory action such as limits on carbon, taxes on carbon, air quality regulations, and prohibition of dangerous products.

Proponents ask Hess to provide a report assessing its potential exposure to a range of carbon-related demand reduction scenarios; the financial impacts to the Company of such demand reductions; and how the Company might adapt its capital planning to respond to these risks. Hess has not provided such an analysis; instead, it asserts that demand for its products is expected to rise and that government action to address climate change is unlikely. Hess has failed to assess the degree of carbon asset risk associated with various low demand scenarios or explain how the Company can address or reduce such risk.

Current low oil prices demonstrate the serious financial consequences of even small demand imbalances in oil markets. Carbon asset risk is a material threat for Hess and it is imperative that the company fully report to shareholders about this risk. The Proponents urge shareholders to vote "Yes" on this resolution, as it will result in crucial information about how Hess is planning to manage and mitigate its growing carbon asset risk.

RESOLVE CLAUSE

Shareholders request that Hess prepare and publish a report by September 2016, at reasonable cost and omitting proprietary information, disclosing the financial risks to the Company of stranded assets related to climate change and associated demand reductions. The report should evaluate a range of stranded asset scenarios, such as scenarios in which 10, 20, 30, and 40 percent of the Company's oil reserves cannot be monetized.

RATIONALE FOR A YES VOTE

[1] Paul Spedding, "Oil & carbon revisited: Value at risk from unburnable reserves." *HSBC*, January 25, 2013, http://dcdivest.org/wp-content/uploads/2015/10/HSBCOilJan13.pdf

1) **Changing market fundamentals are increasing Hess's carbon asset risk.** Fundamental shifts in energy markets are underway which have the potential to substantially reduce demand for Hess' oil and gas products. These shifts include increasing costs for companies such as Hess to find, produce, and develop oil and gas; fuel efficiency innovations that are reducing worldwide demand for oil and gas; new technologies, such as electric vehicles that will reduce demand for fossil fuels; and competition from renewables.
2) **Regulatory risk is intensifying as global governments take action on climate change.** Climate change regulations and air quality standards are steadily increasing the regulatory risks facing Hess, which may render its fossil fuel reserves stranded.
3) **Hess is particularly exposed to carbon asset risk.** Hess' high cost capital investments have exposed the company's portfolio to increasing risk, especially within a low demand, low oil price market.
4) **Carbon Asset Risk is increasingly recognized by financial & regulatory institutions.** Over the past year, a range of financial institutions and regulatory agencies have begun to recognize and acknowledge the need for companies to address carbon asset risk.
5) **Hess does not provide shareholders with sufficient analysis and disclosure on managing its growing risk.** The need for comprehensive disclosure regarding carbon asset risk has been underscored by global investors, yet Hess' publically available material disclosures fail to address the range of associated risks.
6) **Hess compares poorly to peers on carbon asset risk reporting.** Peer companies have begun to affirmatively address these risks.

1. Changing market fundamentals are increasing Hess's carbon asset risk.

Increasing Costs of Oil Development - Current large scale transitions in energy market fundamentals are increasing carbon asset risk for Hess. One example of changing market fundamentals is the increasing cost for Hess to find, produce, and develop new oil and gas resources. As conventional crude oil sources become increasingly hard to find, companies such as Hess are having to pursue "unconventional" resources that are more costly to extract due to extreme and remote locations and a range of technological challenges.[2] Kepler Cheuvreux has declared this trend a "capex crisis," noting that, since 2005, annual investment in extracting and producing oil ("upstream investment") has increased by 100%, while crude oil supply only increased 3%.[3] Given the high production costs of unconventional sources of oil (including deep water and those that require hydraulic fracturing[4]) proponents are concerned that Hess' resources are becoming increasingly uncompetitive, especially in a carbon-constrained economy with the growing potential of excess supply.

