2018

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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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 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 2017 proxy statements of the largest E&P companies in the U.S. This report reviews the annual and long-term incentive (*LTI*) practices of these companies, as well as the total compensation packages for Chief Executive Officers (CEOs) and Chief Financial Officers (CFOs) in the E&P sector and the benefits to which those executives are entitled upon a change in control.

Where possible, this analysis only includes companies with revenue derived primarily from E&P activities (i.e., not primarily midstream, refining, etc.), and excludes companies that did not disclose sufficient data on their compensation programs, such as companies that recently went through an initial public offering 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 plan structure disclosed by these companies. Where warranted, current data is compared to data collected in our prior studies.

COMPANY SELECTION AND STATISTICS

In prior reports, we analyzed the top 100 E&P companies regardless of size. This year, instead of focusing on the number of companies in the study, we utilized a market capitalization minimum of $50 million. Therefore, our 2018 report includes the 76 largest E&P companies, instead of the top 100. Where year-over-year comparisons are made, prior year data was adjusted to take into account only those companies that are included in this year's report.

For comparison purposes, we grouped the companies in quartiles based on market capitalization as shown below:

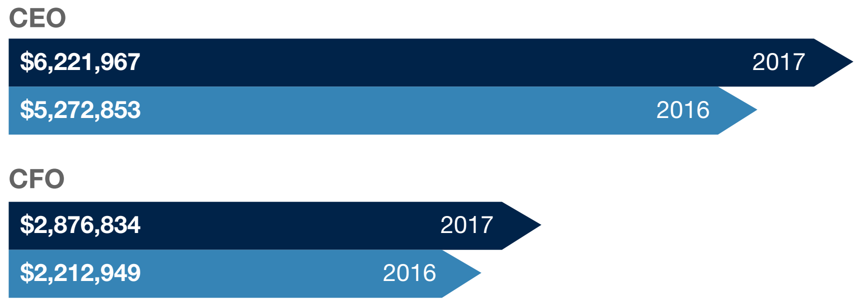
Quartile	Market Capitalization Range*	Median
Top Quartile	$6.3B - $62.1B	$16.3B
Second Quartile	$2.4B - $6.3B	$3.6B
Third Quartile	$285M - $2.1B	$535M
Bottom Quartile	$50M - $247M	$103M

* Market capitalization as of January 2, 2017.

KEY TAKEAWAYS

TOTAL COMPENSATION

- On average, incentive compensation – including annual incentives and LTI – comprises 85 percent of a CEO's and 82 percent of a CFO's total compensation package.
- Compared to last year, the average total compensation was up 18 percent for CEOs and 30 percent for CFOs.



ANNUAL INCENTIVE COMPENSATION

- 84 percent of companies in the top quartile utilize annual incentive plans where payout is at least partially determined in a formulaic manner. Only 50 percent of companies in the bottom two quartiles utilize formulaic performance metrics.
- Production / production growth remains the most prevalent performance metric in annual incentive plans and is utilized by 81 percent of companies. Production as a metric has slightly decreased over the past three years.
- With the ongoing depression in the energy sector, we have seen a notable increase in the use of cost control and safety metrics, while the use of growth metrics such as production and reserves has decreased.

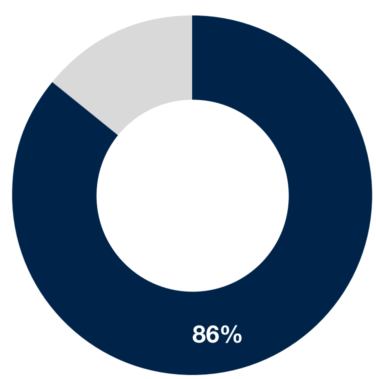
LONG-TERM INCENTIVE COMPENSATION

- The prevalence of LTI awards varies by company size; time-vesting restricted stock / restricted stock units are the most common form of award granted (used by 86 percent of all companies).
- 70 percent of companies grant LTI awards where vesting or payout is determined by one or more performance metrics. The most common performance period is three years, used by 85 percent of all companies.

91%

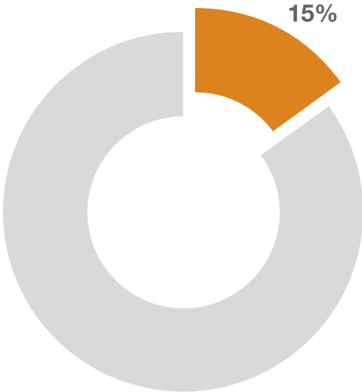
Companies using relative TSR as a performance metric.

Time-Vesting Restricted Stock and RSU Prevalence



CHANGE IN CONTROL BENEFITS

- The most common severance multiple for CEOs is three times compensation or greater (52 percent).
- The most valuable benefit received in connection with a change in control is accelerated vesting and payout of LTI awards, making up 66 percent of the total for CEOs and 60 percent of the total for CFOs.
- Single trigger equity vesting (no termination required) is most prevalent (51 percent), although double trigger equity vesting (termination required) is also common (43 percent).
- 85 percent of companies do not provide any excise tax protection, utilizing a valley provision or not addressing it at all.



Only 15% of CEOs and CFOs are entitled to recieve excise tax "gross ups"

BANKRUPTCY COMPENSATION

- Incentive programs, when properly structured, can help bridge the compensation gap between the onset of financial hardship and a healthy go-forward restructuring. Some common metrics for E&P bankruptcy incentive plans include production, expense reduction (lease operating expenses [LOE] or general and administrative [G&A]) and EBITDA.
- 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.

TOTAL COMPENSATION

We captured compensation data from the summary compensation table disclosed in the 2017 proxy statement for each company. The most prevalent forms of annual compensation include base salary, bonus and LTI awards.

Compared to compensation disclosed in 2016, 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.

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	$1,017,520	$1,844,838	$8,522,223	$592,964	$11,977,545
Second Quartile Average	$740,843	$1,335,399	$5,365,350	$235,984	$7,677,576
Third Quartile Average	$534,144	$838,275	$1,595,517	$106,766	$3,074,702
Bottom Quartile Average	$500,766	$350,013	$1,154,484	$152,781	$2,158,044
2017 — Average	$698,318	$1,092,131	$4,159,393	$272,124	$6,221,967
Year-Over-Year Increase / (Decrease)**					18%

Chief Financial Officer Annual Compensation

Market Capitalization Rank	Base Salary	Annual Incentives	Long-Term Incentives	Other Compensation*	Total
Top Quartile Average	$549,957	$727,000	$2,913,541	$312,792	$4,503,290
Second Quartile Average	$443,314	$604,208	$2,890,648	$101,529	$3,887,559
Third Quartile Average	$298,743	$285,938	$1,113,581	$37,136	$1,735,398
Bottom Quartile Average	$335,040	$253,887	$512,474	$36,573	$1,137,974
2017 — Average	$410,208	$476,108	$1,890,909	$125,511	$2,876,834
Year-Over-Year Increase / (Decrease)**					30%

* 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 2016 and 2017 studies.

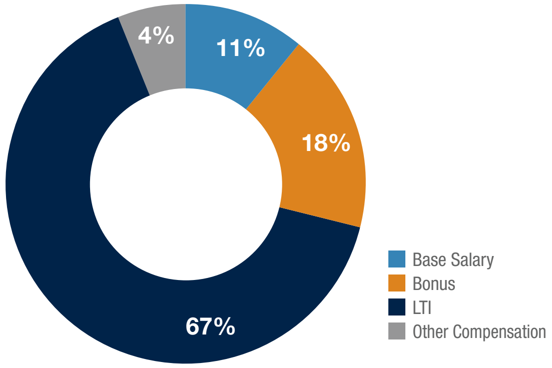
On average, incentive compensation – including annual incentives and LTI – comprises approximately 83 percent of an executive's total compensation package. The following charts show the proportion of total direct compensation delivered in base salary, annual bonus, LTI awards and other compensation for 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 LTI programs in greater detail in the following section.

