2020

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

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

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# Oil and Gas Exploration & Production (E&P) Compensation Report

## Analysis of Compensation Arrangements Among the Largest U.S. E&P Companies

# Introduction

Effective compensation programs are critical to attract, retain and drive performance of executives. Companies should ensure that their executive compensation programs are aligned with market throughout each potential phase of a company's lifecycle, including: initial public offering (IPO), transaction / merger, steady-state, and bankruptcy.

To understand compensation 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 2019 proxy statements of the largest E&P companies in the U.S.

Where possible, this analysis includes only companies with revenue derived primarily from E&P activities (i.e., not primarily midstream, refining, etc.).[1] The report excludes companies that did not disclose sufficient data on their compensation programs, such as some companies that recently went through an IPO or companies that have recently undergone a restructuring or bankruptcy.

The data represents the most up-to-date plan structures 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 | $4.2B — $73.0B | $12.2B |
| Second Quartile | $1.2M — $3.1B | $1.9B |
| Third Quartile | $272M — $1.1B | $621M |
| Bottom Quartile | $29M — $236M | $137M |

*Market capitalization as of January 2, 2019.

1 For an analysis of the top oil and gas oilfield services companies, please see our 2020 Oil and Gas Oilfield Services (OFS) Compensation Report.

# Key Takeaways

## Total Compensation

- Compared to last year, the average total compensation for CEOs and CFOs increased by approximately 4 percent.
- While it remains unclear what constitutes a "good" CEO pay ratio, the data indicates that a ratio of 25x to 100x is most prevalent.

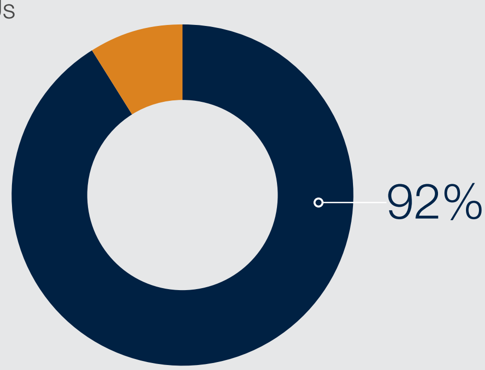
## Annual and Long-Term Incentive Compensation

- On average, incentive compensation — including annual and long-term incentives — comprises approximately 83 percent of a CEO's and 81 percent of a CFO's total compensation package.
- Only 10 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 plans.
- Production / production growth remains the most prevalent performance metric in AIPs and is utilized by 83 percent of companies. The next three most prevalent performance metrics are health, safety and environmental (58 percent); lease operating expense (49 percent); and general and administrative expenses (45 percent).
- The prevalence of long-term incentive (LTI) awards varies by company size, but time-vesting restricted stock / restricted stock units and performance-vesting awards are most common, utilized by 92 percent and 84 percent of companies, respectively.
- For performance-based LTI awards, 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.

**CEO**
4%
**Increase**
2019 Average
$6,752,066

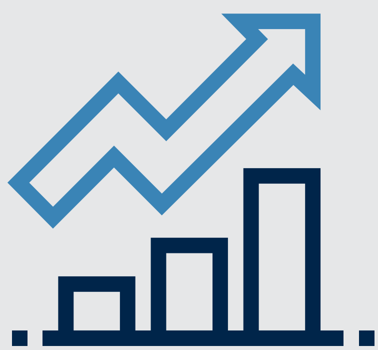
**CFO**
4%
**Increase**
2019 Average
$3,147,248

92% of companies utilize time-vesting restricted stock / RSUs




84%

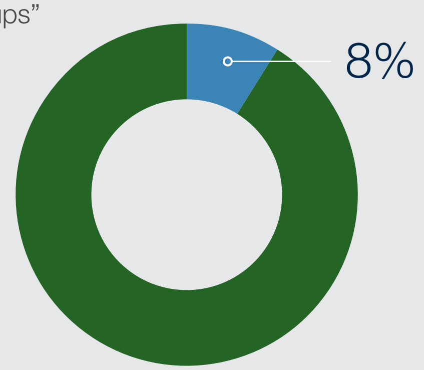
Companies using relative TSR as a performance metric.



## Change in Control Benefits

- 2x to 2.99x compensation is the most common range of cash severance multiples for CEOs and CFOs (51 percent and 63 percent, respectively).
- The most valuable benefit received in connection with a change in control (CIC) is accelerated vesting and payout of LTI, making up 51 percent and 48 percent of the total value for CEOs and CFOs, respectively.
- Double trigger equity vesting (termination required) is most prevalent (65 percent), while single trigger equity vesting (no termination required) is less common (35 percent).
- Only 8 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. 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.

Only 8% of CEOs and CFOs are entitled to receive excise tax "gross-ups"




170+ E&P companies in the U.S. filed for bankruptcy since 2015.

## Bankruptcy Compensation

- More than 170 E&P companies in the U.S. filed for bankruptcy since 2015.
- 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 on a go-forward basis.

## Initial Public Offerings (IPOs) — Observations

- As commodity prices rebounded from 2017 until late 2018, the industry saw an uptick in IPO activity.
- The market for IPOs softened in 2019; however we would expect to see the number of IPOs increase as commodity prices improve.
- 4 E&P companies that recently completed an IPO are included in this report.

“Total compensation of CEOs and CFOs increased slightly year-over-year.”

# Total Compensation

We captured the summary compensation table data disclosed in the 2019 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[1] | Total |
|---|---|---|---|---|---|
| Top Quartile Average | $1,149,345 | $2,199,401 | $8,464,669 | $610,262 | $12,423,678 |
| Second Quartile Average | $795,666 | $1,352,868 | $4,816,920 | $424,257 | $7,389.710 |
| Third Quartile Average | $598,966 | $740,160 | $3,010,875 | $128,057 | $4,478,058 |
| Bottom Quartile Average | $494,587 | $405,521 | $1,408,395 | $319,051 | $2,627,554 |
| 2019 - Average | $759,641 | $1,177,946 | $4,444,073 | $370,407 | $6,752,066 |
| Year-Over-Year Change[2] | | | | | 4% |

**Chief Financial Officer Annual Compensation**

| Market Capitalization Rank | Base Salary | Annual Incentives | Long-Term Incentives | Other Compensation[1] | Total |
|---|---|---|---|---|---|
| Top Quartile Average | $619,522 | $852,516 | $2,934,167 | $335,894 | $4,742,099 |
| Second Quartile Average | $485,004 | $628,168 | $1,948,647 | $83,105 | $3,144,923 |
| Third Quartile Average | $385,152 | $373,046 | $1,291,267 | $58,414 | $2,107,879 |
| Bottom Quartile Average | $367,357 | $212,579 | $1,699,596 | $54,622 | $2,334,154 |
| 2019 - Average | $471,083 | $540,342 | $1,997,294 | $138,529 | $3,147,248 |
| Year-Over-Year Change[2] | | | | | 4% |

[1] Other Compensation includes: change in pension value, above market earnings, and “all other compensation” as disclosed in each company’s proxy statement.
[2] Only includes executives in both 2019 and 2020 studies. Represents median year-over-year change.

Compared to compensation disclosed in 2018, both CEOs and CFOs experienced a slight increase in total compensation. LTI is the most significant driver of pay differences from the bottom quartile to the top quartile.

