



2019

OIL AND GAS EXPLORATION & PRODUCTION (E&P) INCENTIVE COMPENSATION REPORT

ANALYSIS OF COMPENSATION ARRANGEMENTS
AMONG THE LARGEST U.S. E&P COMPANIES



ALVAREZ & MARSAL

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2019 OIL AND GAS EXPLORATION & PRODUCTION (E&P) INCENTIVE COMPENSATION REPORT

ANALYSIS OF COMPENSATION ARRANGEMENTS AMONG THE LARGEST U.S. E&P COMPANIES

INTRODUCTION

Incentive compensation is an integral part of the total compensation package for executives at most large, publicly-traded companies. To understand annual and long-term incentive (LTI) compensation pay practices in the energy sector, specifically for exploration and production (E&P) companies, the Compensation and Benefits Practice of Alvarez & Marsal (A&M) examined the 2018 proxy statements of the largest E&P companies in the U.S. This report also reviews the total compensation packages for Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) in the E&P sector, the benefits to which those executives are entitled upon a change in control (CIC), and the CEO pay ratios in the E&P sector.

Where possible, this analysis only includes companies with revenue derived primarily from E&P activities (i.e., not primarily midstream, refining, etc.)¹ and excludes companies that did not disclose sufficient data on their compensation programs, such as companies that recently went through an initial public offering (IPO) and did not disclose the structure of their go-forward compensation, as well as companies that have recently undergone a restructuring or bankruptcy.

The data represents the most up-to-date compensation structure disclosed by these companies. Where warranted, current data is compared to data collected in our prior studies.

COMPANY STATISTICS

The 76 companies analyzed in this report are diverse in terms of size. For comparison purposes, we grouped the companies in quartiles based on market capitalization as shown below.

QUARTILE	MARKET CAPITALIZATION RANGE*	MEDIAN
Top Quartile	\$6.2B – \$65.6B	\$15.1B
Second Quartile	\$2.3B – \$6.0B	\$3.3B
Third Quartile	\$343M – \$2.1B	\$643M
Bottom Quartile	\$25M – \$343M	\$131M

*Market capitalization as of January 2, 2018.

¹ For an analysis of the top oilfield services companies, please see our 2019 Oilfield Services (OFS) Incentive Compensation Report.

KEY TAKEAWAYS

TOTAL COMPENSATION

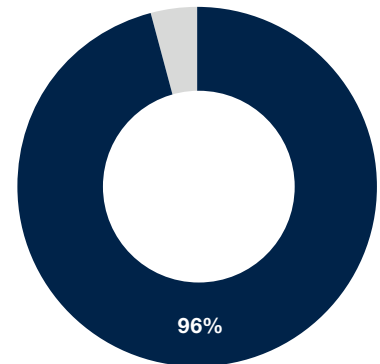
- Compared to last year, the average total compensation for CEOs and CFOs increased, primarily due to the value of LTI granted.
- While it remains unclear what constitutes a “good” CEO pay ratio, the data indicates that a ratio of 25x to 100x is most prevalent.



ANNUAL AND LONG-TERM INCENTIVE COMPENSATION

- On average, incentive compensation – including annual and long-term incentives – comprises approximately 85 percent of a CEO’s and 80 percent of a CFO’s total compensation package.
- Only 5 percent of companies in the top two quartiles utilize annual incentive plans (AIPs) where payout is determined on a purely discretionary basis, while approximately 25 percent of companies in the bottom two quartiles utilize totally discretionary performance metrics.
- Production / production growth remains the most prevalent performance metric in AIPs and is utilized by 87 percent of companies. Production as a performance metric has slightly increased over the past year.
- The prevalence of LTI awards varies by company size, but time-vesting restricted stock / restricted stock units are most common, utilized by 96 percent of companies.
- 76 percent of companies grant LTI awards where vesting or payout is determined by one or more performance metrics. Relative total shareholder return is the most common performance metric, used by 84 percent of companies. The most common performance period is three years, used by 92 percent of all companies.

TIME-VESTING RESTRICTED STOCK AND RSU PREVALENCE



84%

Companies using relative TSR as a performance metric.

CHANGE IN CONTROL BENEFITS

- The most common cash severance multiple is three times compensation or greater (48 percent) for CEOs and between two and three times compensation for CFOs (66 percent).
- The most valuable benefit received in connection with a CIC is accelerated vesting and payout of LTI, making up 59 percent and 56 percent of the total value for CEOs and CFOs, respectively.
- Single trigger equity vesting (no termination required) is most prevalent (53 percent), although double trigger equity vesting (termination required) is also common (45 percent).
- Only 11 percent of CEOs and CFOs are entitled to receive excise tax “gross-up” payments — meaning the company pays the executive the amount of any excise tax imposed, thereby making the executive “whole” on an after-tax basis. Approximately 54 percent of companies do not address excise tax protection at all.
- Since excise tax gross-ups are less common, other excise tax mitigation concepts should be explored. A reasonable compensation analysis is a commonly utilized mitigation concept, whereby a portion of the total parachute payments is attributed to reasonable compensation for services rendered either before or after the CIC.

BANKRUPTCY COMPENSATION

- More than 150 E&P companies in the U.S. have filed for bankruptcy since 2015. In 2018, the oil and gas industry experienced more bankruptcies than any other industry, representing approximately 15 percent of all bankruptcy filings.
- Incentive programs, when properly structured, can help bridge the compensation gap between the onset of financial hardship and a healthy go-forward restructuring.
- Just as incentive plans may be effective tools prior to and during the bankruptcy process, equity granted by companies upon emergence from bankruptcy is utilized to motivate and retain employees after the company has emerged from bankruptcy protection.

INITIAL PUBLIC OFFERINGS (IPOs) — ITEMS TO CONSIDER

- The E&P sector saw approximately five IPOs over the 2017–2018 period.
- There are many executive compensation considerations to address during an IPO, including:
 - **Plan design** — Selecting a peer group, compensation and design benchmarking, and governance policies;
 - **Legal disclosures** — Form S-1 compensation disclosure and Form 8-K compensation related disclosure;
 - **Financial impact** — Tax and accounting impact of equity grants and cost of plan changes;
 - **Plan rules and limits** — Amendments to existing plans and expected overhang and dilution rates; and
 - **Special arrangements** — Founders’ awards, director compensation and CIC arrangements.

“

The vast majority of the total compensation of CEOs and CFOs is comprised of incentive compensation.”

TOTAL COMPENSATION

We captured the summary compensation table data disclosed in the 2018 proxy statement for each company. The most prevalent forms of compensation include base salary, AIP and LTI awards.

The following tables show the average values for each element of compensation broken out by quartile for CEOs and CFOs:

CHIEF EXECUTIVE OFFICER ANNUAL COMPENSATION					
MARKET CAPITALIZATION RANK	BASE SALARY	ANNUAL INCENTIVES	LONG-TERM INCENTIVES	OTHER COMPENSATION*	TOTAL
Top Quartile Average	\$1,102,001	\$2,125,873	\$8,261,562	\$713,936	\$12,203,371
Second Quartile Average	\$854,185	\$1,356,029	\$5,748,181	\$349,308	\$8,307,702
Third Quartile Average	\$567,657	\$781,396	\$4,335,307	\$115,724	\$5,800,084
Bottom Quartile Average	\$493,056	\$455,488	\$1,497,138	\$161,650	\$2,607,332
Average	\$754,225	\$1,189,352	\$5,006,726	\$335,154	\$7,285,457
Year-Over-Year Increase / (Decrease)**					5%

CHIEF FINANCIAL OFFICER ANNUAL COMPENSATION					
MARKET CAPITALIZATION RANK	BASE SALARY	ANNUAL INCENTIVES	LONG-TERM INCENTIVES	OTHER COMPENSATION*	TOTAL
Top Quartile Average	\$583,736	\$900,354	\$2,986,253	\$387,168	\$4,857,511
Second Quartile Average	\$484,538	\$523,083	\$2,147,263	\$145,613	\$3,300,496
Third Quartile Average	\$383,110	\$469,093	\$1,791,937	\$130,551	\$2,774,691
Bottom Quartile Average	\$324,615	\$309,524	\$797,724	\$43,805	\$1,475,669
Average	\$447,226	\$557,027	\$1,977,359	\$179,002	\$3,160,614
Year-Over-Year Increase / (Decrease)**					12%

*Other Compensation includes: change in pension value, above market earnings, and "all other compensation" as disclosed in each company's proxy statement.

**Only includes executives in both 2018 and 2019 studies.

Total pay increases significantly moving from the bottom to the top quartiles, while base salary increases to a far lesser degree. LTI is the most significant driver of pay differences from the bottom quartile to the top quartile.

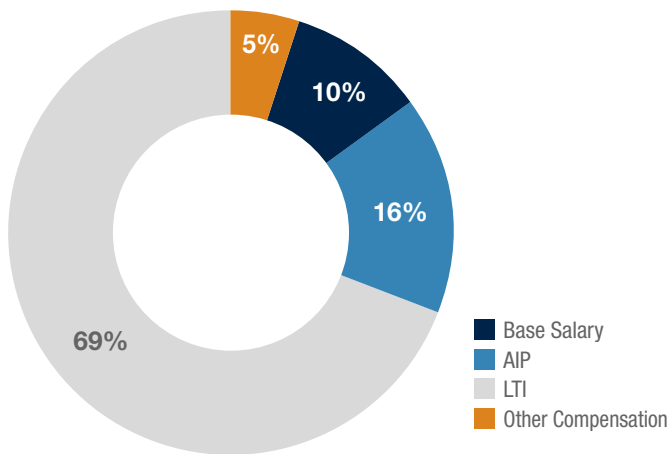
Compared to compensation disclosed in 2017, both CEOs and CFOs experienced an overall increase in total compensation. The increase in total compensation was primarily driven by an increase in the grant date value of LTI awarded.

TOTAL COMPENSATION

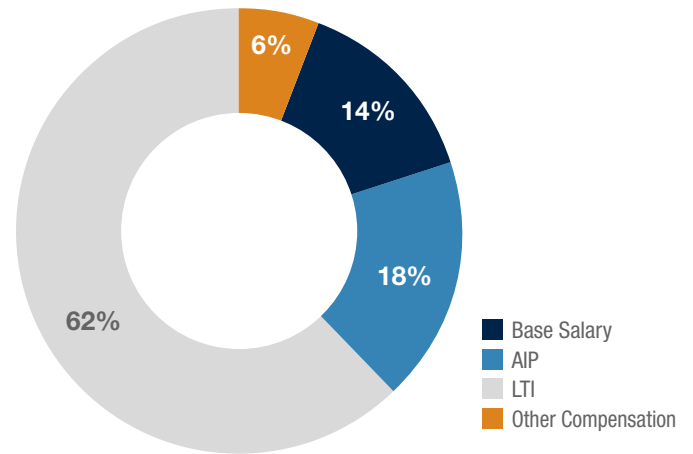
On average, incentive compensation — including annual and long-term incentives — comprises 85 percent of CEO and 80 percent of CFO total compensation. The charts below show the proportion of total direct compensation delivered in base salary, AIP, LTI awards and other compensation for CEOs and CFOs. These findings are consistent with our prior studies.