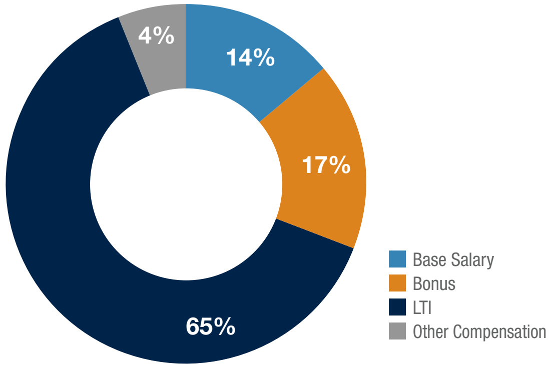
83%

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

CEO Total Compensation



CFO Total Compensation



“Annual incentives drive executive performance in the short term.”

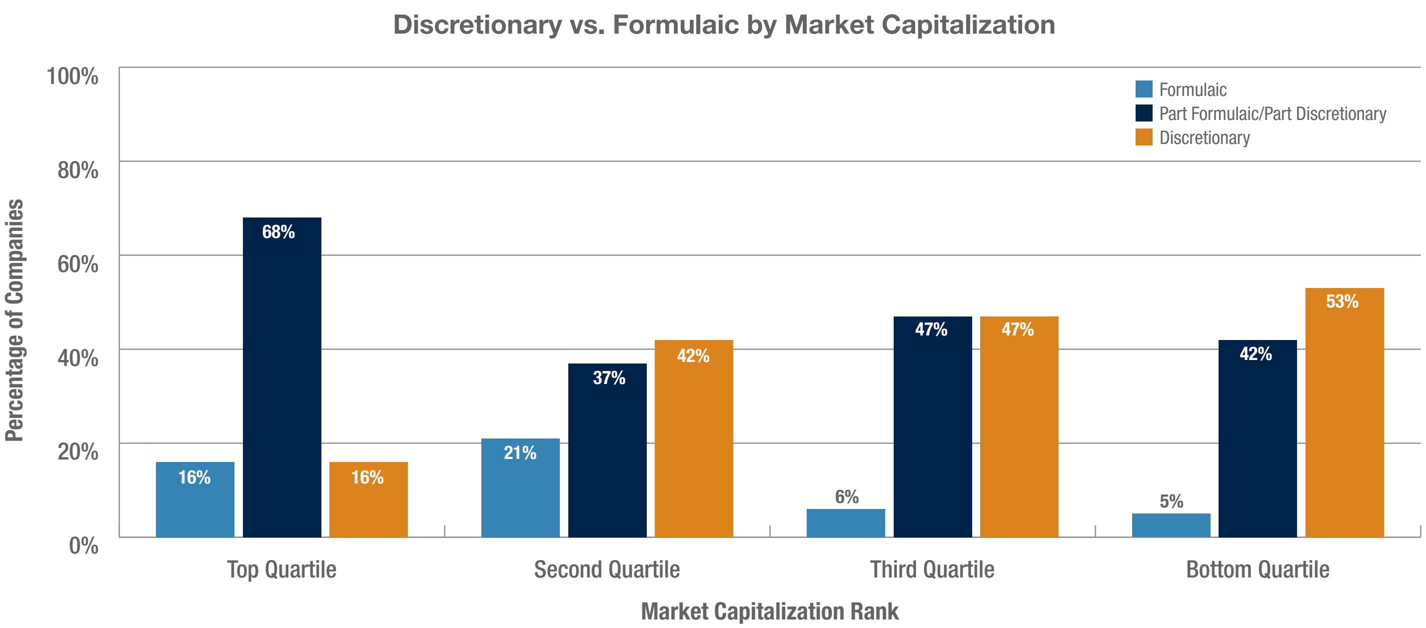
ANNUAL INCENTIVE PLANS

As is the case with most industries, companies in the E&P sector generally provide an opportunity for executives to participate in annual incentive plans (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 (other than negative discretion).
  - **Discretionary** – The plan may or may not utilize specific, pre-established 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 AIPs. However, larger companies tend to use less purely discretionary plans.



ANNUAL INCENTIVE PLANS

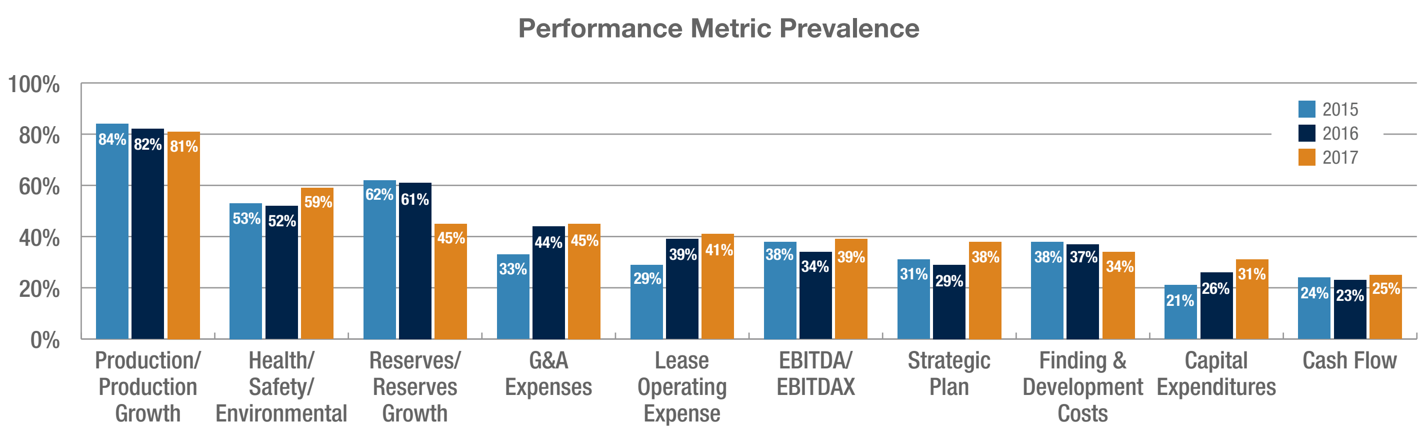
Companies utilize formulaic compensation programs to provide clarity to executives and shareholders on how compensation will be determined. Previously, formuliac plan designs allowed companies to benefit from favorable tax treatment under the now-repealed “performance-based compensation” exemption under Internal Revenue Code (IRC) section 162(m). The Tax Cuts and Jobs Act of 2017 eliminated this exception for calendar years beginning on or after January 1, 2018.

Some companies maintain discretion over the payout of annual bonus plans to allow them to adjust the payouts for events that are unforeseen and/or out of the executives’ control. This is particularly useful considering the volatility of the commodity markets in recent years. 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 the 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.

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 (81 percent), followed by health / safety / environmental metrics, used by 59 percent of companies. This year, reserves / reserve growth dropped from the second-most prevalent (used by 61 percent of companies in 2016) to the third position (now used by only 45 percent of companies).



EFFECT OF RECENT MARKET CONDITIONS

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 AIPs with financial metrics, to ensure that executives focus on profitable growth rather than growth at any cost. Some companies also added a discretionary component to their AIPs due to the state of uncertainty in the marketplace.

