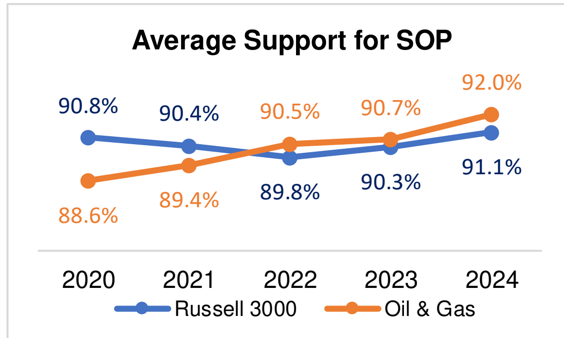
Post #81: Another Year of Strong Shareholder Support: A New Normal for Oil & Gas Say on Pay?

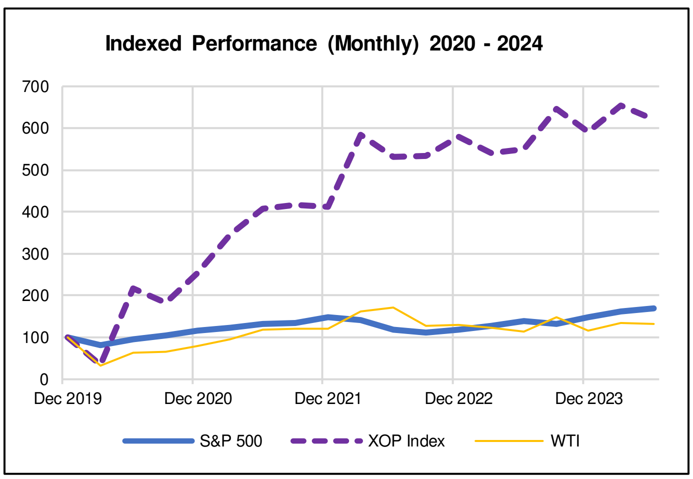
From David Bixby, Partner, The Woodlands TX

Based upon results published through July 19, 2024, average support for oil & gas company Say on Pay (SOP) proposals has exceeded 90% and has surpassed the average level of support within the Russell 3000 for the third year in a row.



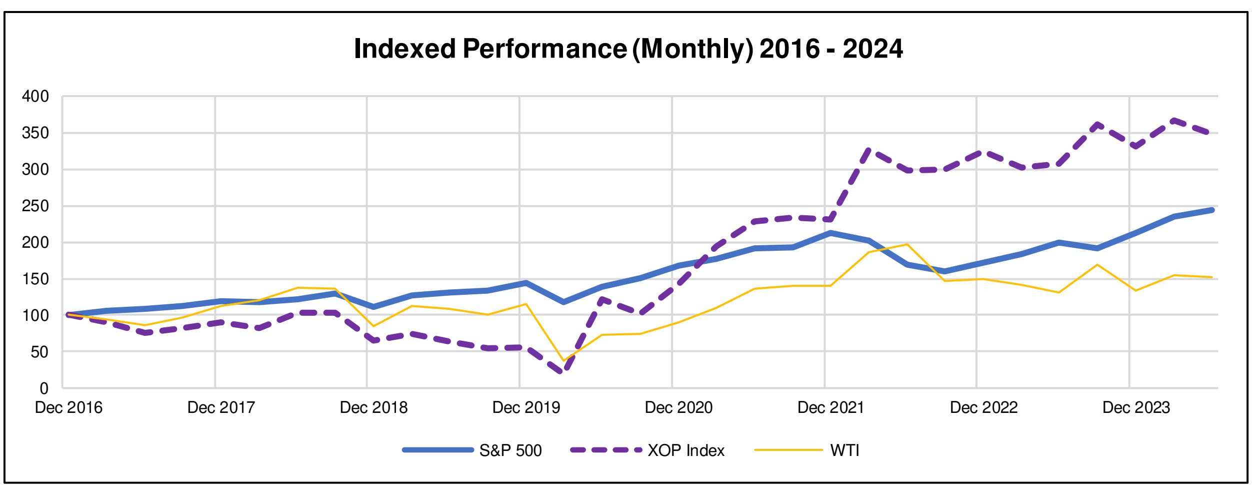
Over the past five years, the average level of support for industry pay programs has steadily increased from 88.6% in 2020 to 92% in 2024. Shareholder returns within the oil & gas sector (represented by the XOP index) have also far outpaced the S&P 500 during this period, following several years of sustained underperformance.