Because incentive compensation is such an integral part of the total compensation package for executives at most companies, we examine annual and long-term incentive programs in greater detail later in this report.

CEO TOTAL COMPENSATION



CFO TOTAL COMPENSATION



83%

Average portion of an executive's total compensation package derived from incentive compensation

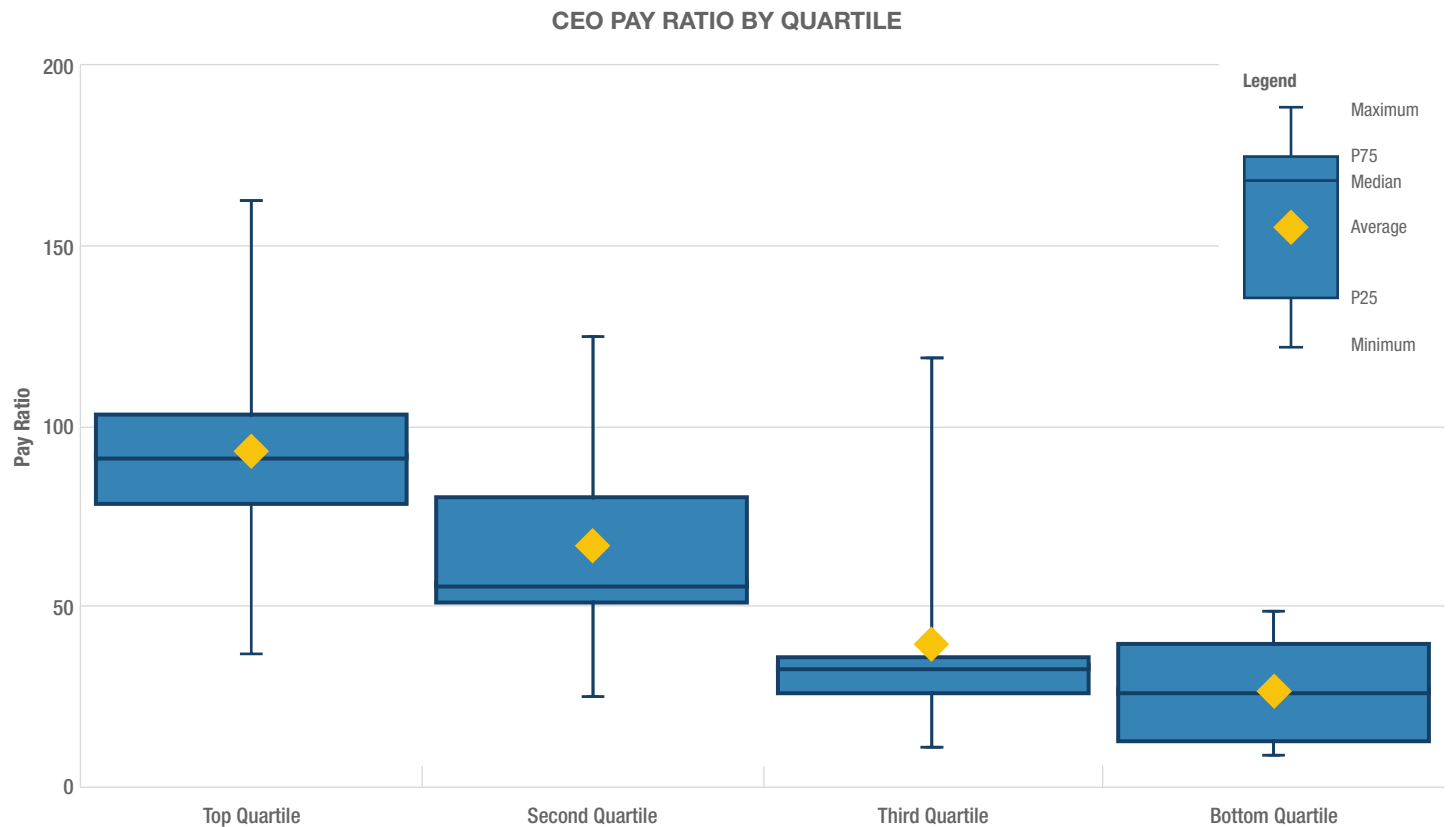
CEO PAY RATIO

The SEC’s “CEO Pay Ratio” rule recently took effect for companies with full fiscal years beginning on or after January 1, 2017. Accordingly, proxy statements filed in 2018 mark the first time that the CEO pay ratio was required to be disclosed for most companies. The CEO pay ratio is calculated as the total compensation of the CEO divided by the total compensation of the “median” employee of a company.

There are various methodologies permitted to calculate the compensation of the CEO and the median employee. Therefore, companies must evaluate which methodologies make the most sense and consider the administrative burden, corporate structure, etc., in their decision-making.

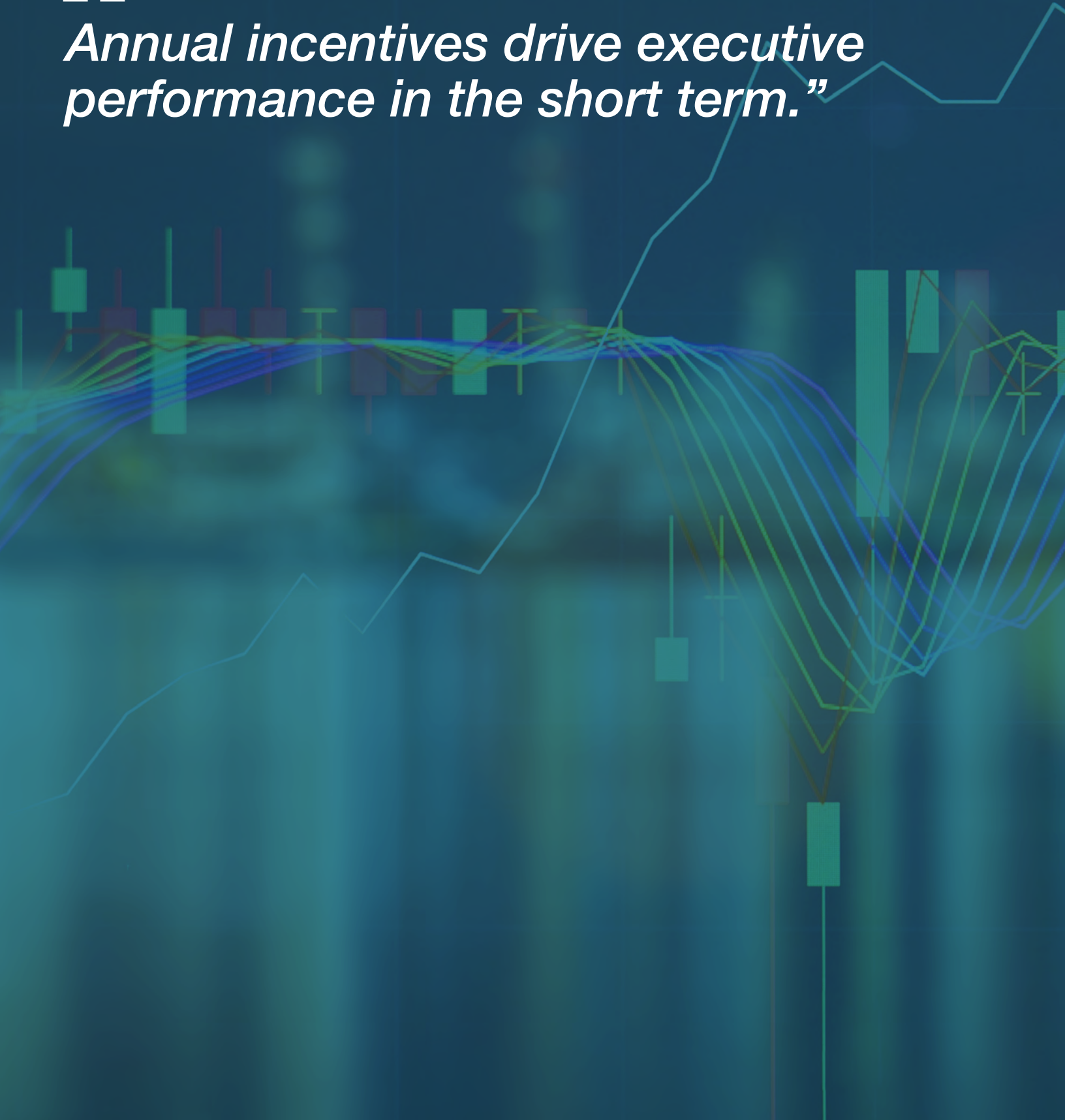
The table below shows summary CEO pay ratio statistics within each quartile.

While it remains unclear what constitutes a “good” CEO pay ratio, the data indicates that a ratio of 25x–100x is most prevalent.



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Annual incentives drive executive performance in the short term.”



ANNUAL INCENTIVE PLANS

As is the case with most industries, companies in the E&P sector generally provide an opportunity for executives to participate in AIPs, also commonly called bonus programs. AIPs utilize performance metrics that are generally measured over a one-year period.

DISCRETIONARY VS. FORMULAIC

For this analysis, we grouped AIPs into the following three categories based on how the AIP payout is determined:

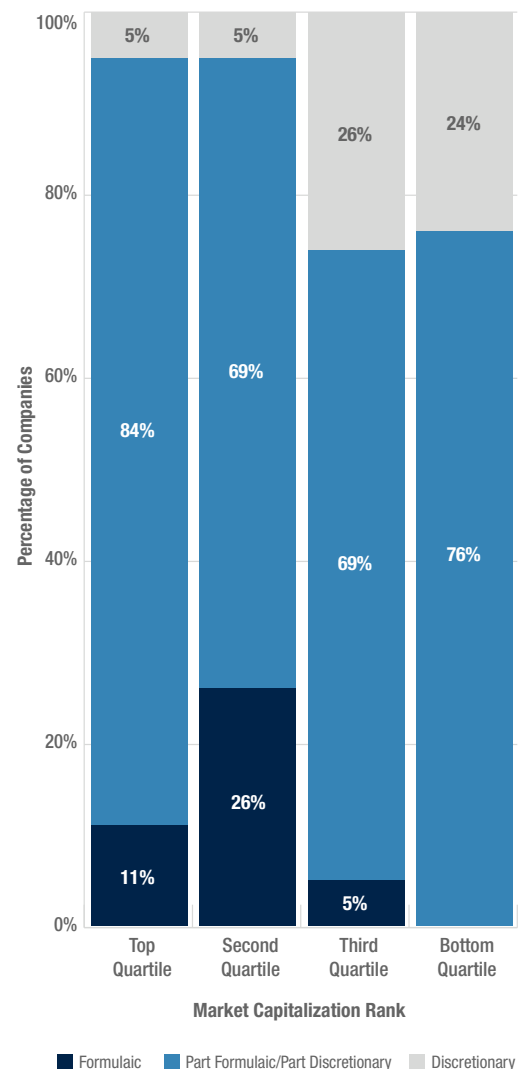
- **Formulaic** — The plan utilizes predetermined performance criteria with established targets that will determine payout, and the compensation committee does not have discretion to adjust payouts (other than negative discretion).
- **Discretionary** — The plan may or may not utilize specific, preestablished performance criteria, but the compensation committee maintains absolute discretion to adjust payout levels upward or downward.
- **Part Formulaic / Part Discretionary** — The plan utilizes certain metrics in which payout is determined formulaically and others in which payout is determined at the discretion of the compensation committee.

