Post #35: Compensation when Oil is in the $40s

From Jim Wolf, Managing Partner, The Woodlands, Texas

Oil prices in the $40s create an entirely new environment for oil and gas compensation decisions this year. From our vantage point across the industry we've noted several important themes and realities:

- **Situations differ**. Low prices impact everyone, but some worse than others. A healthy balance sheet can spell a big difference between "peers" with otherwise similar assets or operations.
- **Programs don't need dramatic intervention**. Most compensation programs should already deliver well-aligned outcomes with the low price environment and market downturn. Outstanding equity incentive values may have dropped even more steeply than a shareholder's equity stake. Bonus programs typically have a standing "strategic" or discretionary component where a board can deliver desired messages about company health or the environment. Program outcomes typically don't require significant changes to deliver the right answer.
- **It's more about 2015 than 2014**. Most companies have concluded that 2014 performance bonuses should follow the normal process and honor the original goal commitments. Overriding financial and operating performance outcomes because of stock price performance can undermine the credibility of future bonus cycles and goals. 2015 poses the real challenge: what level of reduced performance (lower volume, less income) should still earn a "target" bonus? Or even a bonus above target? 2015 may require a more fluid and discretionary approach to evaluate and compensate performance under these uncertain conditions.
- **Shares are a scarce resource.** Stock grants pose serious challenges for companies with significant stock price decline or limited available shares. We expect isolated grant-value reductions at some companies and higher share dilution rates from new grants. Some awards may convert to cash rather than pay in shares, but cash may also be scarce. In many cases the same price-fueled markets that helped increase award values in recent years may serve to flatten or reduce award values this year and in the future.
- **Retention concerns have changed.** Attrition risk has shifted from broad competition for talent to targeted protection of certain individuals whom competitors may recruit while forfeitable holdings are low. With numerous announced layoffs and perhaps more coming, "retention" doesn't otherwise carry the same weight today in supporting compensation actions.
- **"Market" isn't what it used to be.** Benchmark pay data collected last spring and summer reflect the days of $100+ oil more than they do the current environment. At a minimum, companies should evaluate whether to remove "aging" factors from their benchmarks.

Current conditions require a new economic outlook on compensation. Companies in today's market can get to the right answers by following the processes and programs already in place, adapted to the required messages to both employees and shareholders.

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