# Total Compensation

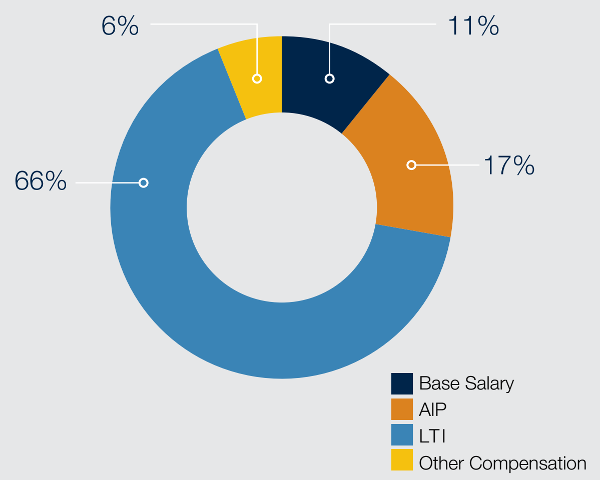
On average, incentive compensation — including annual and long-term incentives — comprises approximately 82 percent of an executive's total compensation package. The charts on the right show the proportion of total direct compensation delivered in base salary, AIP, LTI awards and other compensation for 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.

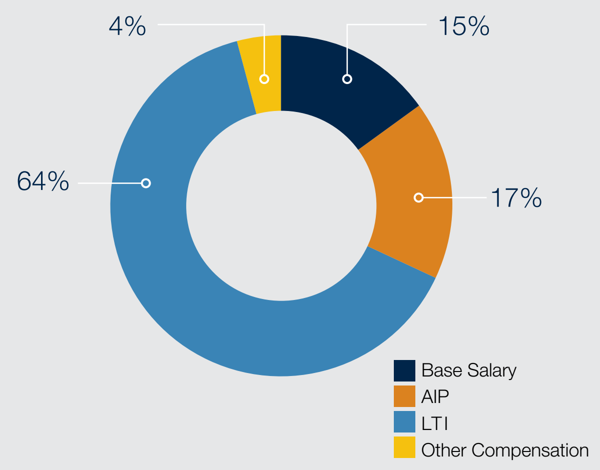
**82%**

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

**CEO Total Compensation**




**CFO Total Compensation**



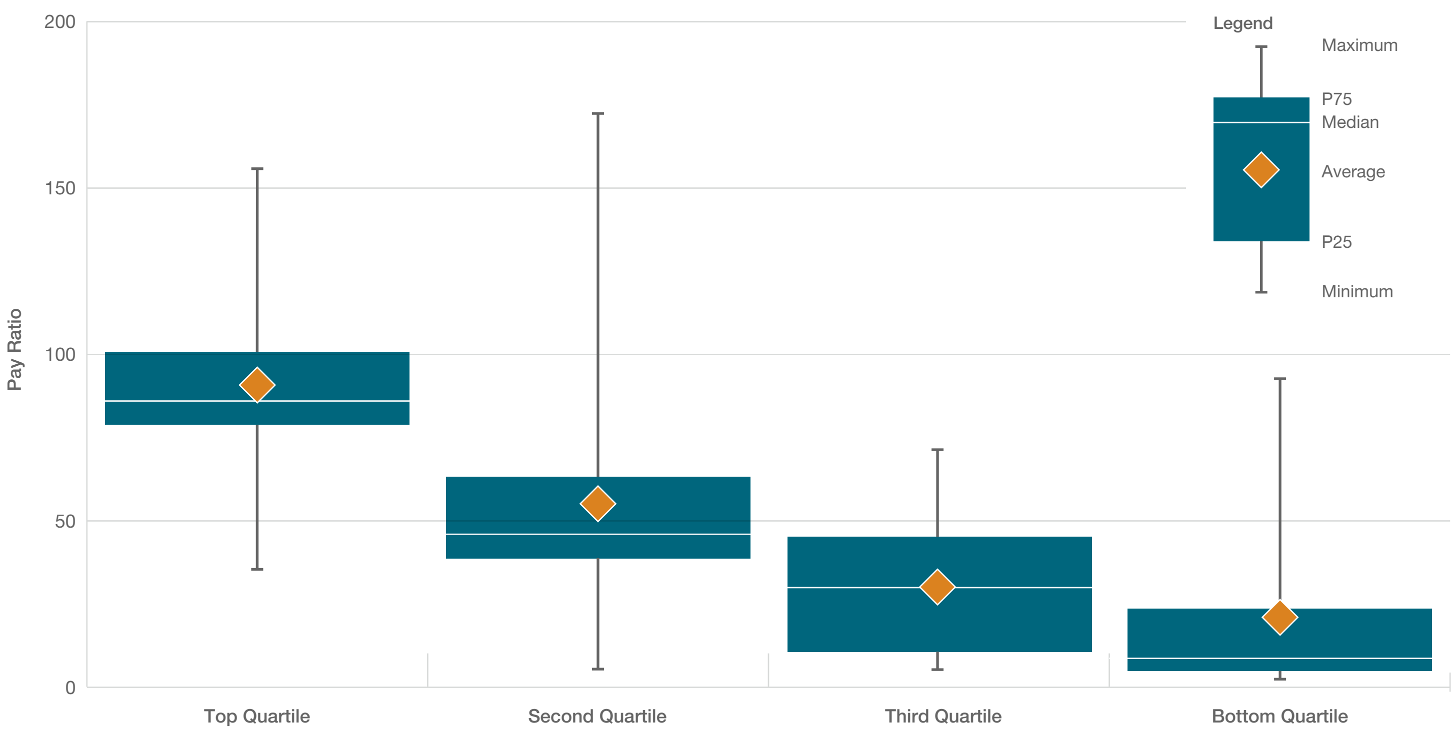
## CEO Pay Ratio

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 2019 mark the second 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 identify 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.

While it remains unclear what constitutes a "good" CEO pay ratio, the data reflects that a ratio of 25x to 100x is most prevalent. The table below shows summary CEO pay ratio statistics within each quartile:

CEO Pay Ratio by Quartile



“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.

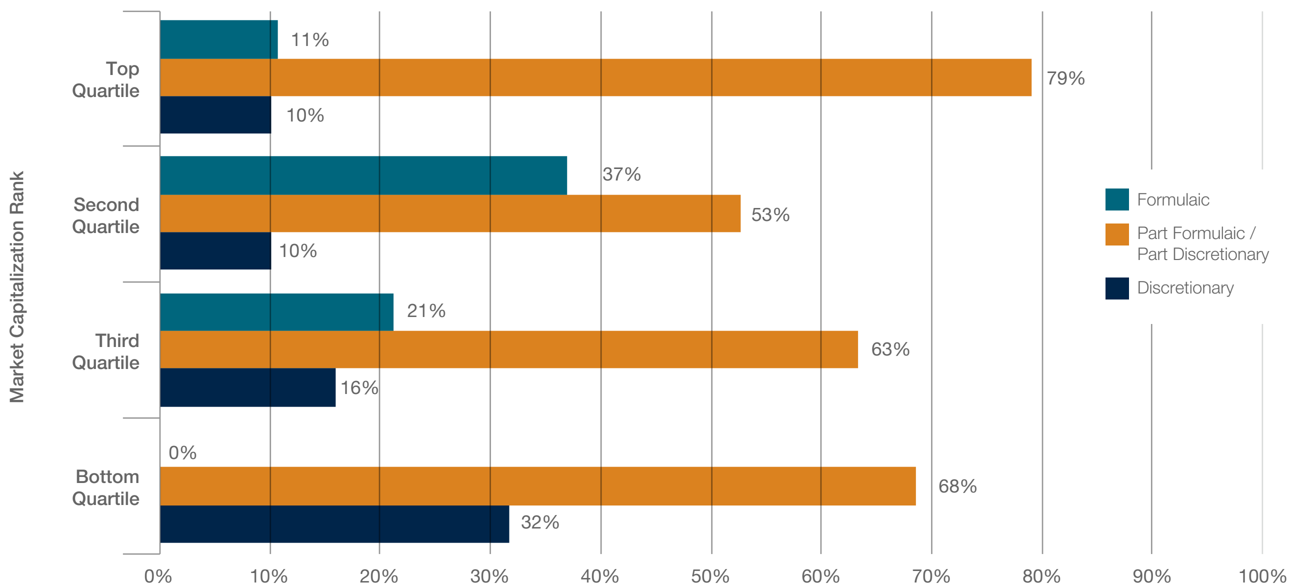
## Discretionary vs. Formulaic

For this analysis, we grouped AIPs into the following three categories based on how the annual bonus 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 upward.
- **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 below, 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.