As shown in the chart to the right, the majority of E&P companies maintain some form of discretion with respect to their AIP. However, larger companies tend to use less purely discretionary plans.

Section 162(m) of the Internal Revenue Code previously required that compensation in excess of \$1 million be performance-based in order to be tax deductible. As this performance-based exception has been eliminated, we will be watching to see if companies shift toward more discretionary plan designs, since under the new law, all compensation in excess of \$1 million is non-deductible regardless of how it is characterized.

Although there is no longer a tax incentive for utilizing performance-based plans, companies should continue to consider input from shareholder advisory firms when structuring AIPs. We will continue to monitor how shareholder advisory firms react to AIP design changes triggered by the Section 162(m) revisions.

DISCRETIONARY VS. FORMULAIC BY MARKET CAPITALIZATION



ANNUAL INCENTIVE PLANS

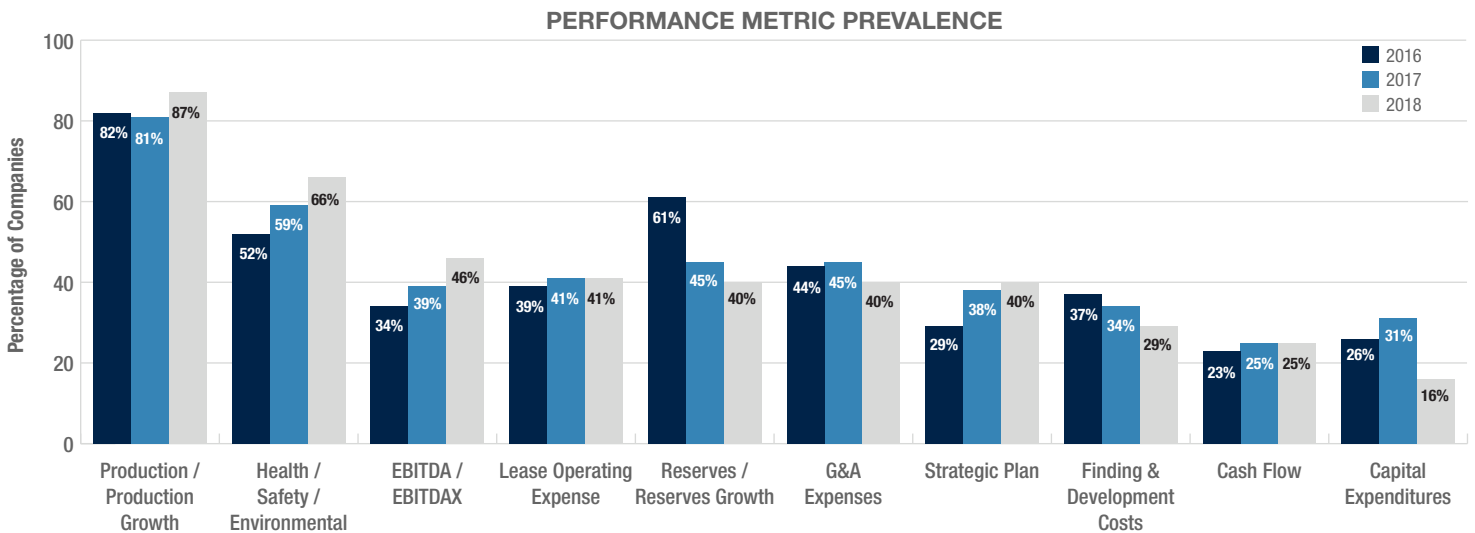
Companies utilize formulaic compensation programs to provide clarity to executives and shareholders on how compensation will be determined. Some companies maintain discretion over the payout of AIPs to allow them to adjust the payouts for events that are unforeseen and/or out of the executives' control. Some companies exercise discretion by implementing an AIP with a formulaic trigger (e.g., achieving a certain level of EBITDA or cash flow, etc.) to fund a bonus pool, which can then be allocated at the discretion of the board.

PERFORMANCE METRICS

Generally, as market capitalization increases, companies have a stronger preference to utilize stated performance metrics. It is important to note that a plan may not necessarily be classified as "formulaic" merely because it utilizes performance metrics. Based on the terms of the plan, it may ultimately be classified as "discretionary" if the board retains full discretion to adjust payouts (higher or lower) under the plan.

As the energy sector suffered from depressed commodity prices, many companies adjusted their performance metrics in response. Companies shifted away from solely using growth metrics such as production to focus their efforts on existing, successful wells, scaling back on unprofitable production, promoting health and safety, and lowering overall costs. Additionally, companies that utilize production and/or reserve metrics also shifted toward balancing their AIP with financial metrics, to ensure that executives focus on profitable growth rather than growth at any cost.

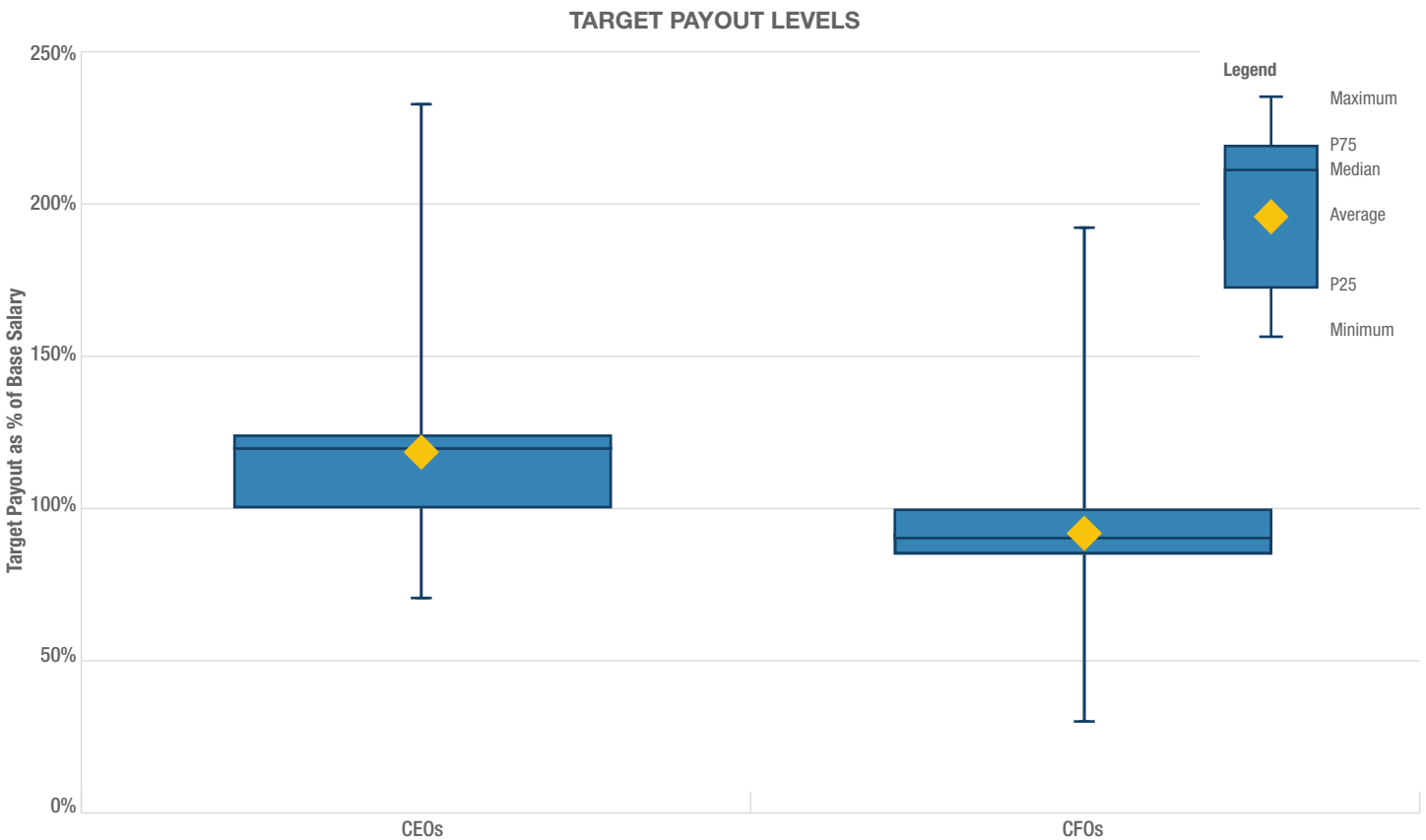
The chart below displays the most prevalent metrics used in AIPs. Production, including production growth, is again the most prevalent metric used by E&P companies (87 percent), followed by health / safety / environmental metrics, used by 66 percent of companies. This year, reserves / reserve growth continued to drop to its lowest level in three years (now used by only 40 percent of companies).



Health / safety / environmental and EBITDA / EBITDAX have steadily increased in prevalence over the past three years, while reserves / reserves growth has decreased year-over-year. We also noticed a sharp decrease in the use of capital expenditures as a performance metric, compared to our prior year's report.

PAYOUT MULTIPLES

The following chart shows the target level of AIPs as a percentage of base salary for CEOs and CFOs. The median target payout is approximately 120 percent of base salary for CEOs and 90 percent of base salary for CFOs. When disclosed, threshold payout generally ranges from 25 percent to 50 percent of the target, and maximum payout is generally 200 percent of the target.