PAYOUT MULTIPLES

The following tables show the threshold, target and maximum level of annual incentive awards as a percentage of base salary for CEOs and CFOs. When disclosed, threshold payout is generally one-half of the target and maximum payout is two times the target. These findings are consistent with our prior studies.

CEO			
Percentile	Threshold	Target	Maximum
25th	50%	100%	200%
Average	54%	110%	229%
50th	50%	100%	200%
75th	63%	125%	256%

CFO			
Percentile	Threshold	Target	Maximum
25th	42%	80%	160%
Average	44%	88%	221%
50th	45%	90%	190%
75th	50%	100%	200%

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

LONG-TERM INCENTIVES

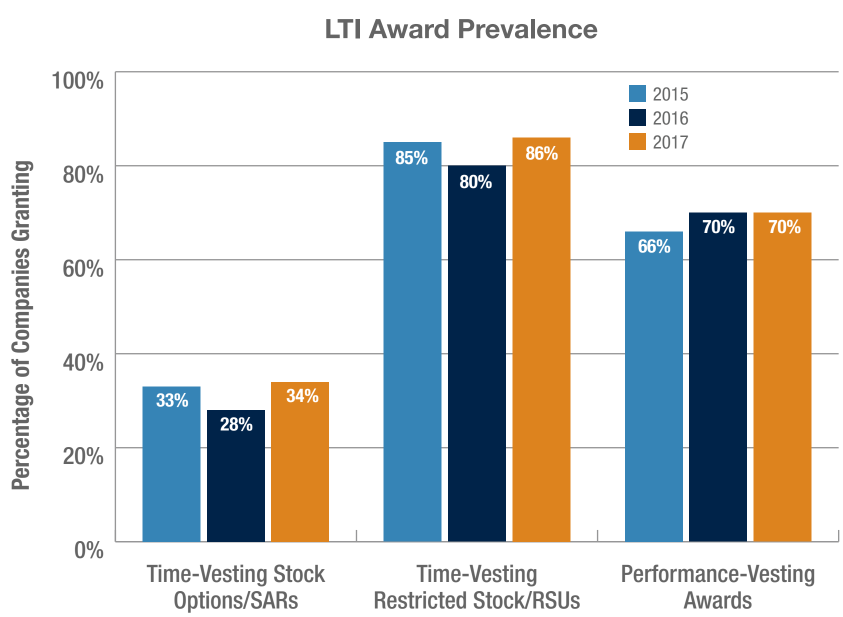
OVERVIEW

Companies grant LTI awards to motivate and retain executives and to align the interests of executives and shareholders. 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 that 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 PREVALENCE

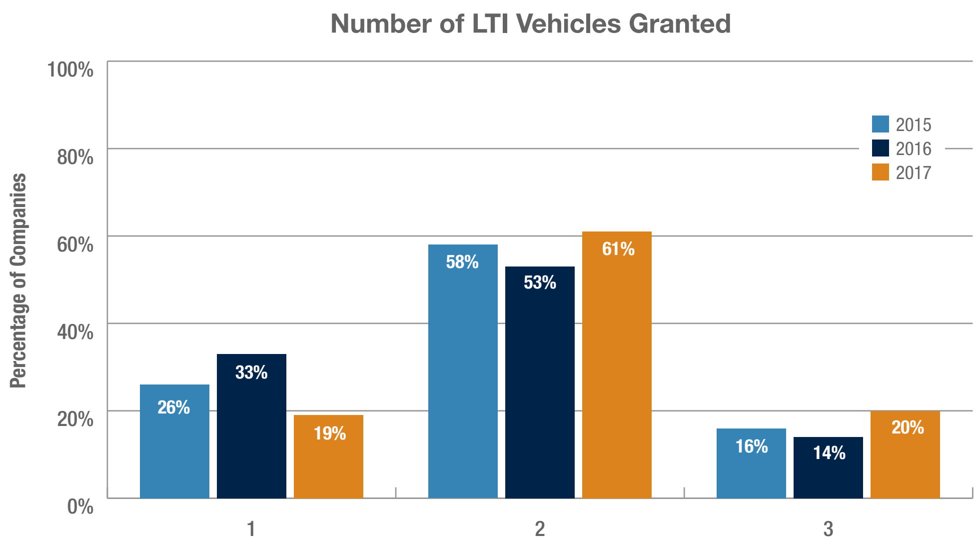
- Stock options / SARs are the least prevalent LTI vehicle utilized. Although stock options / SARs are still used by about one-third of companies and their prevalence increased slightly this year, these awards have generally declined in popularity for reasons including:
  - the overall market shift toward performance-vesting equity and
  - the view of proxy advisers that these types of awards are not "performance-based," even though to receive value from a stock option or SAR, the underlying stock price generally must increase.
- Stock options / SARs 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.
  - The recent rebound in commodity prices may explain the slight uptick in the prevalence of these types of awards.
- 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.

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



LONG-TERM INCENTIVES

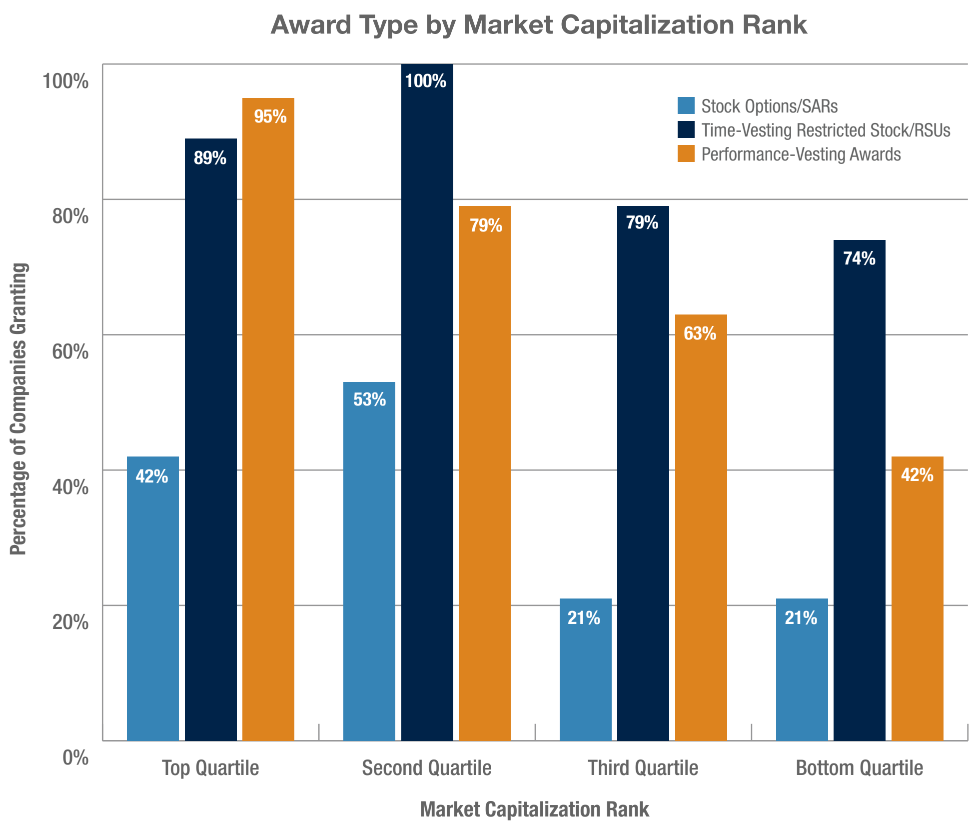
The chart to the right shows the number of LTI vehicles granted at each company. Consistent with previous years, a majority of companies (81 percent) grant two or more types of LTI vehicles.