Discretionary vs. Formulaic by Market Capitalization




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 shareholders and shareholder advisory firms when structuring AIPs. We will continue to monitor how shareholders and shareholder advisory firms react to AIP design changes triggered by the Section 162(m) revisions.

# Annual Incentive Plans

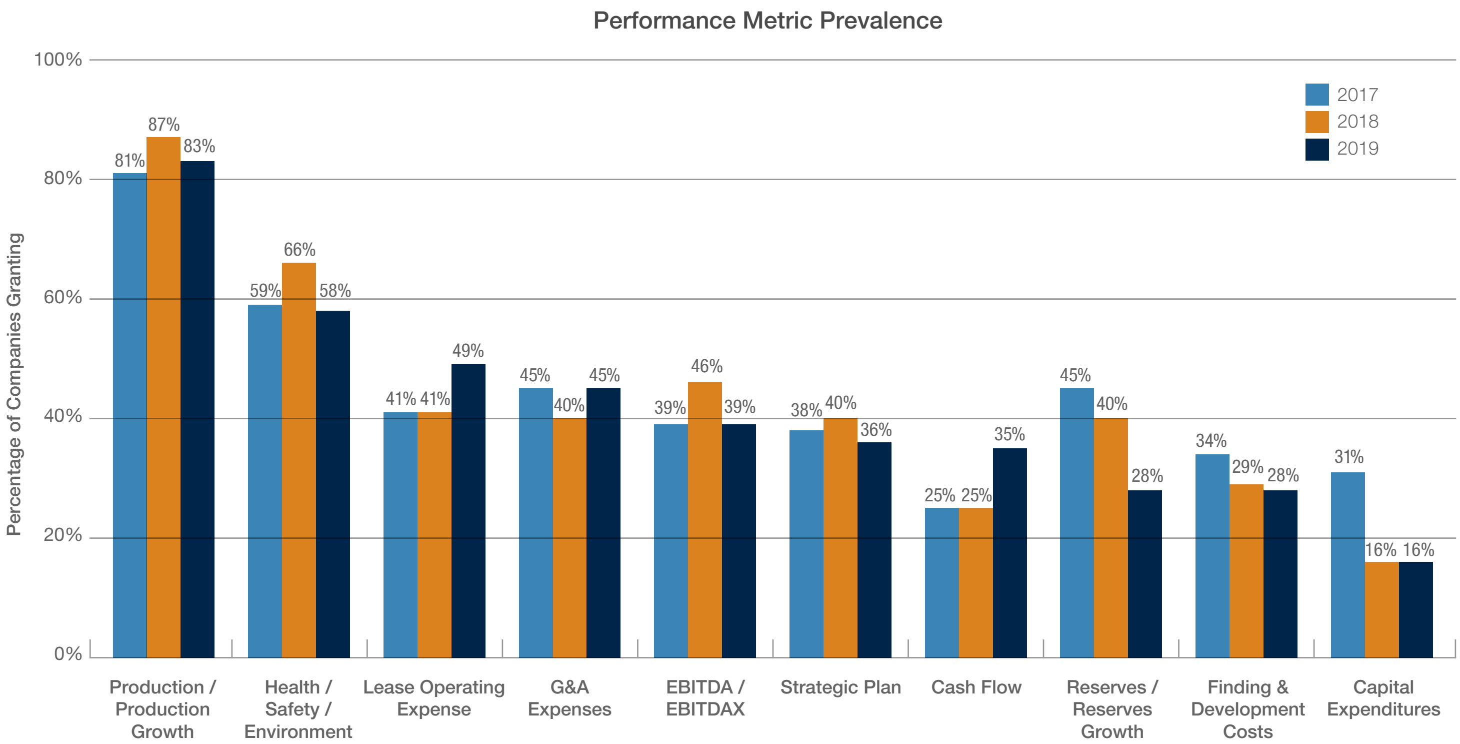
Companies utilize formulaic compensation programs to provide clarity to executives and shareholders on how compensation will be determined. Some companies maintain discretion over the payout of AIPs to allow them to adjust the payouts for events that are unforeseen and/or out of the executives' control. Some companies exercise discretion by implementing an AIP with a formulaic trigger (e.g., achieving a certain level of EBITDA or cash flow) to fund a bonus pool, which can then be allocated within 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 (83 percent), followed by health / safety / environmental metrics (58 percent). This year, reserves / reserve growth continued to drop to its lowest level in four years (now used by only 28 percent of companies).



## Payout Multiples

The following chart shows the target level of AIP payouts as a percentage of base salary for CEOs and CFOs. The median target payout is approximately 115 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.

> "Long-term incentives comprise the largest portion of executive compensation packages."

# Long-Term Incentives

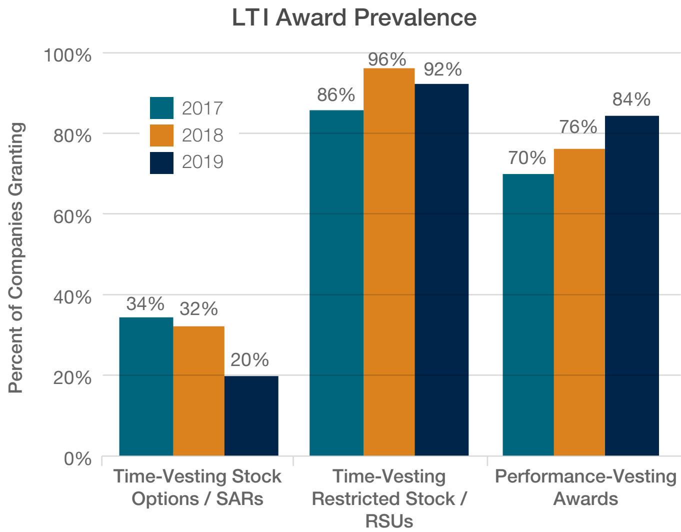
## Overview

Companies grant LTI awards to motivate and retain executives and to align the interests of executives and shareholders. 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 on the right shows the prevalence of stock options / SARs, time-vesting restricted stock / RSUs, and performance-vesting awards for all companies:

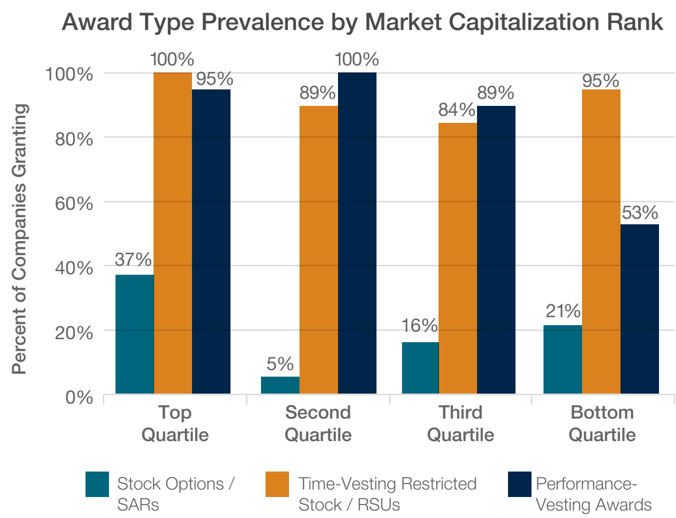
- Time-vesting restricted stock / RSUs and performance-vesting awards remained the most prevalent vehicles year-over-year.
- Stock options / SARs are the least prevalent LTI vehicle utilized, as they provide little to no value to an executive in a down or flat market, which also reduces (or eliminates) any retentive value from this type of award.
- 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.