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[2] Jorge Leis, John McCreery and Juan Carlos Gay, "National oil companies reshape the playing field," *Bain and Company* Oct 10, 2012. http://www.bain.com/publications/articles/national-oil-companies-reshape-the-playing-field.aspx; Christopher Click and Douwe Tideman. "Rediscovering the Art of Exploration," *Pricewaterhouse Cooper,* 2013, http://www.strategyand.pwc.com/media/file/Strategyand_Rediscovering-the-Art-of-Exploration.pdf

[3] Mark C. Lewis, "Toil for Oil Spells Danger for Majors." *Kepler Chevreux. ESG Research,* September 15, 2014, 66, http://www.qualenergia.it/sites/default/files/articolo-doc/KC-ESG_Toil%20for%20Oil-1.pdf

[4] Jeff Brady, "Falling Oil Prices Make Fracking Less Lucrative," *NPR,* Nov 4, 2014, http://www.npr.org/2014/11/04/361204786/falling-oil-make-fracking-less-lucrative

Falling Demand for Oil and Gas – Worldwide demand for fossil fuels is being affected by policies and technology trends related to climate change including: increased fuel efficiency, use of lower-carbon fuels, electrification of ground transportation, and rapidly declining costs of renewable energy, among others.[5] In developed nations, demand for oil has fallen since 2005, primarily as a result of more efficient vehicles.[6] A March 2013 Citi report cites a number of trends indicating that "oil demand is approaching a tipping point" and that it may occur sooner than predicted, potentially leveling off by 2020.[7] Chief among such factors is increased fuel efficiency, which has an outsized impact because transportation accounts for 60 percent of global oil use. Other factors include emerging alternatives to gasoline including plug-in-electric vehicles, clean air regulation in China[8] and the falling price of renewables. The IEA and Deutsche Bank forecast global oil demand could peak in the next ten to fifteen years.[9]

At the same time, competition from carbon-free renewable substitutes are threatening Hess' natural gas business. Low carbon solutions have been adopted at a higher rate than most analysts predicted, and costs for low carbon and renewable infrastructure have declined faster than anticipated. Demonstrating these trends, in 2013, the world added more capacity for carbon free electric power than coal, natural gas, and oil combined.[10] There is no going back. Bloomberg's 2030 Market Analysis predicts that, "[b]y 2030, the world's power mix will have transformed from today's system with two-thirds fossil fuels to one with over half from zero-emission energy sources."[11] Deutsche Bank predicts that solar power systems will be at grid parity in up to 80 per cent of global markets by 2017.[12] As prices of renewable energy becomes equal to or less than fossil fuels, an aggressive shift to these forms of energy is likely to occur. Renewable energy offers benefits that oil and gas do not, including low and predictable fuel and power costs; ease of scalability and distribution; reduced regulatory risk; reduced carbon asset risk; increased safety of operations; improved branding and reputation; and environmental and public health benefits.

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[5] "IEA cuts 2015 oil demand outlook despite plunging prices," *Business Insider,* Dec 12, 2014. http://www.businessinsider.com/afp-iea-cuts-2015-oil-demand-outlook-despite-plunging-prices-2014-12

[6] "Yesterday's fuel: The world's thirst for oil could be nearing a peak. That is bad news for producers, excellent for everyone else," *The Economist,* Aug 3, 2013, http://www.economist.com/news/leaders/21582516-worlds-thirst-oil-could-be-nearing-peak-bad-news-producers-excellent

[7]Paul Tullis, "'Peak Oil' Is Back, but This Time It's a Peak in Demand." *Bloomberg,* May 3, 2013, http://www.bloomberg.com/bw/articles/2013-05-01/peak-oil-is-back-but-this-time-its-a-peak-in-demand

[8] "FACT SHEET: U.S.-China Joint Announcement on Climate Change and Clean Energy Cooperation." *The White House*, November 11, 2014, https://www.whitehouse.gov/the-press-office/2014/11/11/fact-sheet-us-china-joint-announcement-climate-change-and-clean-energy-c

[9] Liam Denning, "Oil's Black Swans on the Horizon," *Wall Street Journal,* Feb 16, 2015, http://www.wsj.com/articles/oils-black-swans-on-the-horizon-1424108038

[10] Tom Randall. "Fossil Fuels Just Lost the Race Against Renewables," *Bloomberg*, April 14, 2015, http://www.bloomberg.com/news/articles/2015-04-14/fossil-fuels-just-lost-the-race-against-renewables