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*Long-term incentives
comprise the largest
portion of executive
compensation packages.”*

LONG-TERM INCENTIVES

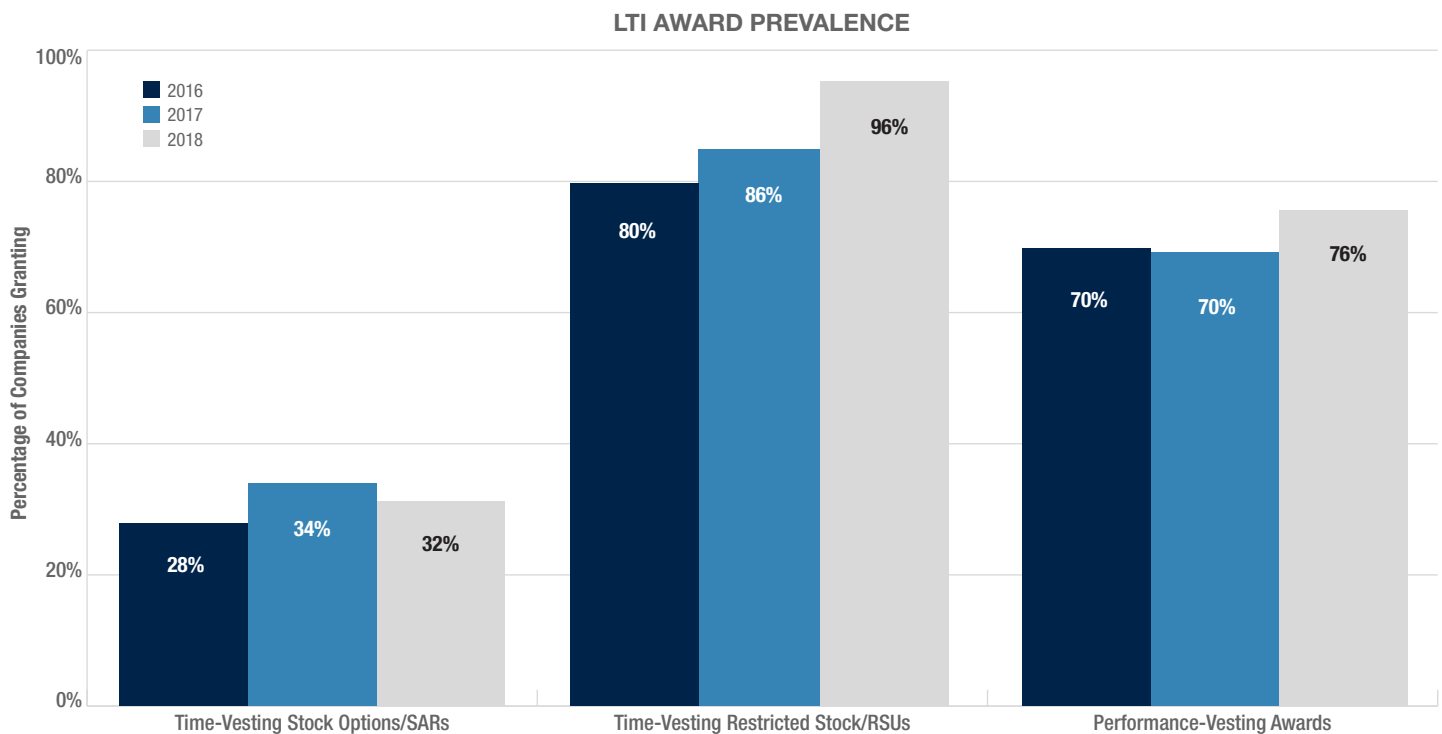
OVERVIEW

Companies grant LTI to motivate and retain executives and to align the interests of executives and shareholders. Nearly all E&P companies analyzed grant some form of LTI award to executives. LTI awards generally consist of stock options, stock appreciation rights (SARs), time-vesting restricted stock or restricted stock units (RSUs), and performance-vesting awards (i.e., awards that vest upon satisfaction of some performance criteria rather than solely based on the passage of time). For purposes of this analysis, we grouped awards into three categories: (1) time-vesting stock options and SARs, (2) time-vesting restricted stock and RSUs and (3) performance-vesting awards.

AWARD TYPE PREVALENCE

The chart below shows the prevalence of stock options / SARs, time-vesting restricted stock / RSUs, and performance-vesting awards for all companies.

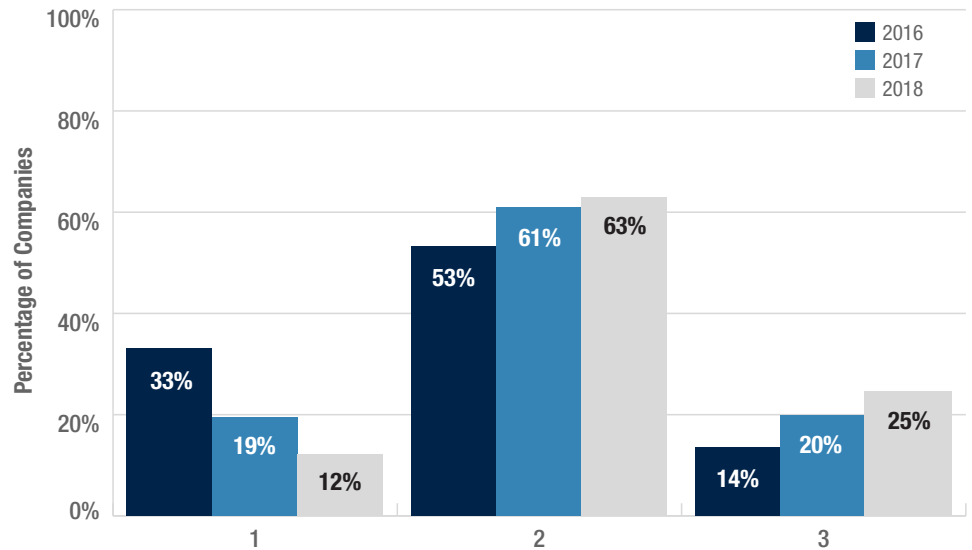
- Stock options / SARs are the least prevalent LTI vehicle utilized, as they provide little to no value to an executive in a down or flat market, which also reduces (or eliminates) any retentive value from this type of award.
- Time-vesting restricted stock / RSUs continue to be the most utilized award type followed by performance-vesting awards.
- Most companies that utilize performance-vesting awards or stock options also grant time-vesting restricted stock or RSUs to balance out the retentive goal of their LTI program.



LONG-TERM INCENTIVES

The chart to the right shows the number of LTI vehicles granted at each company. Consistent with previous years, the majority of companies (88 percent) grant two or more types of LTI vehicles. The use of only one LTI vehicle has steadily declined over the past three years.

NUMBER OF LTI VEHICLES GRANTED

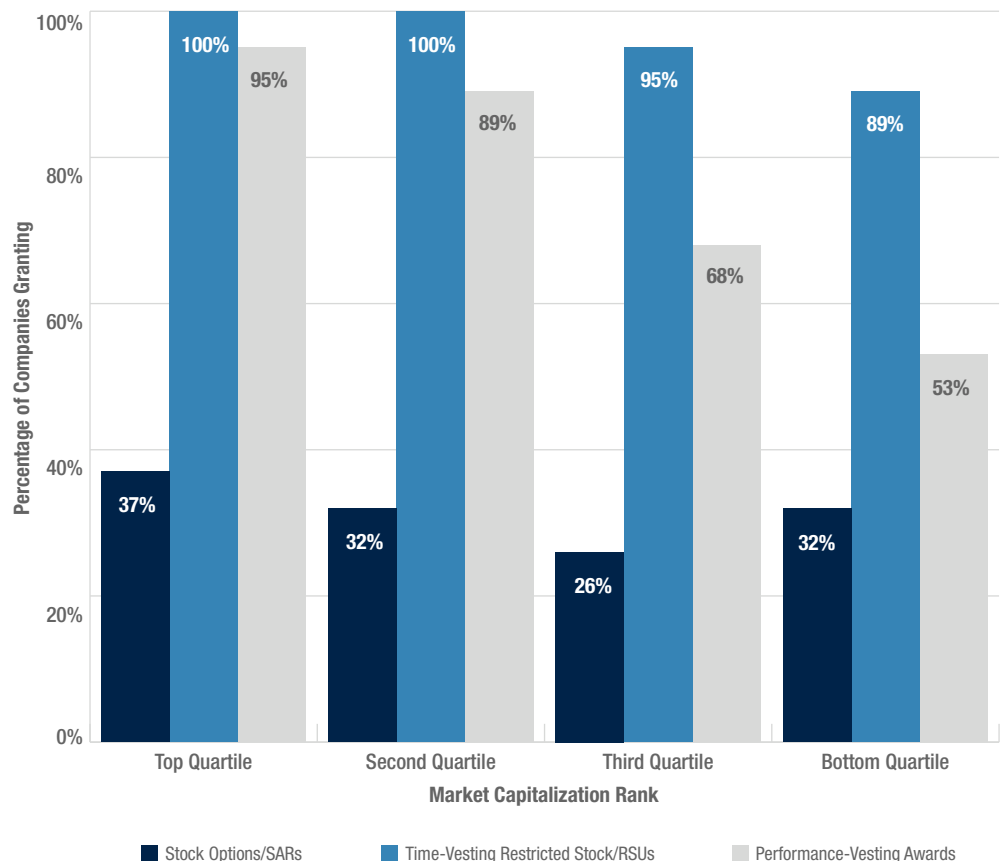


AWARD PREVALENCE BY MARKET CAPITALIZATION

As shown in the chart to the right, A&M also analyzed whether a company's size (in terms of market capitalization) impacts the prevalence of awards that are provided.

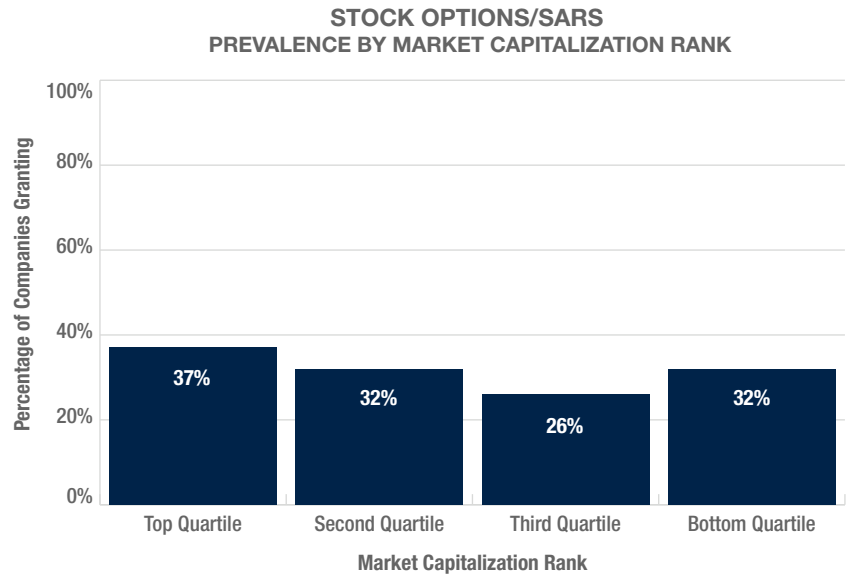
- Stock options / SARs are less widely used than other equity vehicles across all quartiles.
- Time-vesting restricted stock / RSUs are utilized fairly uniformly across all company sizes.
- Performance-vesting awards are significantly more prevalent at larger companies (95 percent of companies in the top quartile utilize such awards versus only 53 percent of companies in the bottom quartile).

AWARD TYPE BY MARKET CAPITALIZATION RANK



STOCK OPTIONS / STOCK APPRECIATION RIGHTS

The chart to the right shows the percentage of companies that grant stock options / SARs by market capitalization.