## Award Prevalence by Market Capitalization

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

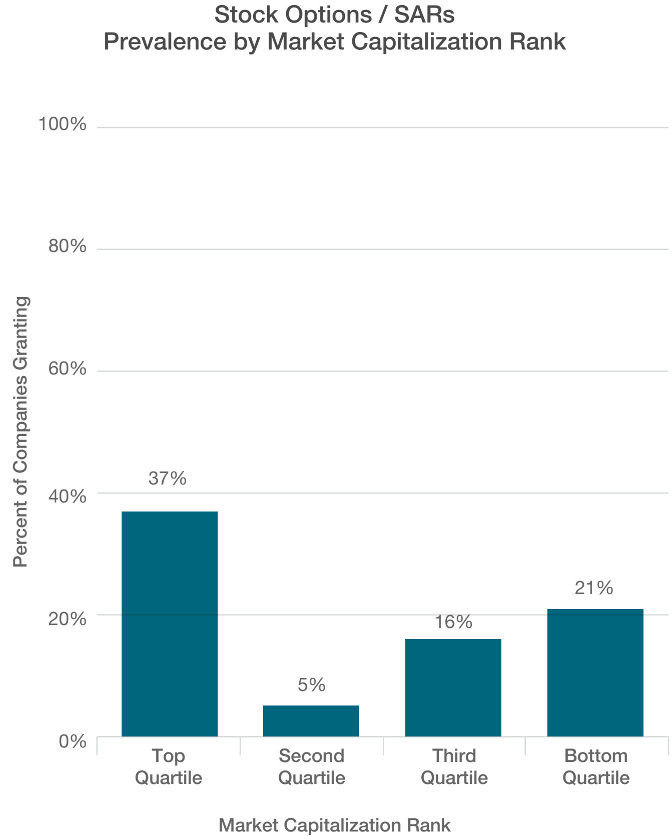
- Stock options / SARs are less widely used than other equity vehicles across all quartiles.
- Time-vesting restricted stock / RSUs are utilized fairly uniformly across all company sizes.
- Performance-vesting awards are significantly less prevalent at smaller companies (utilized by 89 percent to 100 percent of companies in the top 3 quartiles versus only 53 percent of companies in the bottom quartile).
- Consistent with prior years, the majority of companies (84 percent) grant two or more types of LTI vehicles.



# Long-Term Incentives

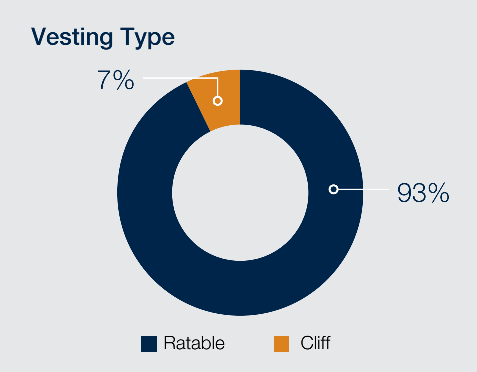
## Stock Options / Stock Appreciation Rights

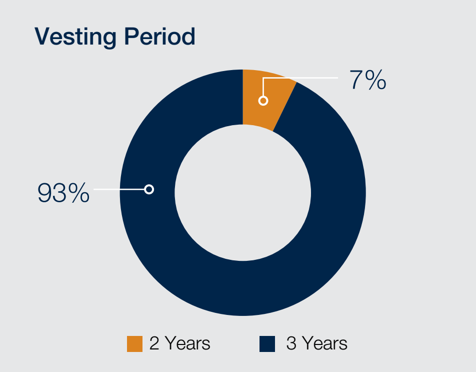
The chart to the right shows the percentage of companies that grant stock options / SARs by market capitalization:

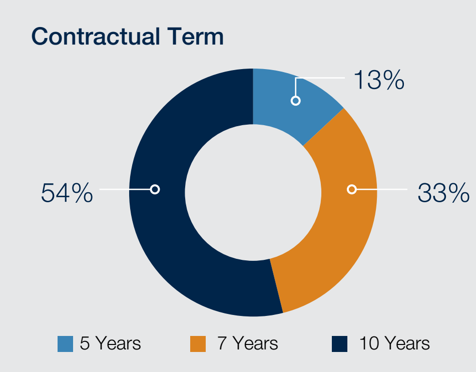



## Award Provisions

- Stock option awards predominantly consisted of nonqualified stock options rather than tax-favored incentive stock options.
- The charts below show the prevalence of the following detail for companies in our study group that granted stock options:
  - o 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.
  - o Vesting Period
  - o Contractual Term
- All of these observations are consistent with our 2019 report.

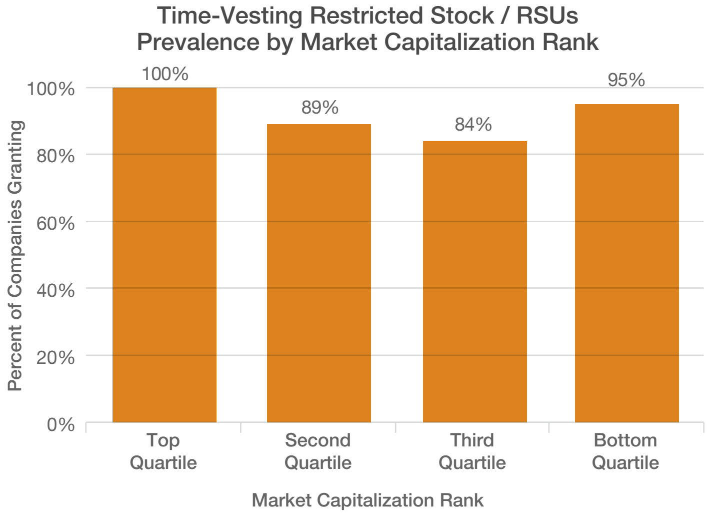


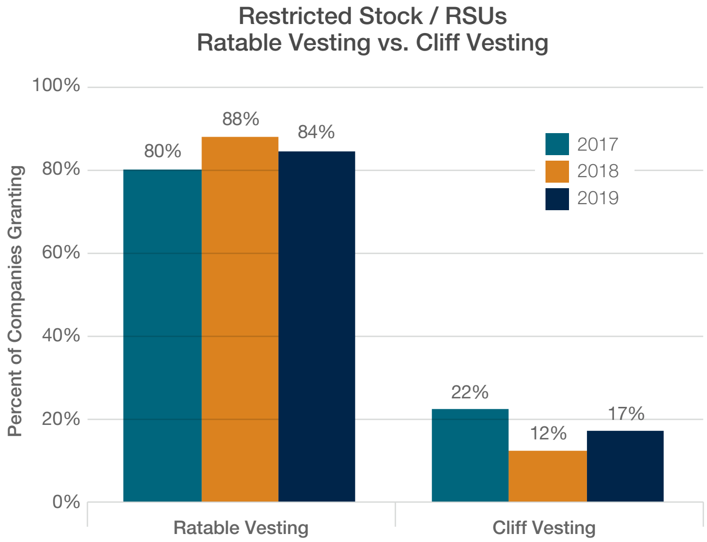
## Time-Vesting Restricted Stock / Restricted Stock Units

The chart on the right shows the percentage of companies that grant time-vesting restricted stock / RSUs by market capitalization. The prevalence is very high, exceeding 80 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 87 percent of companies), while a four-year vesting period is the second most common (utilized by 6 percent of companies).
- As shown in the chart at right, most companies continue to utilize awards that vest ratably rather than cliff vest.