AWARD PREVALENCE BY MARKET CAPITALIZATION

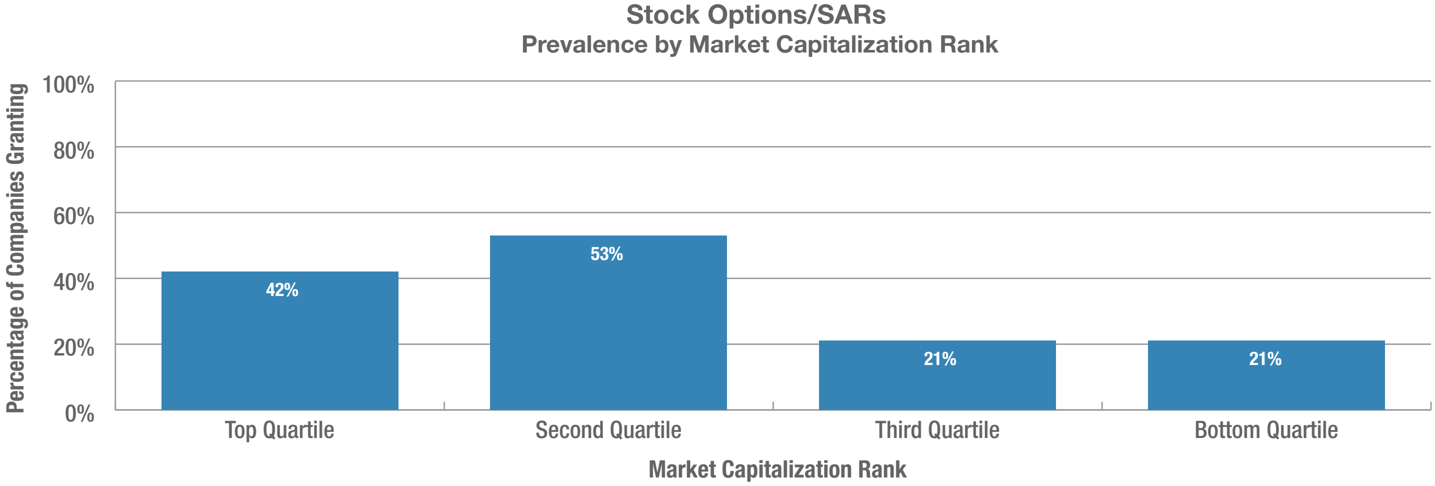
As shown in the chart to the right, A&M also analyzed whether a company's size (in terms of market capitalization) impacts the prevalence of awards that are provided.

- Stock options / SARs vary in their usage, but are more prevalent at larger companies.
- Time-vesting restricted stock / RSUs are slightly more prevalent at larger companies.
- Performance-vesting awards are significantly more prevalent at larger companies (95 percent of companies in the top quartile utilize such awards versus only 42 percent of companies in the bottom quartile).



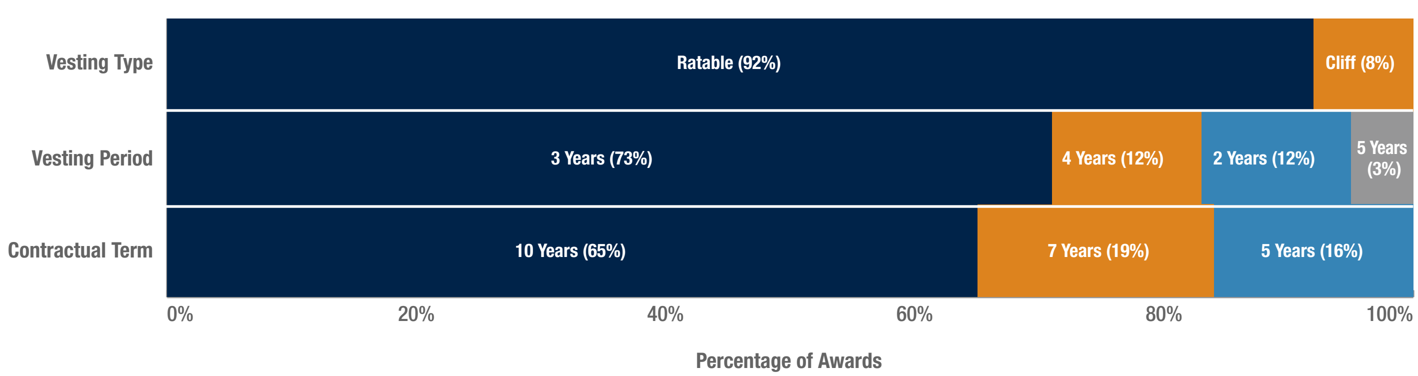
STOCK OPTIONS / STOCK APPRECIATION RIGHTS

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



AWARD PROVISIONS

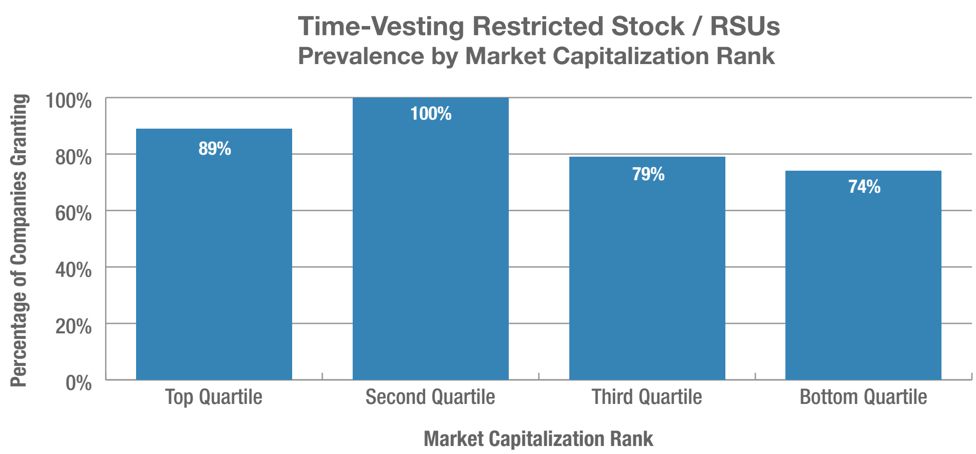
- Stock option awards predominantly consisted of nonqualified stock options rather than tax-favored incentive stock options.
- Awards generally vest on a ratable basis rather than cliff vesting.
  - Ratable vesting is when a portion of the award vests each year during the vesting period (i.e., one-third of the award vests on each of the first three anniversaries of the grant date).
  - Cliff vesting is when the entire award vests at the end of the vesting period (i.e., 100 percent of the award vests on the third anniversary of the grant date).
- The most prevalent vesting period for stock options / SARs is three years.
- The most prevalent contractual term for stock options / SARs is 10 years.
- The chart below summarizes the prevalence of vesting types, vesting periods and award terms.