[11] "Global Overview: 2030 Market Outlook," *Bloomberg New Energy Finance*, 2014 See also; Claire Cameron. *"Report: Renewables to make up 65% of global energy investments by 2030," Utility Dive*, July 7, 2014, http://www.utilitydive.com/news/report-renewables-to-make-up-65-of-global-energy-investments-by-2030/282771/

[12] Giles Parkinson. "Deutsche Bank Predicts Solar Grid Parity In 80% Of Global Market By 2017," *Clean Technica,* January 14, 2015, http://cleantechnica.com/2015/01/14/deutsche-bank-predicts-solar-grid-parity-80-global-market-2017/ See also; Vishal Shah, "Markets Research: Industry Solar: 2015 Outlook." *Deutsche Bank*. January 8, 2015, 22. http://www.qualenergia.it/sites/default/files/articolo-doc/Solar%202015%20Outlook(1).pdf

2. Regulatory risk is intensifying as global governments take action on climate change.

The International Energy Agency, in its 2012 World Energy Outlook, recognized that no more than one-third of proven reserves of fossil fuels can be consumed prior to 2050 if the world is to have a chance at limiting global warming to 2 degree Celsius, the level beyond which severe consequences occur for economies, market participants, and the environment. Climate change – and the risks it is generating for companies – has become a major concern for investors. This concern has been magnified by the 21st Session of the Conference of the Parties (COP 21) in Paris, where 195 global governments agreed to restrict greenhouse gas emissions to less than 2 degrees Celsius from pre-industrial levels and submitted plans to begin achieving the necessary greenhouse gas emission reductions.

The Paris agreement and other laws and regulations adopted to limit carbon emissions will have the effect of reducing fossil fuel use, increasing producer competition, and raising the cost of doing business. In the 2 degree scenario, 35% of oil reserves are expected to remain unburned and Barclays estimates that the oil industry is posed to lose $22.4 trillion in revenues, underscoring the importance of Hess taking transparent action to diversify its portfolio and mitigate its share of these losses.[13]

3. Hess is particularly exposed to carbon asset risk

Hess is particularly exposed to declining demand for oil and gas resources. In the last decade, Hess' cost for exploration and production have drastically increased, reflecting more investment in high cost resources including deepwater and unconventional reserves. From 2004 to 2014, Hess's capital expenditures grew 247%, while production *decreased* 11%.[14] Even before the mid-2014 oil price collapse, analysts at Morningstar have noted that Hess' 2008-2013 capital efficiency, one of the most important financial metrics for evaluating oil and gas companies, was lagging amongst its peer group."[15] The company itself noted in 2014 that it needs $100 a barrel oil prices to be profitable.[16] Hess has since cut costs and reduced its capital expenditures due to the mid-2014 oil price collapse, but these actions do not appear to be sufficient to stem the crisis. Hess has a portfolio built on high cost projects, posing severe risks of stranded assets if oil prices remain low for one or more years. Hess has not fared well amidst low price oil, reporting net income at a loss of $3 billion in 2015, the first negative net income in 14 years.[17]

The proposal requires Hess to assess the financial risks related to climate change and associated demand reductions. This information is particularly important in a low-price environment. This

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[13] Leslie Hayward, "Barclays: $22 Trillion In Oil Revenue At Risk From COP-21 Negotiations" *The Fuse*, Dec 10, 2015. http://www.energyfuse.org/barclays-22-tillion-in-oil-revenue-at-risk-from-cop-21-negotiations/; Roz Pidcock, "Meeting two degree climate target means 80 per cent of world's coal is "unburnable", study says," *Carbon Brief*, January 1, 2015. http://www.carbonbrief.org/meeting-two-degree-climate-target-means-80-per-cent-of-worlds-coal-is-unburnable-study-says.