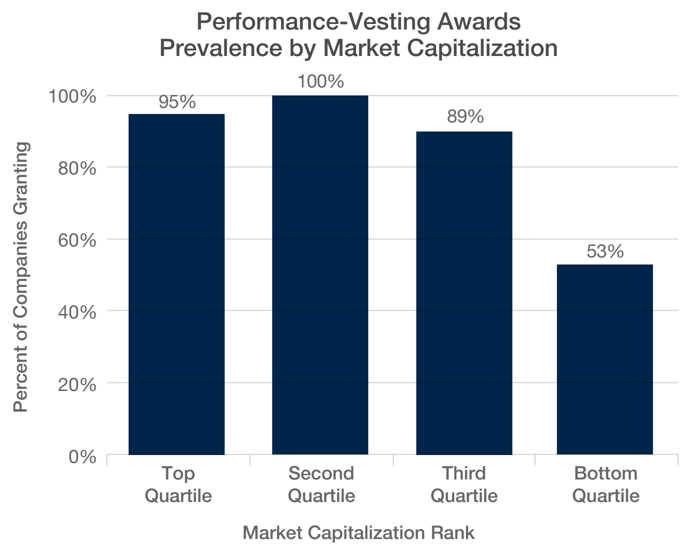



*Note: Yearly totals may not equal 100% since some companies have both ratable and cliff vesting awards.*

# Long-Term Incentives

## Performance-Vesting Awards

The chart at 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.

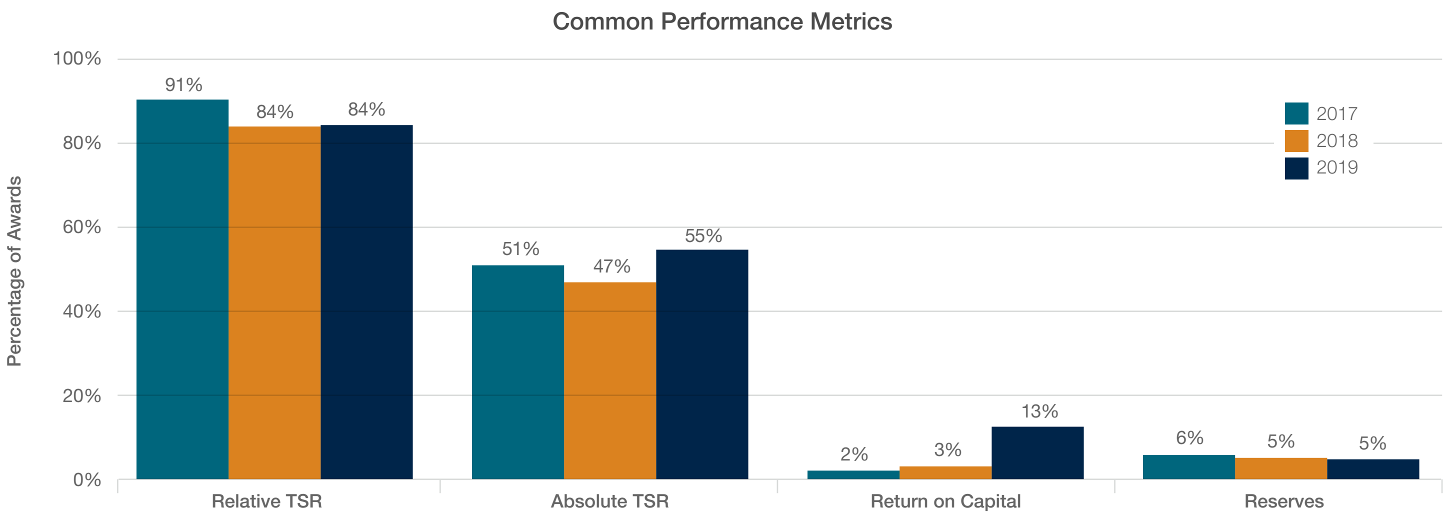



## Performance Metrics

The most prevalent metric is total shareholder return (TSR) relative to a peer group, which is used for 84 percent of performance-vesting awards. 55 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.

66 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.

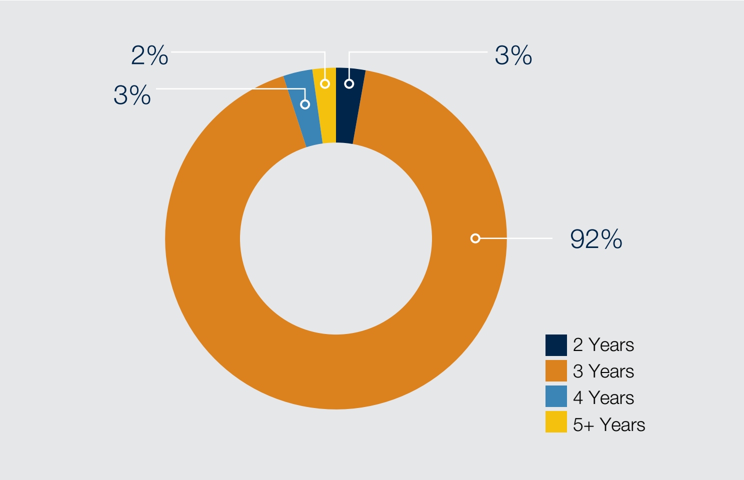
The chart below shows the prevalence of the most common metrics used for performance-vesting awards:



## 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.

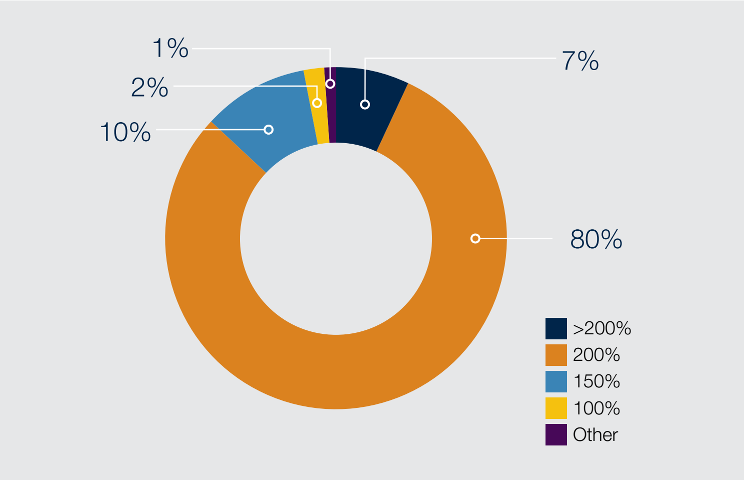



## Maximum Payout

Performance-vesting awards most often provide for a range of payouts. 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 that of prior years.

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.



“In uncertain circumstances, 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. As a result of the Say-on-Pay advisory vote, shareholders now have a louder voice with which to communicate their satisfaction or displeasure with a company's compensation programs. One area of executive compensation that is often embattled with criticism is CIC provisions.

Typical CIC benefits include severance payments, accelerated vesting of LTI awards, enhanced retirement benefits and excise tax protection. The charts below show the average value of CIC benefits for CEOs and CFOs:

| Change in Control Benefit Values for CEOs | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Market Capitalization Rank** | **Severance** | **Annual Bonus** | **Accelerated LTI** | **Retirement Benefits** | **Excise Tax Gross-Up** | **Other[1]** | **Average Total Benefit** |
| Top Quartile | $7,624,463 | $713,259 | $14,890,059 | $741,467 | $655,526 | $780,452 | $25,183,094 |
| Second Quartile | $4,710,367 | $665,286 | $5,252,464 | $694,695 | $556,244 | $46,213 | $11,612,261 |
| Third Quartile | $3,541,321 | $516,908 | $2,909,228 | - | - | $32,589 | $6,168,449 |
| Bottom Quartile | $1,698,694 | $454,989 | $770,829 | - | - | $20,766 | $2,550,051 |
| 2019 - Average | $4,718,291 | $606,679 | $6,576,120 | $432,922 | $368,010 | $236,914 | $12,083,494 |
| Year-Over-Year Change[2] | | | | | | | -6% |

| Change in Control Benefit Values for CFOs | | | | | | | |
|---|---|---|---|---|---|---|---|
| **Market Capitalization Rank** | **Severance** | **Annual Bonus** | **Accelerated LTI** | **Retirement Benefits** | **Excise Tax Gross-Up** | **Other[1]** | **Average Total Benefit** |
| Top Quartile | $2,910,361 | $266,950 | $4,536,986 | $258,154 | $593,555 | $611,625 | $9,059,877 |
| Second Quartile | $1,934,823 | $236,020 | $2,435,229 | $13,748 | - | $37,081 | $4,656,178 |
| Third Quartile | $1,447,732 | $203,194 | $1,177,688 | - | - | $27,971 | $2,537,447 |
| Bottom Quartile | $800,546 | $263,682 | $643,060 | - | - | $30,473 | $1,715,787 |
| 2019 - Average | $1,884,723 | $241,467 | $2,391,187 | $77,268 | $165,417 | $191,631 | $4,774,000 |
| Year-Over-Year Change[2] | | | | | | | -3% |