The chart below shows the extent to which the XOP index has outperformed the S&P 500 over the past five years. Interestingly, within this window the XOP has significantly outperformed not only the broader market but commodity price as well.



The larger chart below, which indexes performance back to the end of 2016, shows how industry stock price performance fell further than the price of WTI from 2016 to early 2020. Since that point, industry returns have risen more than 4x as much as the price of WTI.

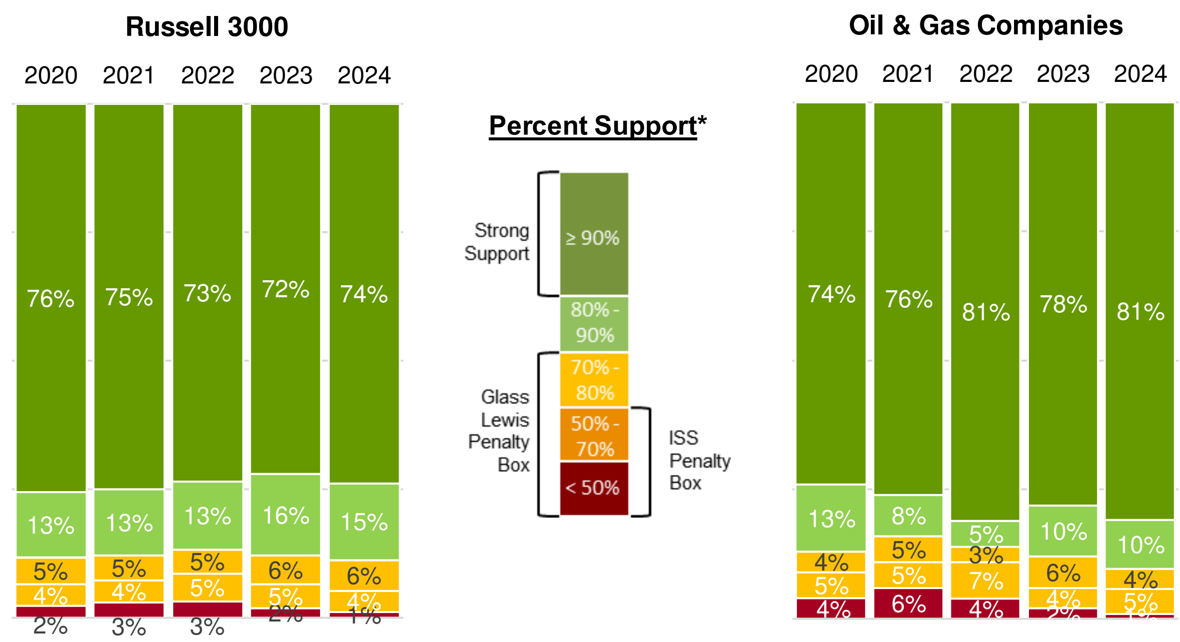
It remains to be seen whether this kind of outperformance relative to commodity price movement will continue. For now, however, improved industry performance has likely been a key factor in improved SOP support.



Higher percentage of oil & gas companies receiving “strong” SOP support than general industry

Over the past five years, the percent of oil & gas companies with “strong” SOP support (≥ 90%) has risen from 74% to 81%. In comparison, the percent of companies with strong support in the broader Russell 3000 has declined slightly over the same period, from 76% in 2020 to 74% in 2024. The portion of companies receiving support of 80% or more in the oil & gas sector has also increased in each of the past three years, from 86% in 2022 to 91% in 2024.