[14] "Hess Corp: Financials." *Morningstar*, Accessed March 29, 2015. http://financials.morningstar.com/income-statement/is.html?t=HES&region=USA&culture=en_US; Hess. *Annual Report 2014 & 2004*. Accessed March 29, 2015. http://phx.corporate-ir.net/phoenix.zhtml?c=101801&p=irol-reportsannual

[15] "Hess Corp: Investment Thesis" *Morningstar*, August 2014, http://analysisreport.morningstar.com/stock/research?t=HES&region=usa&culture=en-US

[16] ". . . our initiatives are positioned to make 5% to 8% compound average annual production growth through 2017, off of our 2012 pro forma base, and to generate free cash flow post 2014 based upon $100 Brent.", Hess Corp. *Q1 2014 Earnings Call Corrected Transcript: Apr 30, 2014, http://www.thestreet.com/story/12695327/1/hess-corp-hes-q1-2014-earnings-call.html*

[17] "Hess Corp: Financials." *Morningstar*, Accessed March 29, 2015. http://financials.morningstar.com/income-statement/is.html?t=HES&region=USA&culture=en_US

information will help investors evaluate the strength of Hess's value proposition and the safety of their investment in Hess.

4. Carbon Asset Risk is Increasingly Recognized by Financial & Regulatory Institutions

Investors require clear, transparent, and comparable information about carbon asset risk to make informed assessments about their use of capital. This need has been underscored by a range of financial institutions and regulatory agencies.

For example, as noted by Mark Carney, the President of the Bank of England, the carbon budget associated with meeting the 2 degree goal will "render the vast majority of reserves 'stranded' – oil, gas, and coal that will be literally unburnable without expensive carbon capture technology, which itself alters fossil fuel economics."[18] Similarly, the Financial Accounting Standards Board (FASB), recently developed a Task Force on Climate-Related Financial Disclosures (TCFD), under the chairmanship of Michael Bloomberg, to create a set of voluntary disclosure mechanisms providing critical information to investors, lenders, insurers, and other stakeholders. France recently created mandatory climate risk disclosure requirements for institutional investors regarding a 2-degree carbon pathway.[19] Australia also announced that its Senate will conduct an inquiry into how Australian companies report their investments in fossil fuels and their exposure to the carbon bubble.[20] Further, Barclays recommends that ". . . fossil-fuel companies should at the very least be stress-testing their business models against a significant tightening of global climate policy over the next two decades."[21]

5. Hess does not provide shareholders with sufficient analysis and disclosure on managing its carbon asset risk

Hess fails to provide shareholders with an analysis regarding carbon asset risk. None of the Company's public disclosures quantify the financial losses it is exposed to, nor assess how low oil demand will harm the company. The company also fails to address the risks associated with worldwide achievement of the 2-degree scenario. Instead, in its Sustainability Report, which has a limited section titled "Carbon Asset Risk," Hess argues that it believes an extended period of low oil demand resulting in stranded assets is unlikely, and that global regulatory action to bring about a 2 degree Celsius limit is unlikely, without meaningfully justifying these positions with data.[22] The company cannot credibly claim that this report has provided the requested information to shareowners. The information requested by shareowners -- an analysis of a range of stranded asset scenarios -- is nowhere found in that report.

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[18] "Breaking the tragedy of the horizon - climate change and financial stability, speech by Mark Carney," Bank of England, September 29, 2015. http://www.bankofengland.co.uk/publications/Pages/speeches/2015/844.aspx#1

[19] Sophie Baker, "France to require institutional investors to disclose carbon exposure," *Pensions & Investments*, May 22, 2015. http://www.pionline.com/article/20150522/ONLINE/150529958/france-to-require-institutional-investors-to-disclose-carbon-exposure

[20] "Greens Senate Inquiry into the Exposure of Australian' Investment to the Carbon Bubble," *The Greens*, February, 2016. http://greens.org.au/news/qld/greens-senate-inquiry-exposure-australians%E2%80%99-investments-carbon-bubble

[21] Ambrose Evans-Pritchard. "COP-21 Climate Deal In Paris Spells End Of The Fossil Era," The Telegraph, Nov 29, 2015, http://www.telegraph.co.uk/finance/economics/12021394/COP-21-climate-deal-in-Paris-spells-end-of-the-fossil-era.html

[22] Hess. *2014 Corporate Sustainability Report.* 36-37. Accessed March 29, 2015 http://www.hess.com/docs/default-source/sustainability/2014-sustainability-report.pdf?sfvrsn=2