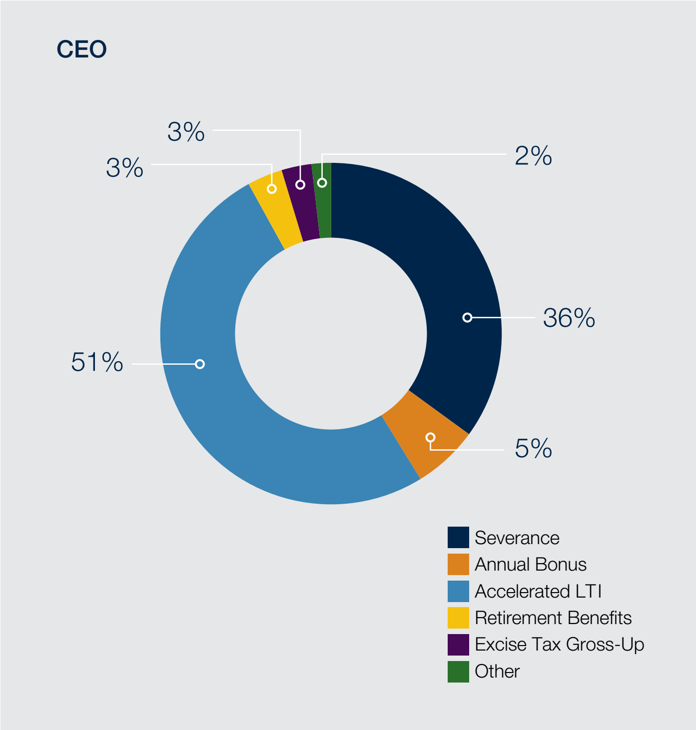
[1]Other includes health & welfare benefit continuation, outplacement services, and other benefits received in connection with a change in control.
[2]Only includes executives in both 2019 and 2020 studies. Represents median year-over-year change.

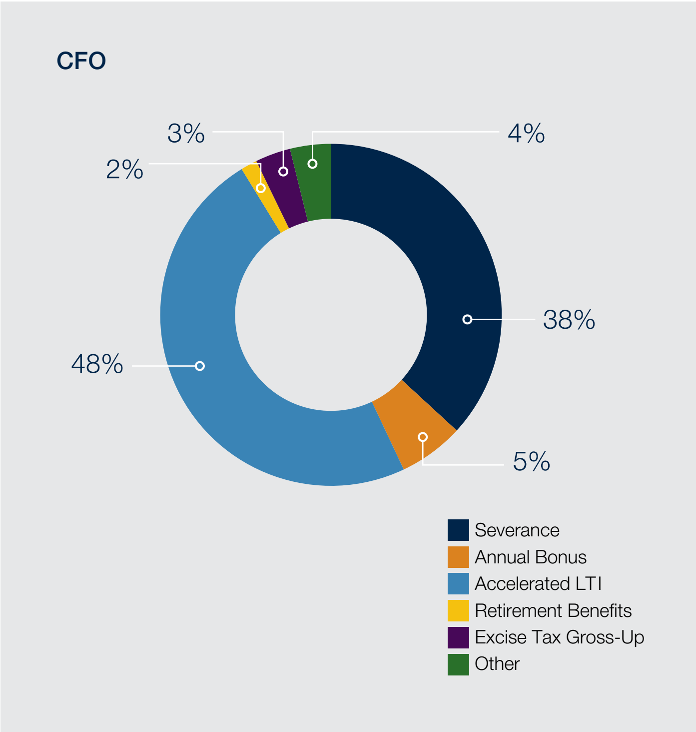
The amount of CIC benefits payable to CEOs and CFOs varies dramatically based on company size. The slight decrease in year-over-year CIC benefits payable to CEOs and CFOs is primarily the result of depressed stock prices, which have lowered the value of accelerated vesting of LTI awards.

# Change in Control Benefits

The charts to the right illustrate the average value for each type of CIC benefit for CEOs and CFOs. Severance and the value of accelerated LTI awards comprise approximately 87 percent and 86 percent of the total value of CIC benefits for CEOs and CFOs, respectively.

> *“Severance and accelerated vesting of 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, which varies at different levels within an organization.
- The definition of compensation used to determine the severance amount varies. The two most prevalent definitions of compensation for this purpose are base salary plus annual bonus and base salary only.