Distribution of Say on Pay Support: General Industry vs. Oil & Gas



* Vote support of below 80% is considered low by Glass Lewis and will subject companies to greater scrutiny for responding to shareholder concerns in the following year’s proxy. For ISS, the threshold for low support is 70%. Hence, the “penalty box” designations in the chart above.

Stronger industry performance is doubtless a catalyst for improved pay program support; a poor SOP outcome frequently reflects concerns with performance as much as it does concerns with the design of the executive pay program. However, two additional interrelated developments have likely also played a role in the improved level of support.

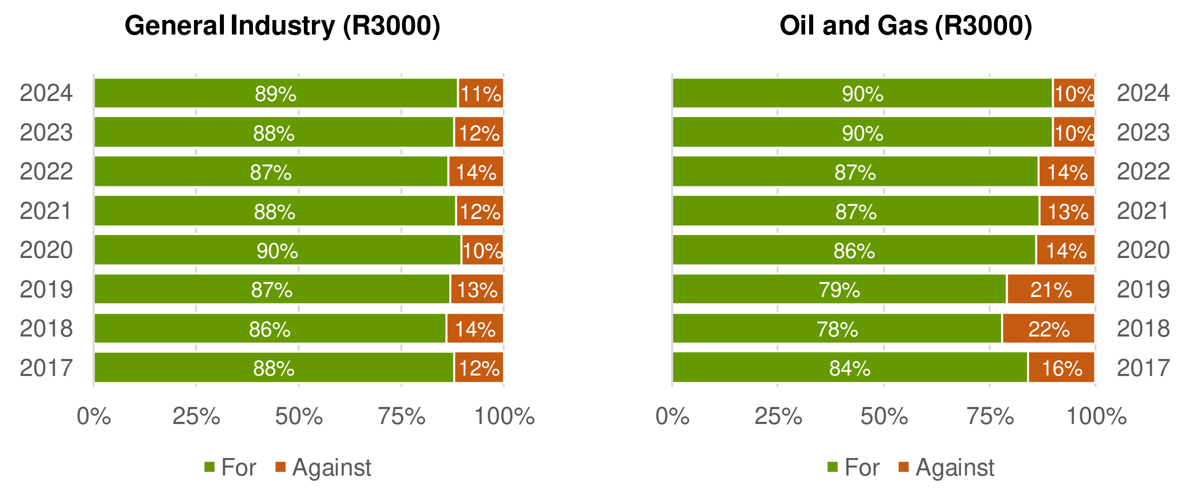
Evolution of industry pay programs reduces external pushback

Following the most recent downturn in 2020, many industry companies began making changes in response to external pushback, including:

- Simpler and more formulaic short-term incentive programs
- Increased emphasis on commodity price-aligned short-term incentive metrics (e.g., free cash flow and EBITDA)
- Decreased emphasis on growth metrics like production volume and reserve additions
- More emphasis on absolute return metrics in long-term incentive programs (e.g., absolute TSR and capital returns)
- Improved disclosure of incentive plan goals, the goal-setting process, and the determination of payouts

Most of these changes are responses to shareholder concerns with industry pay programs and have increased alignment of industry pay programs with broader market practices. In many cases, these changes have also addressed specific ISS concerns, a fact which along with improved performance may have contributed to reduced ISS opposition to SOP votes. As shown in the charts below, prior to 2021 a much larger percent of oil and gas companies received "Against" recommendations than in the broader Russell 3000. Over recent years, the rate of opposition in oil & gas looks much more like general industry.