Hess also attempts to dismiss carbon asset risk by stating that the IEA predicts fossil fuels will comprise 60% of world energy use even under the 2 degree scenario. However, Hess fails to mention that under this scenario the IEA predicts that oil demand will peak in 2020 and gas demand will plateau in 2030, which would have dramatic effects on global supply and price that would certainly effect high-price producers like Hess.[23]

Hess also highlights its Carbon Disclosure Project (CDP) reporting as responsive to the proposal. However, Hess avoids responding to the CDP's carbon asset risk-related questions. In its 2015 CDP reporting, Hess fails to respond to the following relevant questions:

- In your economic assessment of hydrocarbon reserves and resources, do you conduct scenario analysis consistent with global developments to avoid dangerous climate change by reducing GHG emissions?
- Please describe your analysis and the implications for your capital expenditure plans;
- Please explain why you have not conducted any scenario analysis based on a low-carbon scenario.

Simply participating in the broader CDP reporting program, while failing to respond to carbon asset risk–related questions, is not responsive to this Proposal.

Hess also argues that Proponents overestimate the risk of stranded asset due to confusion between proven versus unproven reserves. The reality is quite the contrary. The wide literature on the topic of stranded assets almost exclusively cites to "proven reserves", which are those reserves that have been discovered, are economically producible and have a 90% probability of being monetized. As cited by the IEA in its 2-degree scenario, "[n]o more than one third of ***proven*** reserves of fossil fuels can be consumed prior to 2050 if the world is to achieve the 2 degree Celsius goal." If total reserves are assessed, including unproven "probable" and "possible" reserves, 82% of total oil reserves will remain unburned in a 2-degree scenario, instead of 35%.[24] Including a broader definition of reserves only magnifies the risks of stranded assets.

The company also argues that shareholders are unreasonably concerned with reserves expected to be monetized in the long term, arguing that most of the Company's valuation is based on proved reserves that will be produced in the near term. This argument misunderstands shareholder's concerns. Shareowners seek to understand the risk that Hess' investment of assets *today* will suffer from write-downs, devaluations, or liabilities in the future. Essentially, shareowners are asking: what is the potential that Hess's current assets and investments will become stranded assets in the future? Moreover, Hess ignores the possibility for nearer term demand impacts from market and climate change factors. Proponents believe there are a variety of scenarios in which demand for proved reserves can fall quite rapidly, such as when disruptive change – including new technology or stringent carbon regulations -- occur. As has been demonstrated by the recent dramatic oil price fall, there is a risk to current value from near-term over supply.

6. Hess Compares Poorly to Peers on Carbon Asset Risk Reporting.

[23] "2014 World Energy Outlook" International Energy Agency, 97, 137.
[24] "2014 World Energy Outlook" International Energy Agency, 111.

Hess is quickly being left behind by peers who are taking action. In 2014, ExxonMobil publicly agreed to issue a report on carbon asset risk. Although this report only met shareholder requests on the margins, it was the first company to publicly undertake the task. In 2015, BP, Statoil, and Shell management endorsed shareholder proposals that included stress testing related to climate risk.[25] In 2015, BHP Billiton released a report assessing climate change impact to its portfolio, including an assessment of a 2-degree scenario.[26] ConocoPhillips also states that it stress tests its portfolio against the 2 degree scenario.

CONCLUSION

This is the third year that Hess has received proposals from its shareholders to disclose carbon asset risk. Momentum is building, and votes for Hess to take action are increasing, from 8.4% in 2014 to 26.3% in 2015. This issue is clearly important to shareholders, and has been amplified by the oil price crash starting in 2014. It is critical that shareholders have enough information to evaluate Hess' forward looking prospects, which promise to be dramatically impacted by climate change and associated market changes. Shareholders urge strong support of this proposal, which will bring increased transparency on one of the largest business risks facing the company.

[25] "Carbon Asset Risk: from Rhetoric to Action" *Ceres,* 27, http://2degrees-investing.org/IMG/pdf/car_action_final1015.pdf?iframe=true&width=800&height=500;
[26] "Climate Change Portfolio Analysis," *BHP Billiton*, 2015. http://www.bhpbilliton.com/~/media/bhp/documents/investors/reports/2015/bhpbillitonclimatechangeporfolioanalysis2015.pdf?la=en