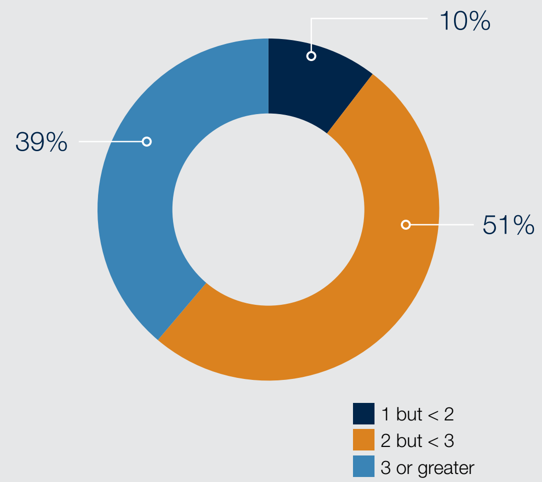
## CEOs

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

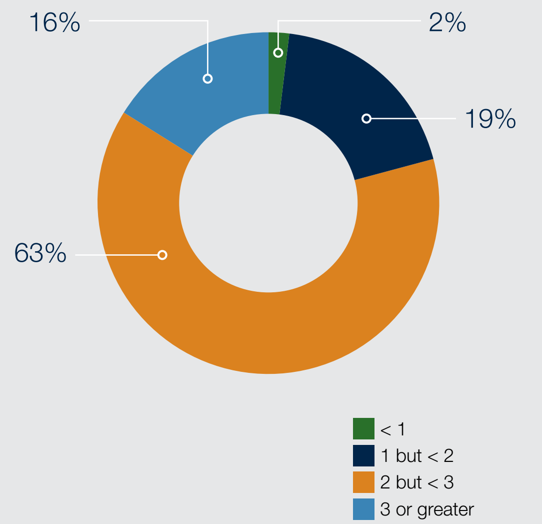
## CFOs

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

**Severance Multiple Prevalence - CEO**




**Severance Multiple Prevalence - CFO**



# Change in Control Benefits

## Accelerated Vesting of LTI Awards

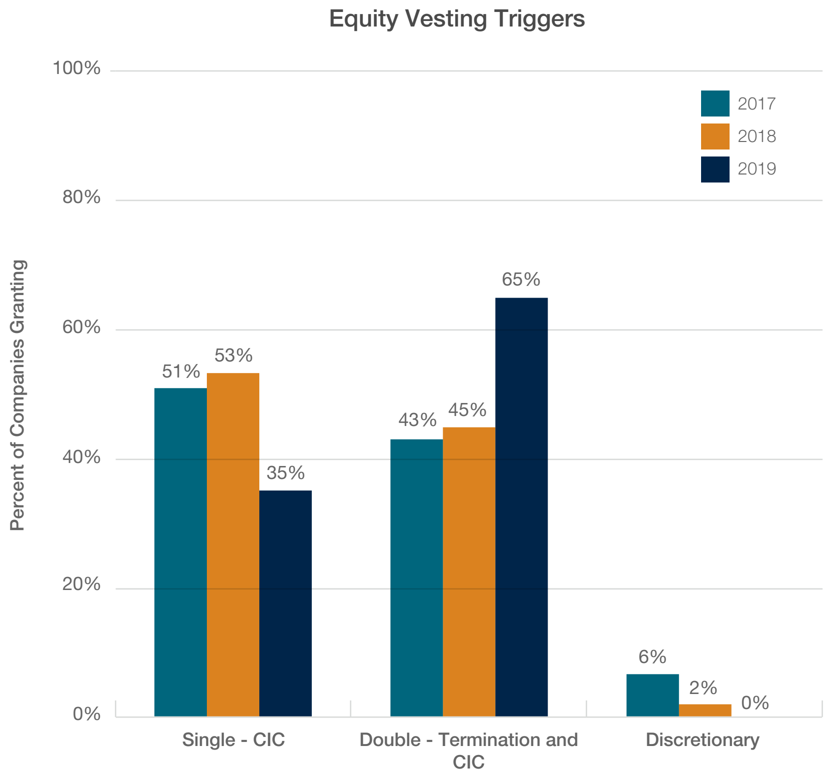
There are generally three types of CIC payout triggers for equity awards:

| 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 payout 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.

Double trigger equity vesting (termination required) is most prevalent (65 percent), while single trigger equity vesting (no termination required) is less common (35 percent). We attribute the shift toward double trigger vesting to pressure from shareholders and shareholder advisory services.

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



## Excise Tax Protection

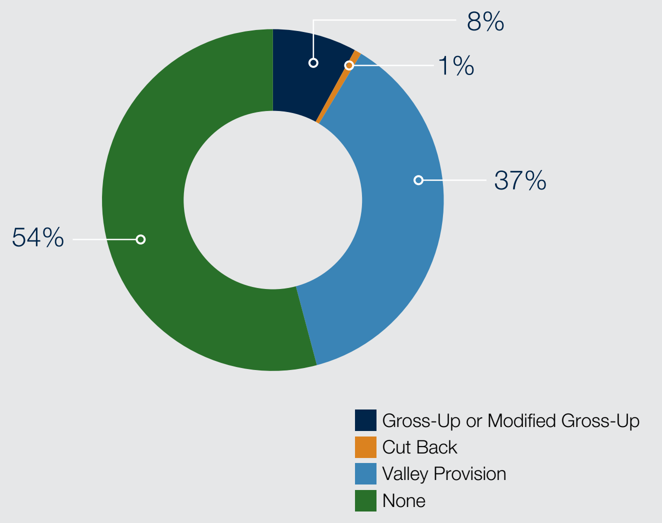
The "Golden Parachute" rules impose a 20 percent excise tax on an executive if the executive receives a parachute payment greater than the "safe harbor" limit. Companies may address this excise tax issue in one of the following ways:

| 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. |

8 percent of companies provide either a gross-up or modified gross-up to their CEOs and CFOs (down from 11 percent in 2018). 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 on 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, an opportunity for base amount planning may exist. 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.

“An effective mitigation concept may reduce or eliminate the risk of excise taxes and lost deductions.”

# Director Compensation

A&M captured board of director compensation data disclosed in the 2019 proxy statement for each company. Director compensation at public companies is mainly comprised of fees paid in cash (director retainers, committee retainers, meeting fees, etc.) as well as an annual equity retainer.

The following tables show the average values for each element of compensation broken out by quartile for non-employee chairs and lead directors, and the average for other directors:

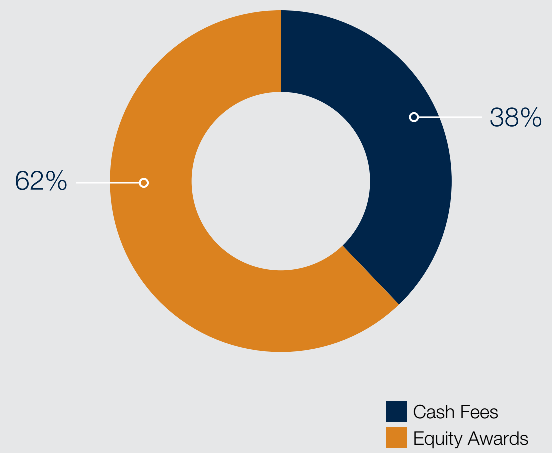
| Board Chair / Lead Independent Director | | | |
|---|---|---|---|
| **Market Capitalization Rank** | **Cash Fees** | **Equity Awards** | **Total Compensation** |
| Top Quartile Average | $159,916 | $218,520 | $378,436 |
| Second Quartile Average | $120,335 | $231,013 | $351,348 |
| Third Quartile Average | $109,968 | $195,306 | $283,573 |
| Bottom Quartile Average | $91,590 | $136,750 | $266,398 |
| 2019 - Average | $122,732 | $198,765 | $325,217 |

| Other Directors | | | |
|---|---|---|---|
| **Market Capitalization Rank** | **Cash Fees** | **Equity Awards** | **Total Compensation** |
| Top Quartile Average | $101,855 | $211,755 | $313,610 |
| Second Quartile Average | $85,674 | $175,543 | $261,217 |
| Third Quartile Average | $76,057 | $124,292 | $200,349 |
| Bottom Quartile Average | $74,700 | $102,097 | $176,797 |
| 2019 - Average | $84,572 | $153,422 | $237,993 |

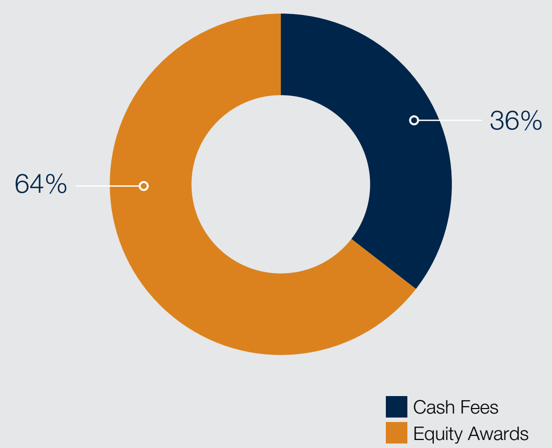
On average, equity compensation comprises 63 percent of a director's total compensation package. The following charts show the proportion of compensation delivered in cash fees (board retainers, committee retainers, meeting fees, etc.) and equity for the board chair / lead independent director and the other directors, respectively.