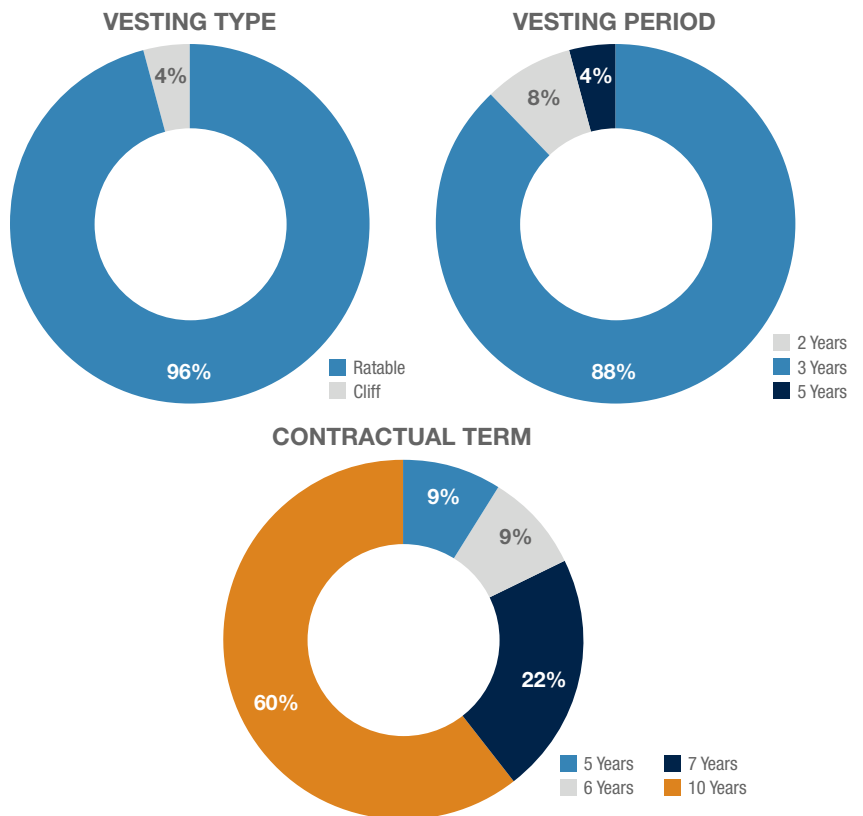
AWARD PROVISIONS

Stock option awards predominantly consisted of nonqualified stock options rather than tax-favored incentive stock options.

The graphs to the right show the prevalence of the following items:

- Vesting Type;
 - Ratable vesting — a portion of the award vests each year during the vesting period.
 - Cliff vesting — the entire award vests at the end of the vesting period.
- Vesting Period; and
- Contractual Term.

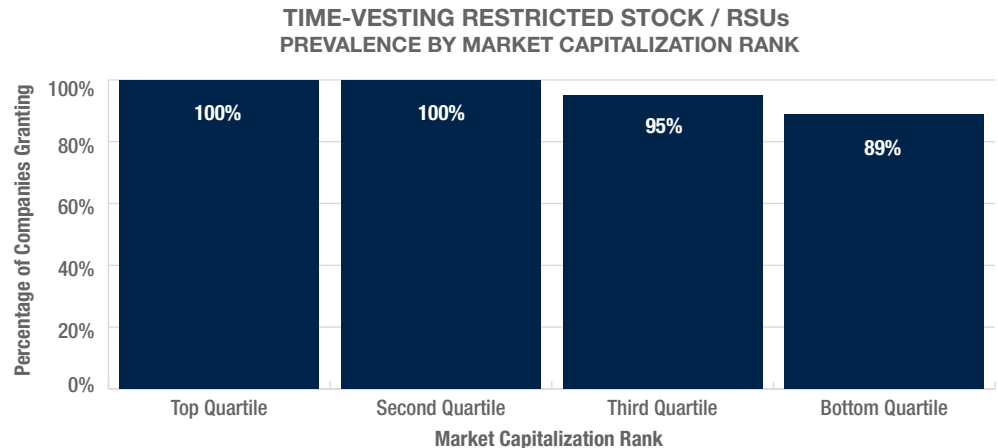
All of these observations are consistent with our 2018 report.



LONG-TERM INCENTIVES

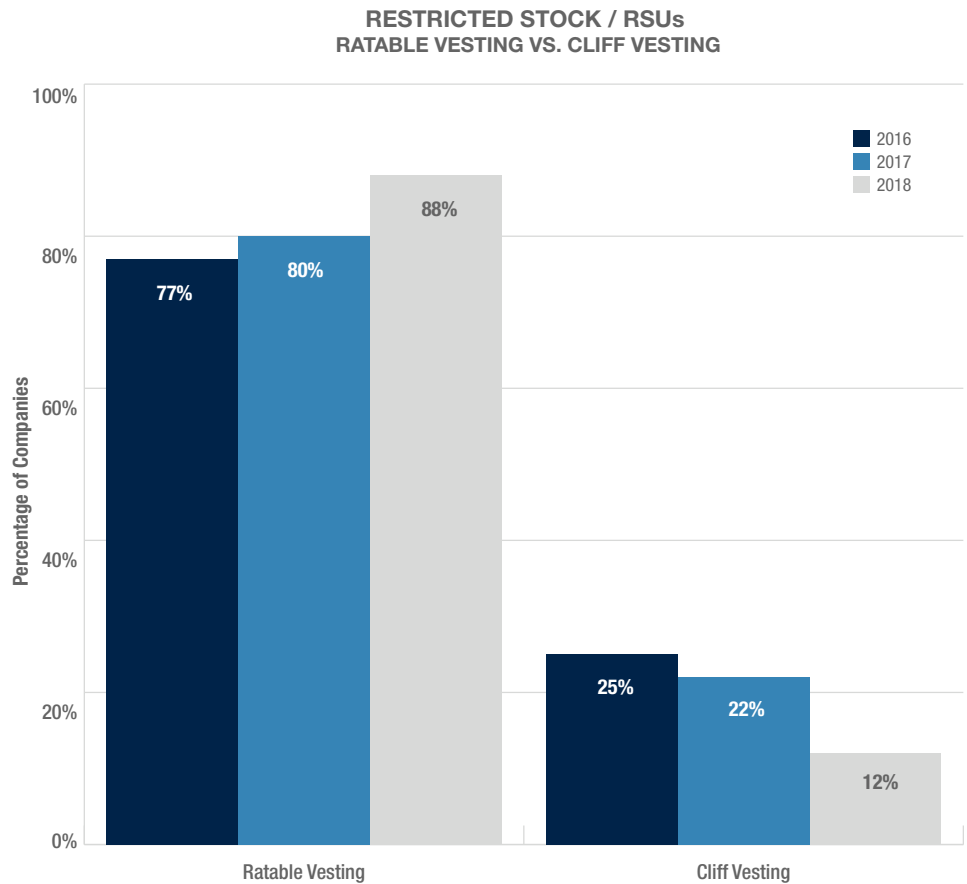
TIME-VESTING RESTRICTED STOCK / RESTRICTED STOCK UNITS

The chart to the right shows the percentage of companies that grant time-vesting restricted stock / RSUs by market capitalization. The prevalence is very high, exceeding 85 percent for all sizes of companies.



AWARD PROVISIONS

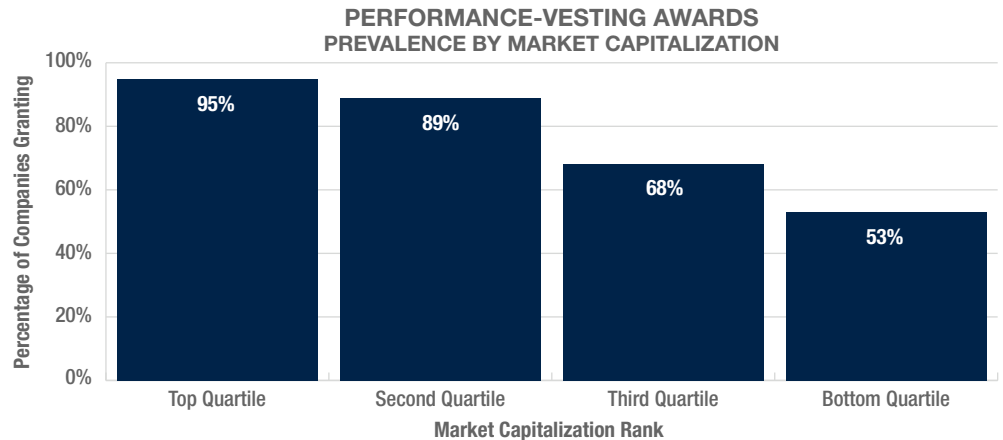
- Of companies that grant time-vesting restricted stock / RSUs, it is slightly more common for companies to grant restricted stock than RSUs.
- A three-year vesting period is the most common vesting period (utilized by 75 percent of companies), while a four-year vesting period is the second most common (utilized by 11 percent of companies).
- As shown in the chart to the right, most companies continue to utilize awards that vest ratably rather than cliff vest.



Note: Yearly totals may not equal 100 percent since some companies have both ratable and cliff vesting awards.

PERFORMANCE-VESTING AWARDS

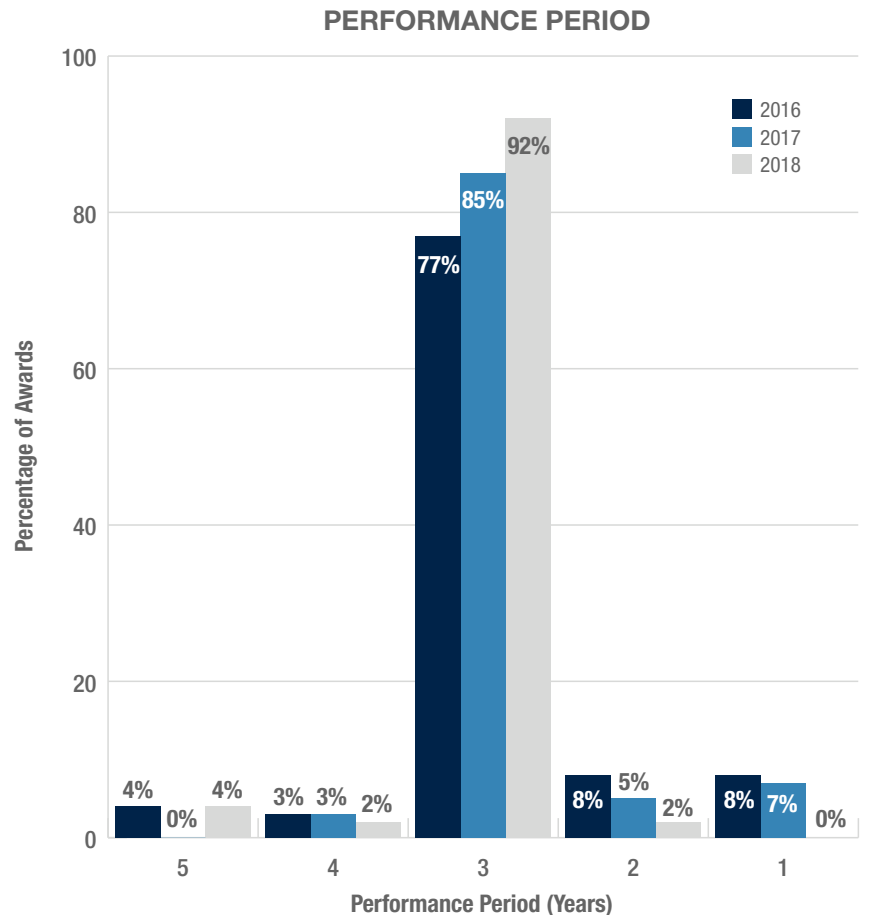
The chart to the right shows the percentage of companies that grant performance-vesting awards by market capitalization. Performance-vesting awards become significantly more prevalent as company size increases.