LONG-TERM INCENTIVES

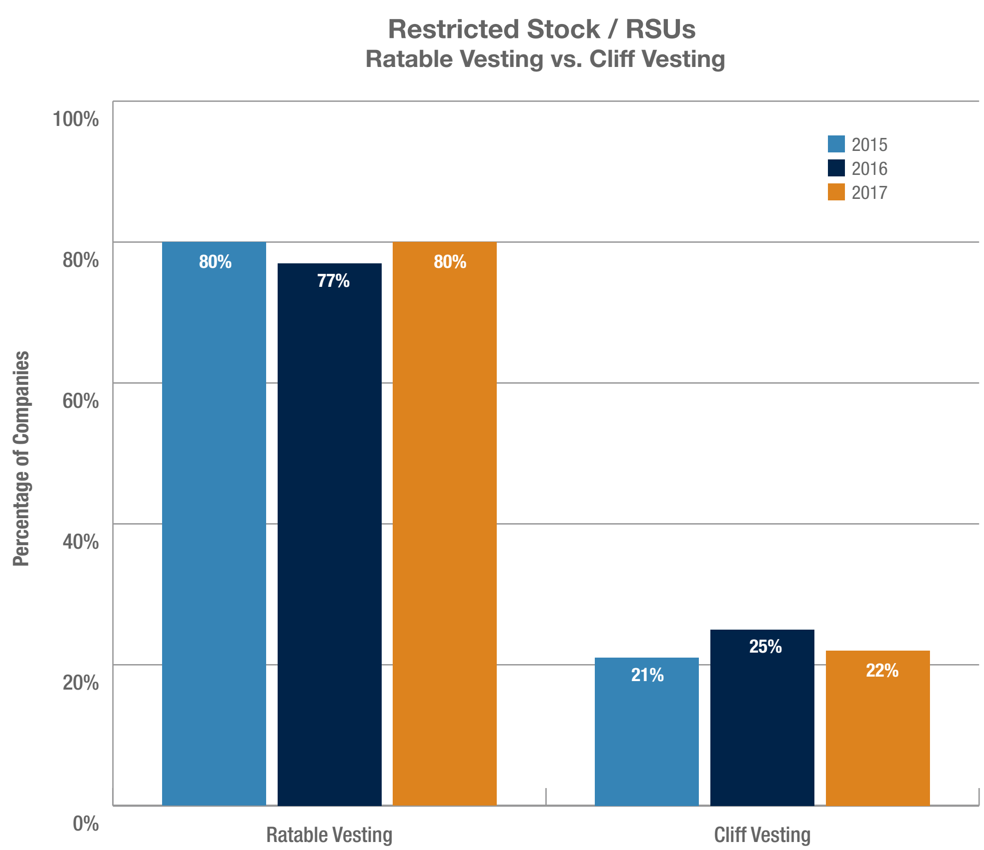
TIME-VESTING RESTRICTED STOCK / RESTRICTED STOCK UNITS

The chart to the right shows the percentage of companies that grant time-vesting restricted stock / RSUs by market capitalization. The prevalence is fairly high, the minimum being 74 percent across all sizes of companies, and is more prevalent at larger companies.



AWARD PROVISIONS

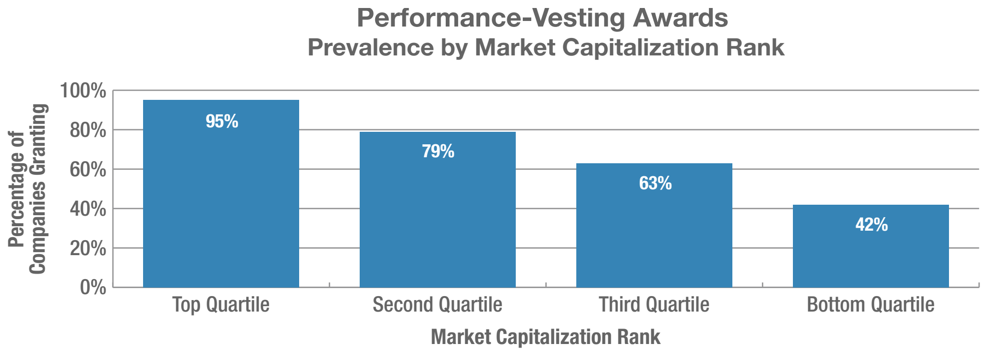
- Of companies that grant time-vesting restricted stock / RSUs, it is more common for companies to grant restricted stock than RSUs.
- A three-year vesting period is the most common vesting period (utilized by 77 percent of companies), while a four-year vesting period is the second most common (utilized by nine 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% 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.



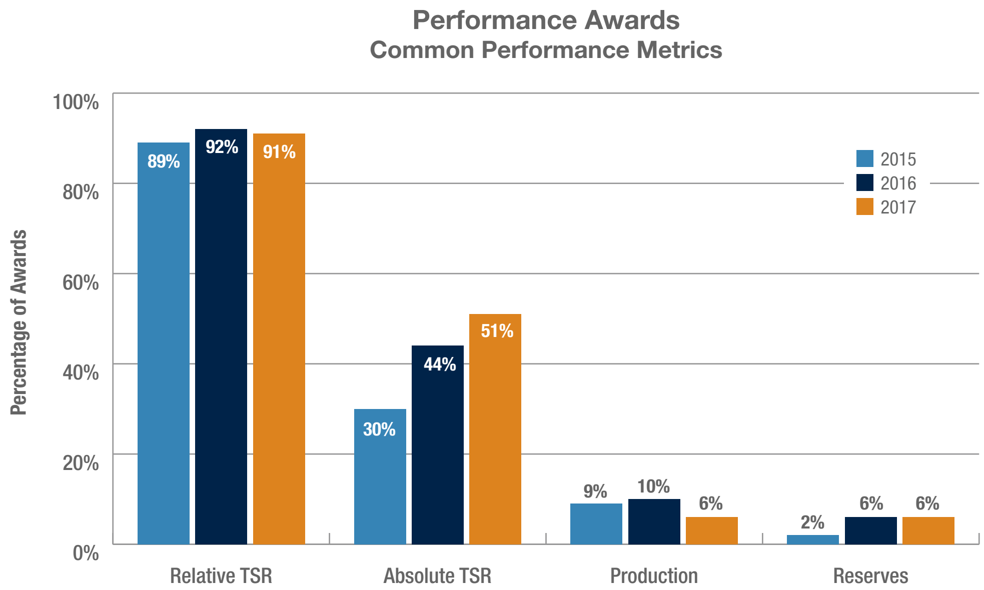
PERFORMANCE METRICS

The most prevalent metric is total shareholder return (TSR) relative to a peer group, which is used for 91 percent of performance-vesting awards. Over 50 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. These market conditions most likely explain the increase in the use of absolute TSR as a metric as reflected in the chart below.

57 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.

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.