**"63% - Average portion of a director's total compensation package derived from equity compensation."**

**Chair / Lead Independent Director Total Compensation**




**Other Directors Total Compensation**



# 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

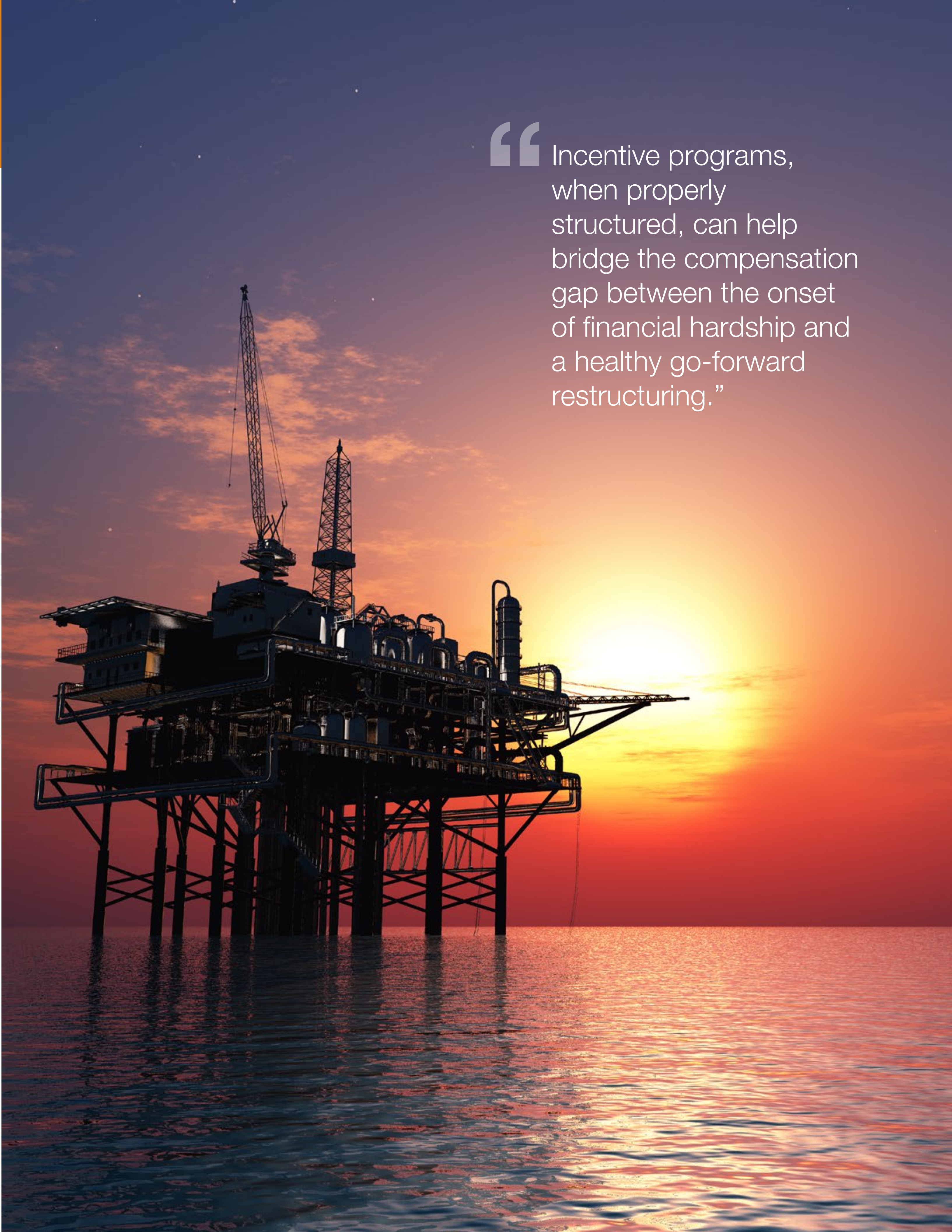
The AIP / KEIP performance metrics must be carefully chosen and structured to be sufficiently challenging. The metrics should also coincide with the company's business plan or objectives. The amount of potential payout is also a consideration, as it should be sufficiently motivating but also should be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



“Incentive programs, when properly structured, can help bridge the compensation gap between the onset of financial hardship and a healthy go-forward restructuring.”

# Initial Public Offerings (IPOs) – Items to Consider

As commodity prices rebounded from 2017 until late 2018, the industry saw an uptick in IPO activity. The market for IPOs softened in 2019; however, we would expect to see the number of IPOs increase if commodity prices improve. 4 E&P companies that recently completed an IPO are included in this report.

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
- 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 |
|---|---|---|---|---|
| ▪ Compensation philosophy, market positioning, data, and peer groups<br>▪ Executive benchmarking and post-IPO target pay determination<br>▪ Salary structures<br>▪ Incentive compensation plan design, stock purchase plan<br>▪ New compensation governance policies (stock ownership, clawback, anti-hedging, etc.)<br>▪ Executive benefits and perquisites policies | ▪ Form S-1 compensation disclosure<br>▪ New incentive compensation plans<br>▪ Forms 3, 4, and 5 for executive officers and non-employee director stock holdings<br>▪ Form 8-K for post-IPO compensation related topics | ▪ Future compensation plans and financial modeling<br>▪ Tax and accounting impact of pre-IPO and post-IPO equity grants<br>▪ Cost of plan changes and any one-time IPO-related compensation<br>▪ Planning for compensation-related issues from investors | ▪ Amendments to existing plans<br>▪ Post-IPO restrictions on stock sales / option exercises<br>▪ Post-IPO share overhang and expected annual dilution rates<br>▪ 162(m) considerations<br>▪ Expectations of new investors and shareholder advisory firms (ISS, Glass Lewis, etc.) | ▪ Founders' stock awards<br>▪ Board of Director compensation<br>▪ Change in control and severance arrangements |

**REQUIRES COORDINATION AMONG LEGAL, FINANCE, AND HR FUNCTIONS**

# Companies Analyzed

Abraxas Petroleum Corporation
Alta Mesa Resources, Inc.
Amplify Energy Corp.
Anadarko Petroleum Corporation
Antero Resources Corporation
Apache Corporation
Approach Resources, Inc.
Berry Petroleum Corporation*
Bonanza Creek Energy, Inc.*
Cabot Oil & Gas Corporation
California Resources Corporation
Callon Petroleum Company
Carbon Energy Corporation
Carrizo Oil & Gas, Inc.
Centennial Resource Development, Inc.
Chaparral Energy, Inc.
Chesapeake Energy Corporation
Cimarex Energy Co.
CNX Resources Corporation
Comstock Resources, Inc.
Concho Resources Inc.
ConocoPhillips
Contango Oil & Gas Company
Continental Resources, Inc.
Denbury Resources Inc.
Devon Energy Corporation
Diamondback Energy, Inc.
Earthstone Energy, Inc.
EOG Resources, Inc.
EP Energy Corporation
EQT Corporation
Evolution Petroleum Corporation
Extraction Oil & Gas, Inc.
Goodrich Petroleum Corporation*
Gulfport Energy Corporation
Halcón Resources Corporation
Hess Corporation
HighPoint Resources Corporation*
Jagged Peak Energy Inc.*
Kosmos Energy Ltd.*
Laredo Petroleum, Inc.
Legacy Reserves Inc.
Lilis Energy, Inc.
Lonestar Resources US Inc.
Magnolia Oil & Gas Corporation*
Marathon Oil Corporation
Matador Resources Company
Mid-Con Energy Partners, LP
Midstates Petroleum Company, Inc.*
Murphy Oil Corporation
Noble Energy, Inc.
Northern Oil and Gas, Inc.*
Oasis Petroleum Inc.
Occidental Petroleum Corporation
Panhandle Oil and Gas Inc.
Parsley Energy, Inc.
PDC Energy, Inc.
Penn Virginia Corporation
Pioneer Natural Resources Company
QEP Resources, Inc.
Range Resources Corporation
Ring Energy, Inc.*
Roan Resources, Inc.*
Rosehill Resources Inc.*
SandRidge Energy, Inc.*
SilverBow Resources, Inc.
SM Energy Company
Southwestern Energy Company
SRC Energy Inc.
Talos Energy Inc.*
TransAtlantic Petroleum Ltd.
Ultra Petroleum Corp.
VAALCO Energy, Inc.*
W&T Offshore, Inc.
Whiting Petroleum Corporation
WPX Energy, Inc.

*Companies added to 2020 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.

## ALVAREZ & MARSAL'S EXECUTIVE COMPENSATION SERVICE OFFERINGS

**Executive Compensation Advisory Consulting**

**Pre- & Post-Merger and Acquisition Advisory**

**Bankruptcy Compensation Design**

**Incentive & Deferred Compensation Design**

**Risk Management Consulting**

**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

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## ABOUT ALVAREZ & MARSAL

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