PERFORMANCE PERIOD

The performance period is the duration over which the applicable performance metrics are measured. As shown in the chart to the right, the most prevalent performance period for performance-vesting awards, by a wide margin, continues to be three years (92 percent of awards).

Many companies use three-year performance periods to promote long-term sustainable growth, rather than shorter periods that tend to focus only on short-term performance.



LONG-TERM INCENTIVES

PERFORMANCE METRICS

The most prevalent metric is total shareholder return (TSR) relative to a peer group, which is used for 84 percent of performance-vesting awards. Roughly 41 percent of performance-based awards use TSR on an absolute basis either as a standalone metric or to limit payout if absolute TSR is negative (i.e., if absolute TSR is negative, then the maximum payout is capped at a lower amount). The absolute TSR cap is designed to address circumstances similar to those that the energy sector is currently experiencing — a company may have the highest TSR relative to its peer group, but negative absolute TSR due to declines in the commodity markets.

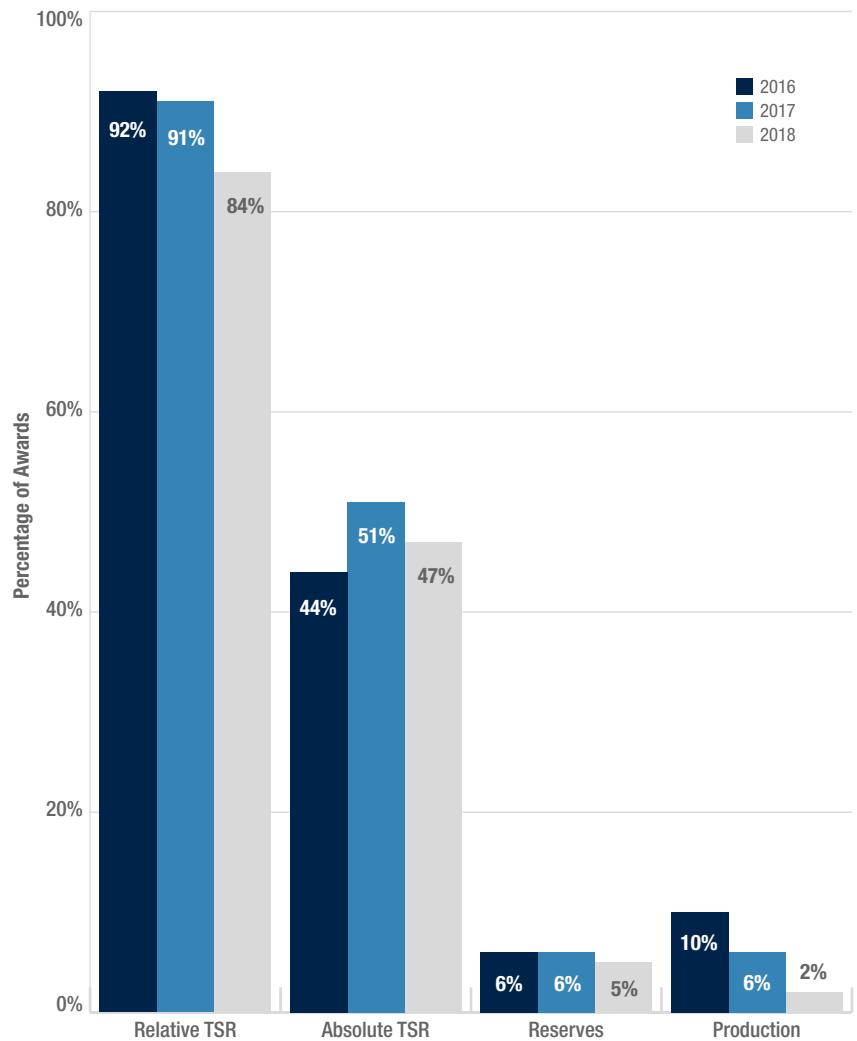
53 percent of performance-based awards utilize more than one performance metric. For purposes of this analysis, an absolute TSR modifier was considered a separate metric.

The chart to the right shows the prevalence of the most common metrics used for performance-vesting awards

We have noticed a steady decline in the use of production as a performance metric over the past three years. The prevalence of other performance metrics remained fairly consistent year-over-year.

Although the pay-for-performance link for relative TSR awards is fairly straightforward, the valuation of these awards can be quite complex. The vesting of relative TSR awards is dependent on future market conditions for both the company and its peer group. Therefore, the valuation of these awards requires sophisticated modeling techniques, such as a Monte Carlo valuation.

COMMON PERFORMANCE METRICS



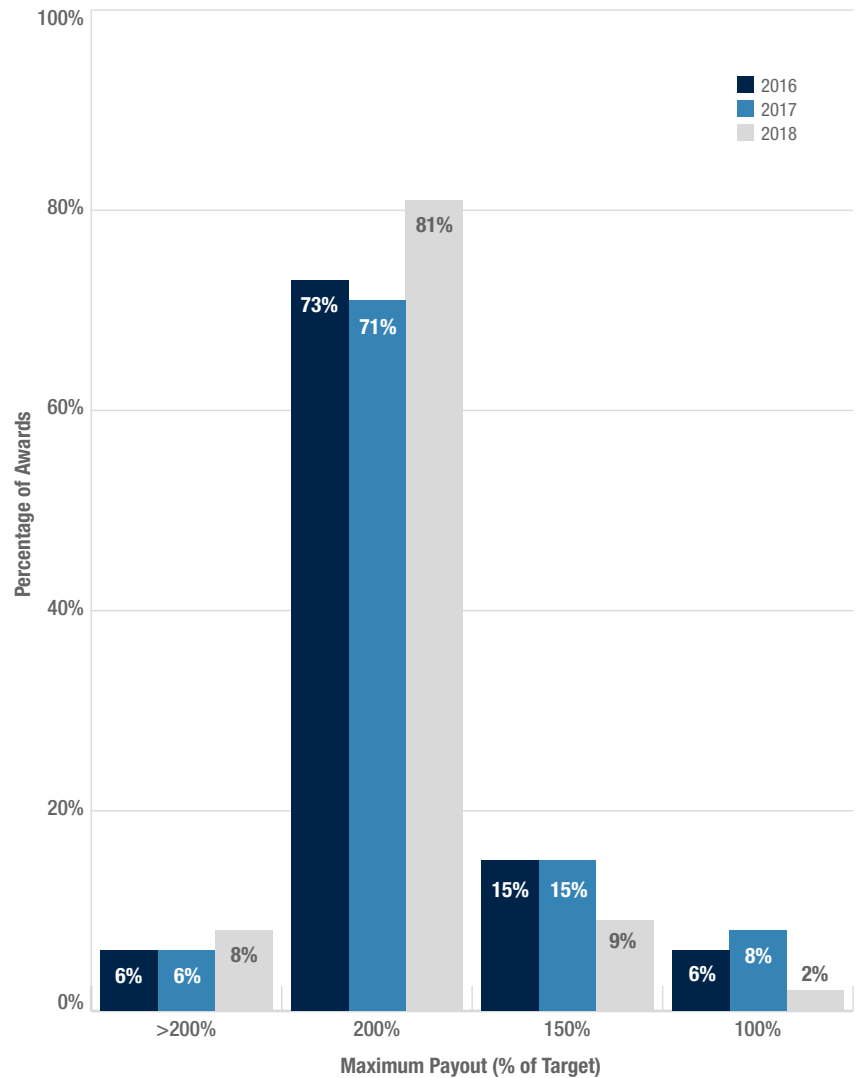
MAXIMUM PAYOUT

Performance-vesting awards most often provide for a range of payouts based upon performance with respect to the underlying performance metrics. For example, if the threshold level of performance is achieved, 50 percent of the award will be earned; if the target level of performance is achieved, 100 percent of the award will be earned; and if the maximum level of performance is achieved, 200 percent of the award will be earned.

As shown in the chart to the right, most performance-vesting awards granted by E&P companies provide for a maximum payout equal to 200 percent of the target. This observation is consistent with our 2018 report.

Although 200 percent of target payout is the most prevalent maximum payout percentage, each company should examine its own circumstances and determine what payout scale is most effective for the company's unique circumstances. For example, an established company that does not expect a sharp growth curve may consider granting more awards with a lower maximum payout. This will allow the company to grant additional awards with lower compensation expense, while retaining value for the executives.

MAXIMUM PAYOUT (AS PERCENTAGE OF TARGET)



Relative TSR is the most prevalent performance metric.”



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In uncertain market conditions, change in control arrangements help to keep executive talent retained and focused.”

CHANGE IN CONTROL BENEFITS

OVERVIEW

In recent years, external forces have continued to advocate for more transparency and change with respect to executive compensation. The one area of executive compensation that is often besieged with criticism is CIC provisions. As a result of the SEC's Say-on-Pay advisory vote, shareholders now have a louder voice with which to communicate their satisfaction or displeasure with the company's compensation programs.

Typical CIC benefits include severance payments, accelerated vesting of LTI, enhanced retirement benefits and excise tax protection. The charts below show the average value of CIC benefits for CEOs and CFOs, as well as the percentage decrease from the preceding year.

CHANGE IN CONTROL BENEFIT VALUES FOR CEOs							
MARKET CAPITALIZATION RANK	SEVERANCE	ANNUAL BONUS	ACCELERATED LTI	RETIREMENT BENEFITS	EXCISE TAX GROSS-UP	OTHER*	AVERAGE TOTAL BENEFIT
Top Quartile	\$6,692,216	\$1,403,051	\$19,650,419	\$1,882,539	\$889,292	\$144,267	\$30,661,786
Second Quartile	\$5,865,476	\$1,185,835	\$9,167,266	\$831,273	\$716,994	\$130,005	\$16,954,910
Third Quartile	\$2,046,650	\$662,624	\$4,819,883	—	—	\$26,532	\$6,904,342
Bottom Quartile	\$1,377,349	\$1,183,834	\$1,838,923	—	\$134,535	\$30,185	\$4,398,653
2018 Average	\$3,996,487	\$1,112,866	\$9,075,103	\$694,947	\$447,556	\$82,868	\$14,729,923
Year-Over-Year Increase / (Decrease)**							-13%

CHANGE IN CONTROL BENEFIT VALUES FOR CFOs							
MARKET CAPITALIZATION RANK	SEVERANCE	ANNUAL BONUS	ACCELERATED LTI	RETIREMENT BENEFITS	EXCISE TAX GROSS-UP	OTHER*	AVERAGE TOTAL BENEFIT
Top Quartile	\$2,549,778	\$542,502	\$6,313,049	\$998,828	\$288,500	\$111,998	\$10,804,655
Second Quartile	\$1,987,720	\$410,113	\$3,361,367	\$26,209	\$92,457	\$116,672	\$5,679,035
Third Quartile	\$1,038,466	\$324,873	\$2,295,669	—	—	\$47,538	\$3,511,464
Bottom Quartile	\$775,966	\$553,256	\$868,405	—	\$70,179	\$29,775	\$2,209,826
2018 Average	\$1,612,619	\$456,188	\$3,319,282	\$273,937	\$118,123	\$77,638	\$5,641,553
Year-Over-Year Increase / (Decrease)**							-10%

*Other includes health & welfare benefit continuation, outplacement services, and other benefits received in connection with a change in control.