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



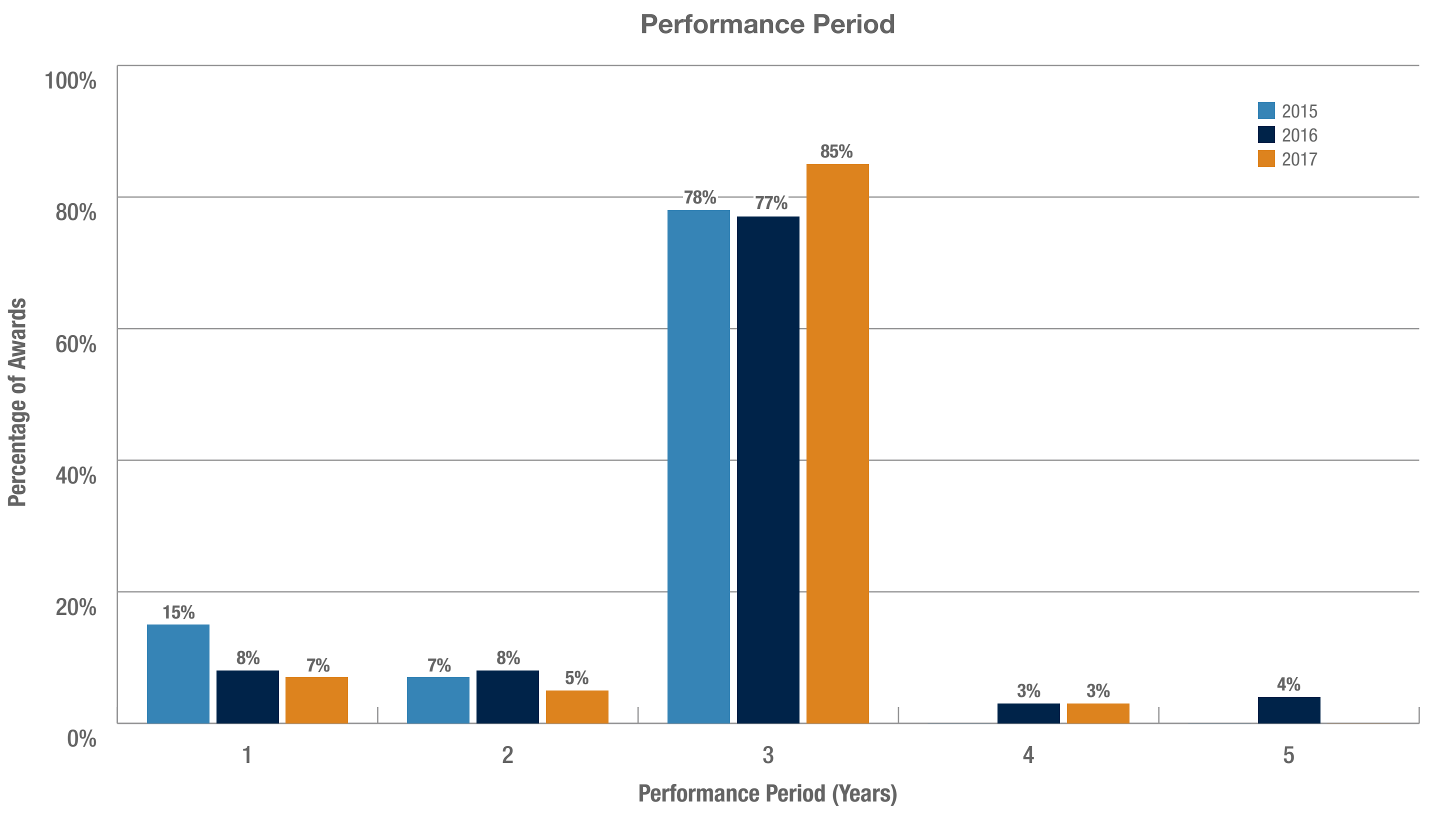
LONG-TERM INCENTIVES

PERFORMANCE PERIOD

The performance period is the duration over which the applicable performance metrics are measured. As shown in the chart below, the most prevalent performance period for performance-vesting awards, by a wide margin, continues to be three years (85 percent of awards) followed by one year (seven percent of awards).

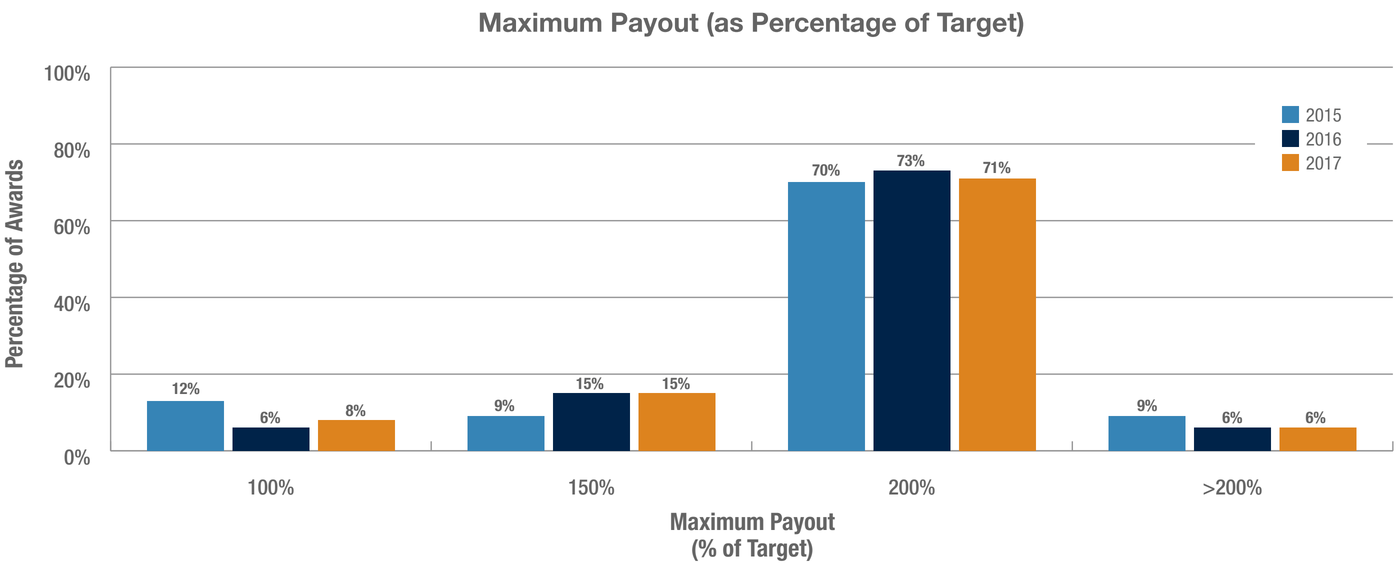
Many companies use three-year performance periods to promote long-term sustainable growth, rather than shorter periods that tend to focus only on short-term performance.

> *"Performance periods of appropriate length keep executives focused over time."*



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 below, most performance-vesting awards granted by E&P companies provide for a maximum payout equal to 200 percent of the target.



Although 200 percent of target payout is the most prevalent maximum payout percentage, each company should examine its own circumstances and determine what target would be most effective for the company's unique position. 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 market conditions, change in control arrangements help to keep executive talent retained and focused."

CHANGE IN CONTROL BENEFITS

OVERVIEW

Typical change in control benefits include severance payments, annual bonus, accelerated vesting of LTI, retirement benefits and excise tax protection. The charts below show the average value of change in control benefits for CEOs and CFOs, as well as the percentage increase over the preceding year:

Change In Control Benefit Values for CEOs

Market Capitalization Rank	Severance	Annual Bonus	Long-Term Incentives	Retirement Benefits	Excise Tax Gross-Up	Other*	Average Total Benefits
Top Quartile	$7,128,975	$602,900	$25,974,128	$2,727,297	$1,836,347	$199,462	$38,100,536
Second Quartile	$4,936,348	$705,808	$11,408,131	$122,823	$0	$39,897	$17,027,267
Third Quartile	$2,043,739	$411,286	$5,086,146	$2,859	$251,784	$26,532	$7,456,056
Bottom Quartile	$2,153,587	$178,178	$1,295,000	$155,131	$73,732	$23,439	$3,329,388
2017 — Average	$4,234,262	$465,976	$11,620,137	$762,124	$517,434	$72,984	$16,653,631
Year-Over-Year Increase / (Decrease)**							83%

Change In Control Benefit Values for CFOs

Market Capitalization Rank	Severance	Annual Bonus	Long-Term Incentives	Retirement Benefits	Excise Tax Gross-Up	Other*	Average Total Benefits
Top Quartile	$2,869,940	$199,217	$7,402,904	$1,268,390	$685,321	$114,782	$12,427,242
Second Quartile	$1,963,345	$355,611	$4,807,741	$63,003	$101,828	$30,308	$7,228,254
Third Quartile	$900,094	$208,402	$2,134,632	$2,859	$0	$23,874	$3,158,114
Bottom Quartile	$1,296,786	$132,514	$853,105	$94,680	$36,030	$20,085	$1,997,192
2017 — Average	$1,837,196	$221,627	$4,079,942	$373,562	$217,278	$48,720	$6,420,216
Year-Over-Year Increase / (Decrease)**							71%

* Other includes health & welfare benefit continuation, outplacement services, and other benefits received in connection with a change in control.
** Only includes executives in both 2016 and 2017 studies.