ISS Opposition Nearly Identical to General Industry*



*percentage of companies for which ISS made a recommendation

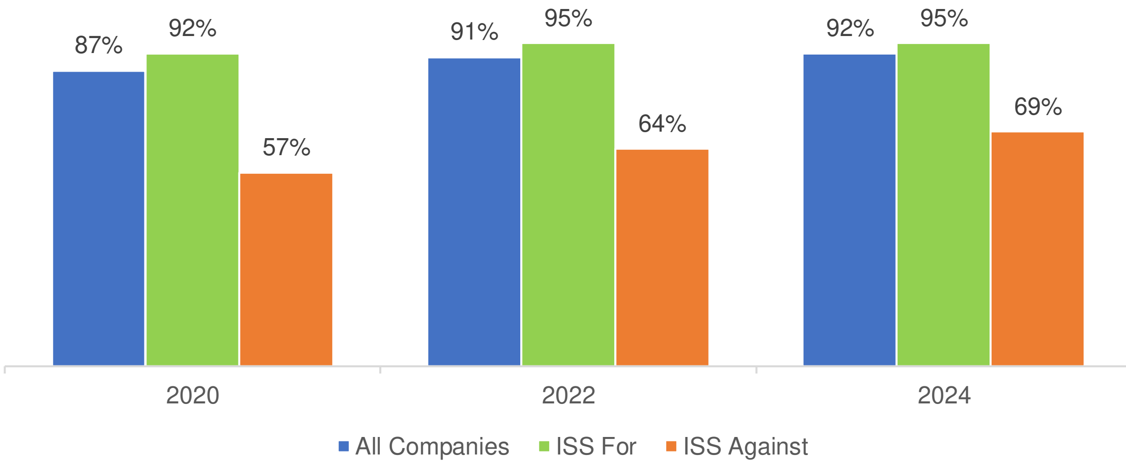
As the frequency of ISS opposition and the increase in shareholder support for SOP have eased the pressure on oil & gas companies to modify pay programs, the rate of change in program design has decreased. Over the past two years we have mostly observed smaller incremental changes in program design, or improvements in the transparency of pay disclosures. In many cases, these incremental adjustments are in response to shareholder feedback gathered as part of proactive outreach efforts rather than in response to weak SOP support.

Proactive shareholder outreach insulating companies against proxy advisory firm impact

Many companies who have been caught off guard by negative proxy advisory firm recommendations in the past have decided that launching reactive shareholder outreach efforts in the heat of proxy voting season is not a sustainable strategy. It is increasingly common to find companies engaging in conversations with key shareholders about compensation program design as part of proactive "off season" outreach efforts. Through these engagements, companies can gain insights into key shareholder concerns or preferences before they manifest themselves as negative votes. Regular dialogue with shareholders can also help insulate companies from the impact of ISS opposition by earning them the benefit of the doubt the next time an unexpected "Against" recommendation appears.

While ISS recommendations continue to have a significant impact on SOP support, the average damage done by an "Against" recommendation in the oil & gas sector has declined over the past five years. As shown, the average impact of an ISS "Against" remains significant but has fallen from a thirty-five-percentage point reduction in support in 2020 to a reduction of twenty-six percentage points in 2024, when compared to support with a "For" recommendation.

Average SOP Support: Russell 3000 Oil & Gas Companies



Rationale for negative recommendations consistent with prior years

While a pay-for-performance concern in the ISS quantitative tests may weigh heavily in their vote recommendation, it is not automatic cause for a SOP "Against;" it is a trigger for a deeper review of pay program design. Qualitative concerns that contributed to negative recommendation in 2024 followed themes we have seen repeated in recent years:

- **Large one-time or "special" awards** particularly without forward-looking performance criteria
- **Termination-related payments or enhancements (like accelerated vesting)** for apparently voluntary terminations like retirement or resignations
- **Insufficiently robust incentive plan goals** where performance targets were set below prior year goals or prior year performance, and payouts exceeded target
- **Significant pay increases** without "clearly disclosed" rationale
- **Lack of responsiveness** to a low vote in the prior year, where the extent of shareholder outreach and/or accompanying program changes were not deemed sufficient

Crucially, SOP vote recommendations based on a "lack of responsiveness" are often also accompanied by negative recommendations for Compensation Committee members. For the five Russell 3000 oil and gas companies that received below 70% support in 2023 and held a SOP vote in 2024, most were successful in avoiding this consequence. Extensive disclosure of shareholder outreach, improvements to the clarity of compensation disclosures, and (in a few cases) material program changes, contributed to an average increase in support of roughly thirty percentage points within the group. For the small group of industry companies who received less than 70% support in 2024, similar efforts are likely in store for 2025.

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