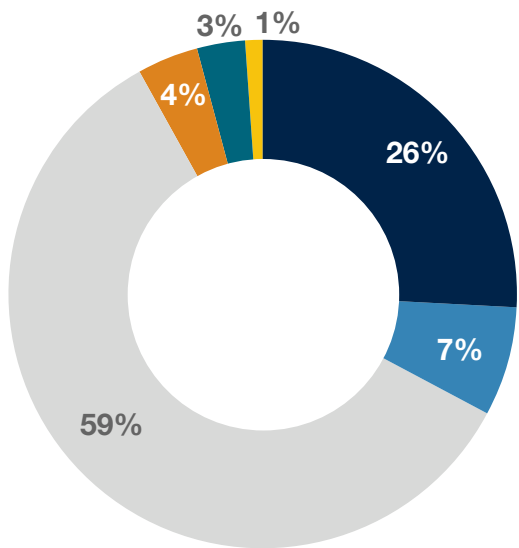
**Only includes executives in both 2018 and 2019 studies.

As with compensation in general, the amount of CIC benefits payable to CEOs and CFOs varies dramatically based on company size. Although the table above shows a slight decrease in year-over-year CIC benefits payable to CEOs and CFOs, this is the result of (i) a depressed stock price at the end of 2018 compared to 2017 and (ii) outlier instances where mega-grants of equity captured in the 2018 study had subsequently vested in the ordinary course prior to the 2019 study. Accordingly, disregarding the stock price depression and "mega-grant outliers," CIC benefits payable to CEOs and CFOs remained relatively flat year-over-year.

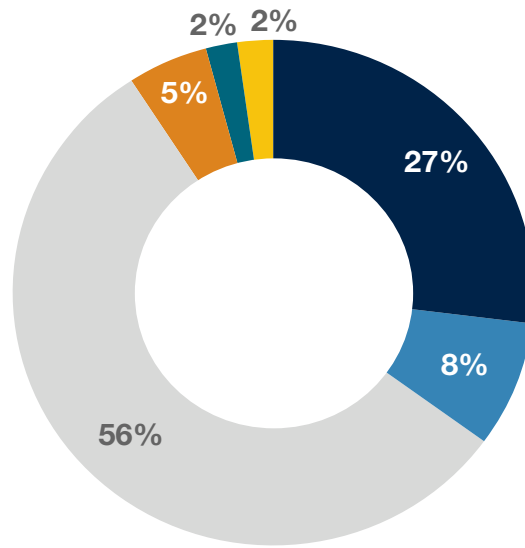
CHANGE IN CONTROL BENEFITS

The charts below illustrate the average value for each type of CIC benefit for CEOs and CFOs. Severance and accelerated LTI comprise approximately 85 percent and 83 percent of the total value of CIC benefits for CEOs and CFOs, respectively.

CIC BENEFIT VALUES FOR CEOs



CIC BENEFIT VALUES FOR CFOs



- Severance
- Annual Bonus
- Accelerated LTI
- Retirement Benefits
- Excise Tax Gross-up
- Other

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Severance and accelerated LTI comprise the most substantial portion of change in control benefits provided to executives.”

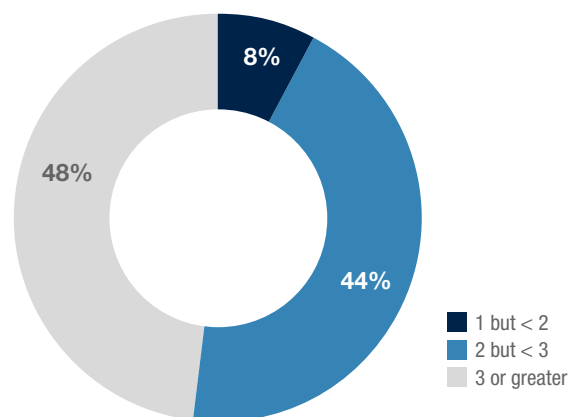
CASH SEVERANCE PAYMENTS

- Most agreements or policies with CIC protection provide for a cash severance payment.
- Severance is usually expressed as a multiple of compensation that generally varies at different levels within an organization.
- The definition of compensation used to determine the severance amount varies between companies. The two most prevalent definitions of compensation for this purpose are base salary plus annual bonus and base salary only.

CEOs

- 83 percent of CEOs are entitled to receive a cash severance payment upon termination in connection with a CIC.
- The pie chart to the right identifies the most common severance multiples provided to CEOs upon a termination in connection with a CIC.

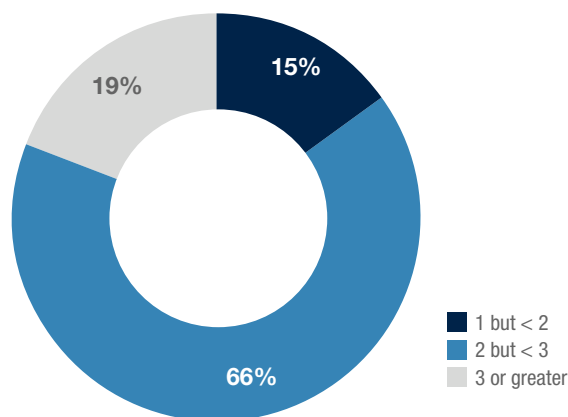
SEVERANCE MULTIPLE PREVALENCE – CEO



CFOs

- 81 percent of CFOs are entitled to receive a cash severance payment upon termination in connection with a CIC.
- The pie chart to the right identifies the most common severance multiples provided to CFOs upon a termination in connection with a CIC.

SEVERANCE MULTIPLE PREVALENCE – CFO



CHANGE IN CONTROL BENEFITS

ACCELERATED VESTING OF LTI AWARDS

There are generally three types of CIC payout triggers for equity awards:

Trigger	Description
Single	Only a change in control must occur for vesting to be accelerated.
Double*	A change in control plus termination without cause or resignation for “good reason” must occur within a certain period after the change in control.
Discretionary	The Board has the discretion to trigger the vesting of an award after a change in control.

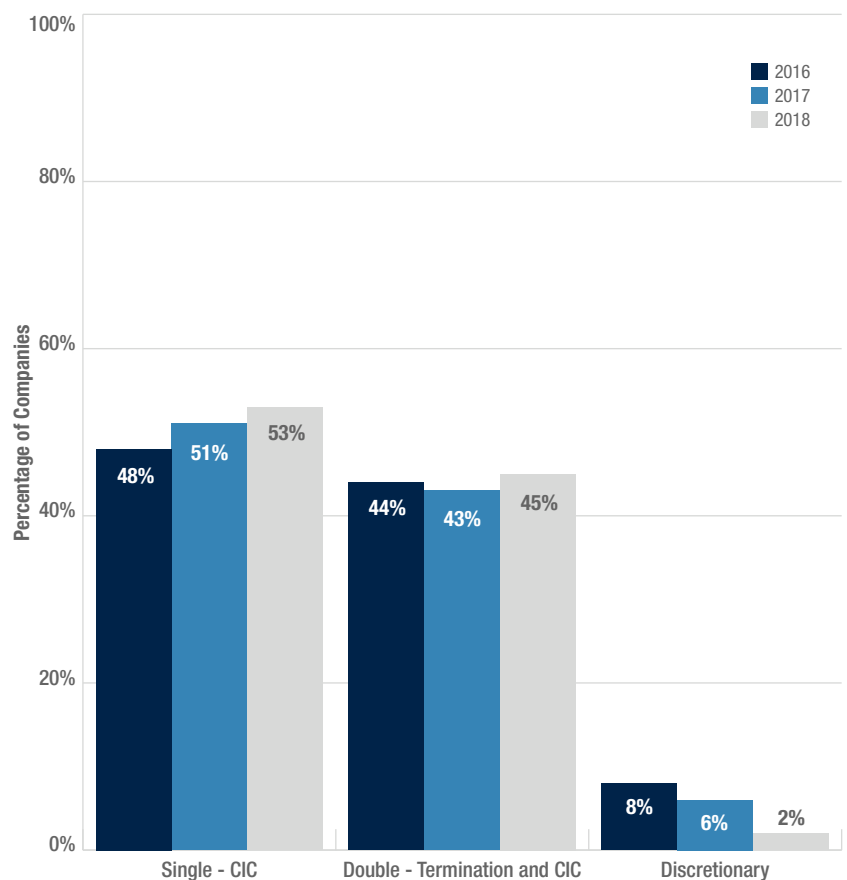
* Sometimes companies allow for single trigger vesting if the acquiring company does not assume the equity awards, but require double trigger vesting if the awards are assumed by the acquirer. For the purposes of this study, this treatment was included in the double trigger vesting category.

The most common trigger found in equity plans is single trigger (53 percent). However, 45 percent of companies have at least some equity awards outstanding with a double trigger. Only 2 percent of companies provide the board with discretion to accelerate the vesting of some outstanding equity awards.

The chart to the right shows the prevalence of CIC triggers for outstanding equity awards of CEOs and CFOs.

Due to pressure from shareholders and shareholder advisory services, there has been a trend in recent years for companies to move to double trigger vesting provisions. Although we saw a slight increase in single trigger vesting this year, we expect an overall trend toward double trigger vesting provisions will prevail into the foreseeable future.

EQUITY VESTING TRIGGERS



EXCISE TAX PROTECTION

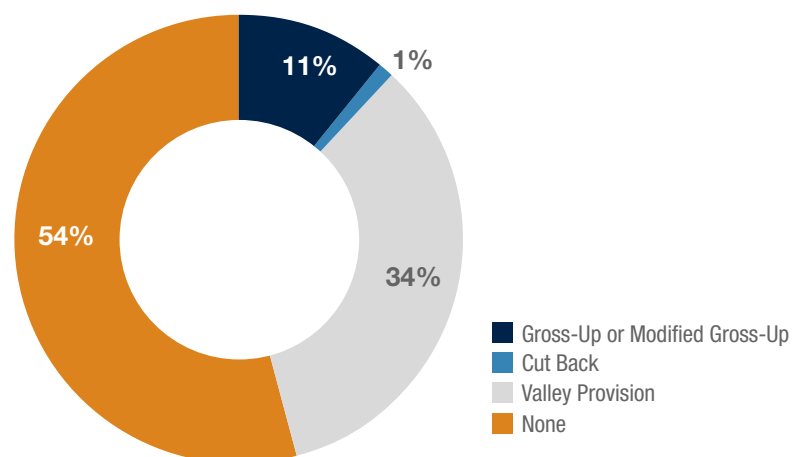
The “Golden Parachute” rules impose a 20 percent excise tax on an executive if the executive receives a parachute payment greater than the “safe harbor” limit. Companies may address this excise tax issue in one of the following ways:

Provision	Description
Gross-Up	The company pays the executive the full amount of any excise tax imposed. The gross-up payment thereby makes the executive “whole” on an after-tax basis. The gross-up includes applicable federal, state and local taxes resulting from the payment of the excise tax.
Modified Gross-Up	The company will gross-up the executive if the payments exceed the “safe harbor” limit by a certain amount (e.g., \$50,000) or percentage (e.g., 10%). Otherwise, payments are cut back to the “safe harbor” limit to avoid any excise tax.
Cut Back	The company cuts back parachute payments to the “safe harbor” limit to avoid any excise tax.
Valley Provision	The company cuts back parachute payments to the “safe harbor” limit, if it is more financially advantageous to the executive. Otherwise, the company does not adjust the payments and the executive is responsible for paying the excise tax.
None	Some companies do not address the excise tax; therefore, executives are solely responsible for the excise tax.