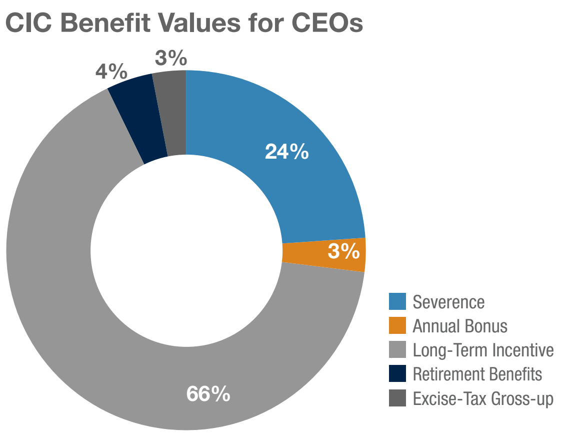
These numbers reflect a dramatic increase in benefit amounts — 83 percent for CEOs and 71 percent for CFOs. This marked increase is mainly due to an increase in the value of outstanding LTI awards that would become vested upon a change control.

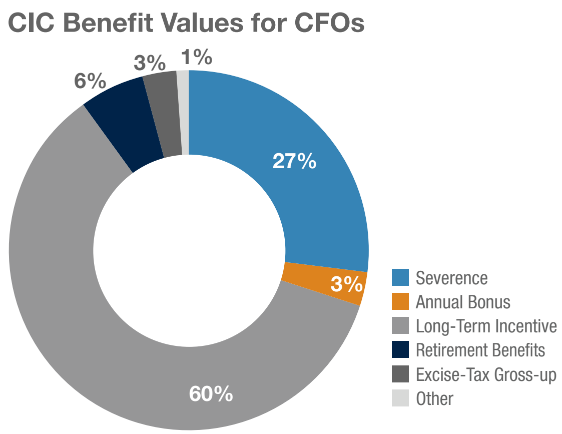
The substantial increase in LTI value occurred because many companies increased the number of shares subject to LTI awards when the commodities markets and E&P stock prices were depressed, in order to provide LTI award values comparable to historical award values. The subsequent rebound in share values substantially increased the aggregate value of outstanding LTI awards.

If LTI is factored out of the foregoing analysis, the year-over-year increase on change in control benefits would be only five percent for CEOs and eight percent for CFOs.

CHANGE IN CONTROL BENEFITS

The charts below illustrate the average value for each type of change in control benefit for CEOs and CFOs. Severance and LTI value comprise more than 90 percent and 87 percent of the total change in control benefits value for CEOs and CFOs, respectively.





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

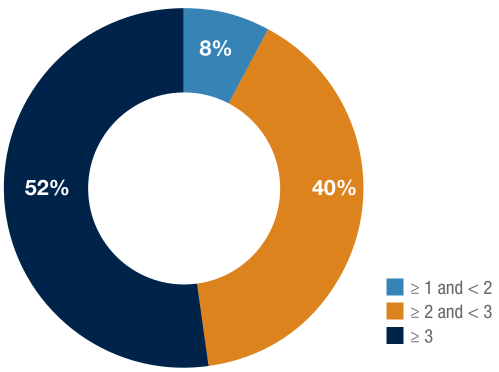
CASH SEVERANCE PAYMENTS

- Most agreements or policies with change in control 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

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

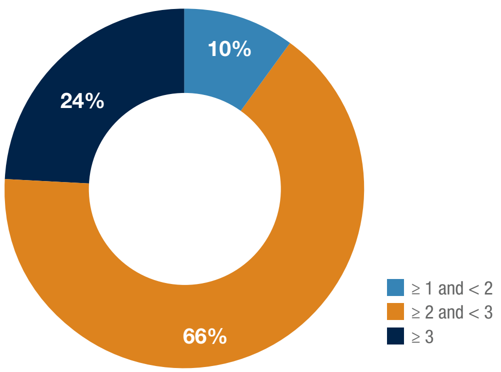
Severance Multiple Prevalence – CEO



CFOs

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

Severance Multiple Prevalence – CFO



CHANGE IN CONTROL BENEFITS

ACCELERATED VESTING OF LTI AWARDS

There are generally three types of change in control payout triggers for equity awards:

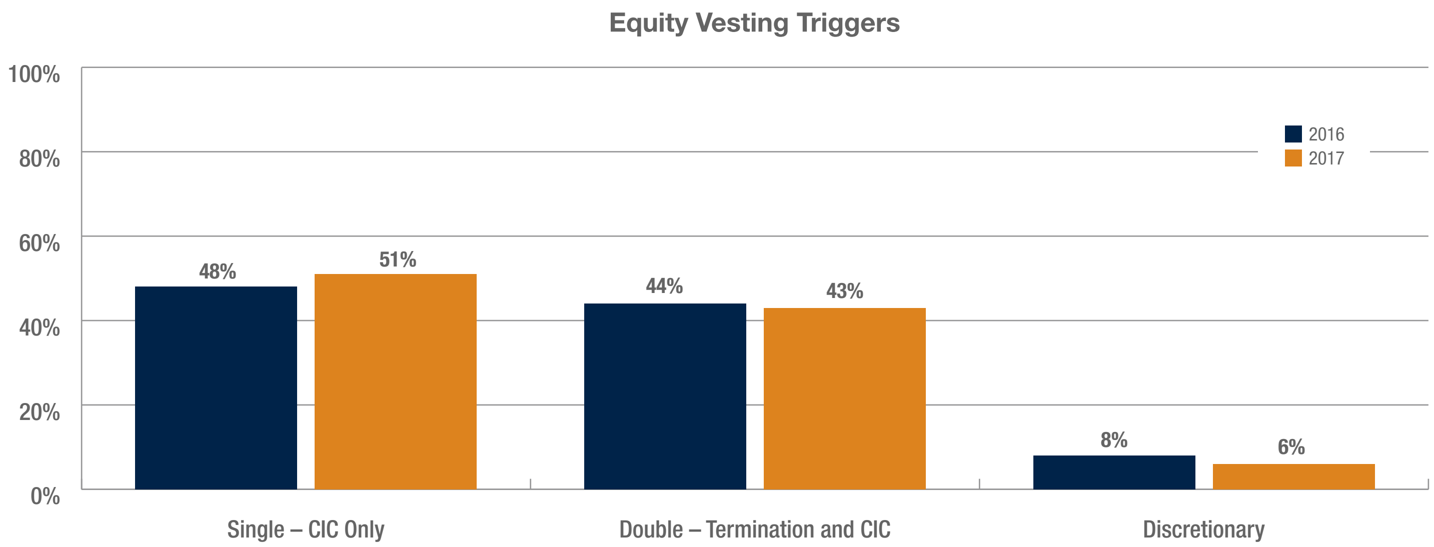
Trigger	Description
Single	Only a change in control must occur for vesting to be accelerated.
Double*	A change in control plus termination without cause or resignation for "good reason" must occur within a certain period after the change in control.
Discretionary	The board has the discretion to trigger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

The most common trigger found in equity plans is the single trigger (51 percent). However, 43 percent of companies have at least some equity awards outstanding with a double trigger. Six percent of companies also provide the board with discretion to accelerate the vesting of some outstanding equity awards.

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 that the trend toward double trigger vesting provisions will continue into the foreseeable future.

The chart below shows the prevalence of change in control triggers for outstanding equity awards of CEOs and CFOs:



EXCISE TAX PROTECTION

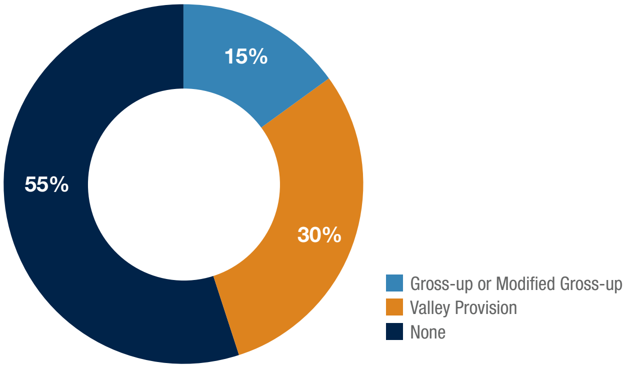
The "Golden Parachute" rules impose a 20 percent excise tax on an executive if the executive receives a parachute payment greater than the "safe harbor" limit. Companies may address this excise tax issue in one of the following ways:

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.

15 percent of companies provide either a gross-up or modified gross-up to their CEOs and CFOs. A majority of companies (55 percent) do not provide any form of excise tax protection. This is consistent with our broader study of change in control arrangements at the top 200 companies across 10 industries.

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

Excise Tax Protection Among CEOs and CFOs



BANKRUPTCY COMPENSATION

To remain resilient under current market conditions, E&P companies must reevaluate their traditional executive incentive programs.

BANKRUPTCY OVERVIEW

Prior to 2005, companies entering bankruptcy typically retained executives by implementing key employee retention plans (KERPs) whereby executives were paid for simply remaining on the job through specified dates. However, changes to the bankruptcy code enacted in 2005 effectively ended the use of KERPs for “insiders.” As a result, many companies now 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. Conversely, retention plans are generally utilized for “non-insiders.” An “insider” is generally defined as a director, an officer or a person in control of the company.

BALANCE SHEET RESTRUCTURING / BANKRUPTCY ON THE HORIZON

If a balance sheet restructuring or bankruptcy filing is on the horizon, there are certain immediate changes to the incentive plans that should be considered in order to motivate and retain key talent. Because the company’s equity will generally become worthless in the event of a bankruptcy filing, a common defensive approach is to collapse the annual and LTI program into a single cash-based incentive program that pays out over shorter measurement periods based on hitting established performance metrics. In addition, often the annual incentive program will be modified to incorporate performance metrics that are more commonly utilized in bankruptcy and acceptable to the creditors. This allows the annual incentive plan to be easily transitioned into a KEIP in the event of a filing, thus reducing disruption to the key employees.

BANKRUPTCY FILING

In the event of a bankruptcy filing, the type and magnitude of the changes to the compensation plans will be influenced by the anticipated time frame to perform a restructuring or emergence from bankruptcy. In a “free fall” situation (where the debtor enters into bankruptcy proceedings in response to a significant liquidity event without having restructuring arrangements in place with its major stakeholders), the entire incentive compensation program will generally need to be revamped. In a prepackaged bankruptcy (where the debtor has negotiated, documented and disclosed to creditors a plan of reorganization that has been approved by creditors before the bankruptcy case is filed), there might be fewer changes to existing incentive programs and more of an emphasis on equity to be granted to management upon emergence from bankruptcy. Many bankruptcy filings will fall somewhere in between these two extremes, but in any case, the annual and LTI programs will need to be adjusted or overhauled.

BANKRUPTCY FILING

The 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. Bankruptcy courts have refused to approve KEIPs where performance metrics are easily attainable and considered "lay-ups," finding such arrangements to be impermissible retention plans. Some performance metrics used by E&P companies in bankruptcy include:

- Production targets;
- Expense reductions (e.g., lease operating or general and administrative expenses);
- Financial metrics (e.g., EBITDA, EBITDAR);
- Confirmation of plan of reorganization / emergence from bankruptcy by a specified date; and / or
- Amount of proceeds realized from sale of company or designated assets.

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. The potential payout should also result in total compensation that is reasonable when compared to market compensation levels and other bankruptcy filings.

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. Some important considerations for emergence grants include:

- What percentage of the new company's equity should be reserved for employee equity awards?
- What portion of the equity pool should actually be granted at emergence?
- Who should receive emergence grants (e.g., officers, middle management, all employees)?
- How will the emergence grants be structured (i.e., size and type of award, vesting, etc.)?
- Should the emergence grant be structured as time-vesting or performance-vesting?
- What should be the targeted total direct compensation upon emergence from bankruptcy?

When a company's financial health is not optimal, a general practitioner may not have the required expertise to guide the company through these issues during the recovery period, so retaining a qualified compensation specialist is critical.

COMPANIES ANALYZED

Abraxas Petroleum Corporation
Anadarko Petroleum Corporation
Antero Resources Corporation
Apache Corporation
Approach Resources, Inc.
Bill Barrett Corporation
Cabot Oil & Gas Corporation
California Resources Corporation
Callon Petroleum Company
Carbon Natural Gas Company
Carrizo Oil & Gas, Inc.
Centennial Resource Development, Inc.
Chesapeake Energy Corporation
Cimarex Energy Co.
Clayton Williams Energy, Inc.
Cobalt International Energy, Inc.
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.
Eclipse Resources Corporation
Energen Corporation
EOG Resources, Inc.
EP Energy Corporation
EQT Corporation
Erin Energy Corporation
EV Energy Partners, L.P.
Evolution Petroleum Corporation
EXCO Resources, Inc.
Extraction Oil & Gas, LLC
Gastar Exploration Inc.
Gulfport Energy Corporation
Harvest Natural Resources Inc.
Hess Corporation
Isramco Inc.
Jones Energy, Inc.
Laredo Petroleum, Inc.
Legacy Reserves LP
Lilis Energy, Inc.
Lonestar Resources US Inc.
Marathon Oil Corporation
Matador Resources Company
Mid-Con Energy Partners, LP
Murphy Oil Corporation
Newfield Exploration Company
Noble Energy, Inc.
Northern Oil and Gas, Inc.
Oasis Petroleum Inc.
Panhandle Oil and Gas Inc.
Parsley Energy, Inc.
PDC Energy, Inc.
PetroQuest Energy, Inc.
Pioneer Natural Resources Company
PrimeEnergy Corporation
QEP Resources, Inc.
Range Resources Corporation
Resolute Energy Corporation
Rice Energy Inc.
Ring Energy, Inc.
RSP Permian, Inc.
Sanchez Energy Corporation
SM Energy Company
Southwestern Energy Company
SRC Energy Inc.
Torchlight Energy Resources, Inc.
TransAtlantic Petroleum, Ltd.
VAALCO Energy, Inc.
Vanguard Natural Resources, LLC
W&T Offshore, Inc.
Whiting Petroleum Corporation
WPX Energy, Inc

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 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

Within our executive and mergers and acquisitions advisory services, we provide a range of support around Golden Parachutes including:

- **Executive Compensation Disclosures:** The SEC requires greater disclosure of executive compensation information. We assist companies in drafting the executive compensation proxy disclosures and quantifying the change in control payments in SEC disclosures.
- **Change in Control Planning:** We assist companies in designing and implementing competitive change in control protections, and gauge the potential tax implications of existing agreements to make recommendations for remedial redesigns.
- **Change in Control in Process:** When a change in control is underway, we assist with the calculation of the parachute payment and excise tax consequences. Further, we assist with planning opportunities to mitigate the excise tax and lost deduction.

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