11 percent of companies provide either a gross-up or modified gross-up to their CEOs and CFOs (down from 15 percent in 2017). A majority of companies (54 percent) do not provide any form of excise tax protection.

The prevalence of these provisions for CEOs and CFOs is illustrated in the chart to the right.

**EXCISE TAX PROTECTION
AMONG CEOs AND CFOs**



CHANGE IN CONTROL BENEFITS

EXCISE TAX MITIGATION CONCEPTS

Since excise tax gross-ups are becoming less common, other excise tax mitigation approaches should be explored. A reasonable compensation analysis is a commonly utilized mitigation concept, whereby a portion of the total parachute payments is attributed to reasonable compensation for services rendered either before or after the CIC. Alternatively, rather than focusing on the value of parachute payments, base amount planning can help increase an executive's safe harbor limit.

- Pre-CIC Reasonable Compensation — Section 280G provides that an excess parachute payment is reduced by the portion of the payment established by clear and convincing evidence to be reasonable compensation for personal services rendered before the date of the CIC.
- Post-CIC Reasonable Compensation — Section 280G provides that the amount treated as a parachute payment does not include the portion of a payment established by clear and convincing evidence to be reasonable compensation for personal services to be rendered on or after the date of the CIC.
 - A common payment that can be treated as post-CIC reasonable compensation is a payment for a covenant not to compete that is intended to keep an individual from competing with his employer after the CIC. An expert valuation of the covenant not to compete should be performed.
- Base Amount Planning — If it is known far enough in advance that a CIC will occur in a future calendar year, there may be an opportunity for base amount planning. It would be advantageous to include as many payments as possible to a disqualified individual in the calendar year prior to the CIC. This will increase the base amount and Section 280G threshold of the disqualified individual, which can lower or completely eliminate any excess parachute payments. Section 409A should be considered when accelerating any payments.



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An effective use of mitigation concepts may reduce or eliminate the risk of excise taxes and lost tax deductions.”

BANKRUPTCY COMPENSATION

If a balance sheet restructuring or bankruptcy filing is on the horizon, there are certain immediate changes to the compensation plans that should be considered to motivate and retain key talent. The company's equity will generally become worthless in the event of a bankruptcy filing. Thus, a common defensive approach is to collapse the AIP and LTI programs into a single cash-based incentive program that pays out over shorter measurement periods based on hitting established performance metrics.

For "non-insiders," companies often utilize Key Employee Retention Plans (KERPs) — which pay out retention bonuses based on the employee's remaining employed through a certain date. The Bankruptcy Code greatly restricts a debtor's ability to include "insiders" in a KERP. Therefore, many companies implement Key Employee Incentive Plans (KEIPs) for insiders — performance-based plans that are essentially designed to fall outside of the Bankruptcy Code's restrictions on the use of KERPs.

PERFORMANCE METRICS

The AIP/KEIP performance metrics must be carefully chosen and structured to be sufficiently challenging. The metrics should also coincide with the company's business plan or objectives. The amount of potential payout is also a consideration, as it should be sufficiently motivating but should be reasonable when compared to other similar payments made in bankruptcy.

Below are the suggested steps for installing incentive, retention and severance arrangements for a distressed company evaluating strategic alternatives.

1	Development of KEIP/KERP/severance programs (determine population, cost, performance measures, benchmark to peers, etc.)
2	Discussions with senior/key creditors regarding programs
3	Board or Compensation Committee review and approval (as applicable) of KEIP/KERP/severance programs
4	File motion to request court approval of programs
5	Work to resolve objections by Stakeholders, Creditors Committee, equity representatives and/or U.S. Trustee (both before and after filing motion)
6	Hearing (including expert witness testimony, if necessary) to approve plans
7	Program implementation

POST-EMERGENCE INCENTIVE AND RETENTION

When emerging from bankruptcy, most pre-bankruptcy company stock, along with unvested equity awards held by employees, have lost their value. Lack of meaningful equity ownership in the go-forward entity, coupled with an uncertain company future, leads to difficulties retaining and motivating key executives post-emergence. Consequently, emergence equity grants are a way to ensure that companies retain motivated personnel who are vital to a successful post-emergence entity.



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Effective executive compensation programs are critical to drive performance and motivate change in the restructuring context.”

IPO CONSIDERATIONS

INITIAL PUBLIC OFFERINGS (IPOs) — ITEMS TO CONSIDER

The E&P sector experienced approximately five IPOs over the 2017–2018 period.

Preparing for an IPO involves many different facets of an organization’s business, including legal, regulatory, financial and operational considerations. Public companies face additional regulations and greater disclosure requirements than private companies, particularly regarding the transparency of a company’s executive compensation programs. Because of the additional requirements, executive compensation has become a relatively complex aspect of preparing for an IPO.

By forming an IPO roadmap, however, a company can ensure that its executive compensation programs and policies are:

- Competitive with the market;
- Within industry norms;
- Compliant with various governance requirements; and
- Aligned with executive and shareholder interests.

There are many executive compensation considerations to address during an IPO, including the items summarized below.

PLAN DESIGN	LEGAL DISCLOSURES	FINANCIAL IMPACT	PLAN RULES AND LIMITS	SPECIAL ARRANGEMENTS
<ul style="list-style-type: none"> ▪ Compensation philosophy, market positioning, data, and peer groups ▪ Executive benchmarking and post-IPO target pay determination ▪ Salary structures ▪ Incentive compensation plan design, stock purchase plan ▪ New compensation governance policies (stock ownership, clawback, anti-hedging, etc.) ▪ Executive benefits and perquisites policies 	<ul style="list-style-type: none"> ▪ Form S-1 compensation disclosure ▪ New incentive compensation plans ▪ Forms 3, 4, and 5 for executive officers and non-employee director stock holdings ▪ Form 8-K for post-IPO compensation related topics 	<ul style="list-style-type: none"> ▪ Future compensation plans and financial modeling ▪ Tax and accounting impact of pre-IPO and post-IPO equity grants ▪ Cost of plan changes and any one-time IPO-related compensation ▪ Planning for compensation-related issues from investors 	<ul style="list-style-type: none"> ▪ Amendments to existing plans ▪ Post-IPO restrictions on stock sales / option exercises ▪ Post-IPO share overhang and expected annual dilution rates ▪ 162(m) considerations of tax-deductibility for incentive compensation ▪ Expectations of new investors and shareholder advisory firms (ISS, Glass Lewis, etc.) 	<ul style="list-style-type: none"> ▪ Founders’ stock awards ▪ Board of Director compensation ▪ Change in control and severance arrangements



COMPANIES ANALYZED

Abraxas Petroleum Corporation	Earthstone Energy, Inc.	Oasis Petroleum Inc.
Alta Mesa Resources*	Eclipse Resources Corporation	Occidental Petroleum Corporation*
Amplify Energy Corp.*	Energen Corporation	Panhandle Oil and Gas Inc.
Anadarko Petroleum Corporation	Energy XXI Gulf Coast, Inc.*	Parsley Energy, Inc.
Antero Resources Corporation	EOG Resources, Inc.	PDC Energy, Inc.
Apache Corporation	EP Energy Corporation	Penn Virginia Corporation*
Approach Resources, Inc.	EQT Corporation	PetroQuest Energy, Inc.
Cabot Oil & Gas Corporation	Erin Energy Corporation	Pioneer Natural Resources Company
California Resources Corporation	EV Energy Partners, L.P.	QEP Resources, Inc.
Callon Petroleum Company	Evolution Petroleum Corporation	Range Resources Corporation
Carbon Natural Gas Company	Extraction Oil & Gas, LLC	Resolute Energy Corporation
Carrizo Oil & Gas, Inc.	Gastar Exploration Inc.	Sanchez Energy Corporation
Centennial Resource Development, Inc.	Gulfport Energy Corporation	SilverBow Resources, Inc.*
Chaparral Energy, Inc.*	Halcon Resources Corporation*	SM Energy Company
Cheniere Energy, Inc.*	Hess Corporation	Southwestern Energy Company
Chesapeake Energy Corporation	Jones Energy, Inc.	SRC Energy Inc.
Cimarex Energy Co.	Laredo Petroleum, Inc.	Stone Energy Corporation*
CNX Resources Corporation*	Legacy Reserves LP	TransAtlantic Petroleum, Ltd.
Comstock Resources, Inc.	Lilis Energy, Inc.	Ultra Petroleum Corp.*
Concho Resources Inc.	Lonestar Resources US Inc.	Vanguard Natural Resources, LLC
ConocoPhillips	Marathon Oil Corporation	W&T Offshore, Inc.
Contango Oil & Gas Company	Matador Resources Company	Whiting Petroleum Corporation
Continental Resources, Inc.	Mid-Con Energy Partners, LP	WildHorse Resource Development Corp.*
Denbury Resources Inc.	Murphy Oil Corporation	WPX Energy, Inc
Devon Energy Corporation	Newfield Exploration Company	
Diamondback Energy, Inc.	Noble Energy, Inc.	

*Companies added to 2019 E&P survey.

ALVAREZ & MARSAL'S COMPENSATION AND BENEFITS PRACTICE

The Compensation and Benefits Practice of Alvarez & Marsal assists companies in designing compensation and benefits plans, evaluating and enhancing existing plans, benchmarking compensation and reviewing programs for compliance with changing laws and regulations. We do so in a manner that manages risks associated with tax, financial and regulatory burdens related to such plans. Through our services, we help companies lower costs, improve performance, boost the bottom line and attract and retain key performers.

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Compensation Design**



**Incentive & Deferred
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**Risk Management
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**Global Incentive
Compensation Services**

EXECUTIVE COMPENSATION

- Executive compensation consulting, including the design of tax-efficient compensation packages and competitive benchmarking
- Preparation of executive compensation disclosures for publicly held entities
- Annual / long-term incentive and deferred compensation design

MERGERS AND ACQUISITIONS

- Pre- and post-merger integration services, including:
 - Executive compensation design
 - Golden parachute analysis (Section 280G)
 - Due diligence of welfare / pension considerations
 - Severance / retention planning

BANKRUPTCY

- Bankruptcy-related compensation, including:
 - Design of key employee incentive plans, retention plans and severance plans
 - Expert witness testimony
 - Post-emergence management incentive plans





BRIAN L. CUMBERLAND

NATIONAL MANAGING DIRECTOR, COMPENSATION & BENEFITS

+1 214 438 1013

bcumberland@alvarezandmarsal.com



J.D. IVY

MANAGING DIRECTOR

+1 214 438 1028

jivy@alvarezandmarsal.com

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Editor: James Deets

Research Assistance and Data Compilation:

Ryan Wells, Matt Porter, Vance Yudell, Daniel Muñoz and Nicholas Cumberland



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