Post #50: 2019 Say on Pay Outcomes in Oil & Gas Continue to Trail General Industry

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Several oil & gas companies had a rough proxy season in 2019, with overall lukewarm shareholder support for executive pay programs in the industry. While many companies received kudos from investors for the addition of returns-oriented incentive metrics, others struggled to demonstrate pay-for-performance alignment or continued to make aggressive pay actions despite lackluster shareholder returns in 2018.

In this posting, we take a look at outcomes and key themes from the last three years of Say on Pay votes among the oil & gas industry and general industry (within the Russell 3000). So far this year, 2019 say on pay voting results for both groups are comparable to 2017 and 2018 in terms of the broad themes:

- Most companies are indeed securing support from 90% or more of shareholders,
- A small minority of companies are failing, and
- ISS continues to have a meaningful impact on vote outcomes for most widely-held companies.

In our 9th year of say on pay voting, by now we are programmed to hear these themes as unimpeachable truths. However, when looking more closely at how oil & gas companies compare to general industry, a few additional themes begin to emerge:

- In the last couple of years, oil & gas companies have averaged lower Say on Pay support, with only about 69% of companies receiving strong shareholder support (i.e., greater than 90%) in 2018 and 2019, versus ~77% of general industry companies. This level also falls below the 78% of oil & gas companies that received strong support in 2017.
- After a spike in 2018, the number of oil & gas companies failing Say on Pay in 2019 decreased, despite generally worse stock price performance in the industry last year.
- Companies in the oil & gas industry have consistently received higher ISS opposition over the last three years than general industry companies, and the percent of oil & gas companies receiving ISS “against” recommendations has remained at an elevated level over the last two years at around 22%.

Oil & Gas Say on Pay Support Drops for 2018 and 2019

The tables below show the distribution of Say on Pay support levels (e.g., <50%, 50%-90%, and 90%+) from 2017 to 2019 for general industry companies and the oil & gas industry.

2017			
	General Industry Say on Pay Vote Result (n=2,447)		
	< 50%	50%-90%	>90%+
Count	33	488	1926
% of total	1.3%	19.9%	78.7%
	Oil & Gas Industry Say on Pay Vote Result (n=107)		
	< 50%	50%-90%	>90%+
Count	3	21	83
% of total	2.8%	19.6%	77.6%

2018			
	General Industry Say on Pay Vote Result (n=2,098)		
	< 50%	50%-90%	>90%+
Count	52	447	1,599
% of total	2.5%	21.3%	76.2%
	Oil & Gas Industry Say on Pay Vote Result (n=122)		
	< 50%	50%-90%	>90%+
Count	6	33	83
% of total	4.9%	27.0%	68.0%

2019			
	General Industry Say on Pay Vote Result (n=1,718)		
	< 50%	50%-90%	>90%+
Count	36	345	1,337
% of total	2.1%	20.1%	77.8%
	Oil & Gas Industry Say on Pay Vote Result (n=108)		
	< 50%	50%-90%	>90%+
Count	2	31	75
% of total	1.9%	28.7%	69.4%

The data show an overall decline in Say on Pay support in oil & gas from 2017 levels, with a greater number of companies receiving less than the standard 90%+ support enjoyed by the great majority of general industry companies. This tracks with oil & gas industry shareholder returns that have lagged general industry. For the industry as a whole, total shareholder return decreased from +41.6% in 2016 down to -8.8% in 2017 and -30.3% in 2018. Further, as we explore in the next section, ISS continues to have a significant impact on Say on Pay votes.

ISS Opposition to Oil & Gas Increased Further in 2018 and 2019

The next set of tables show the percentage of companies receiving ISS “against” vote recommendations for 2017-2019 between the oil & gas industry and general industry.

2017		
	ISS Recommendation	
	For	Against
Oil & Gas Industry	84%	16%
General Industry	88%	12%

2018		
	ISS Recommendation	
	For	Against
Oil & Gas Industry	78%	22%
General Industry	86%	14%

2019		
	ISS Recommendation	
	For	Against
Oil & Gas Industry	79%	21%
General Industry	87%	13%

We know from our analysis of historical Say on Pay voting results that ISS can have a significant impact on voting outcomes. For 2019, on average, an ISS “against” recommendation for companies in the Russell 3000 can depress Say on Pay votes by approximately 30 percentage points, and this has generally been the case since the outset of Say on Pay.

ISS has shown consistently higher opposition to oil & gas industry pay programs in all three years, with heightened opposition in 2018 and 2019, which aligns with lower Say on Pay outcomes shown in the previous section.

2019 Say on Pay Results by Oil & Gas Sub-Industry

The table below provides a breakdown of 2019 say on pay voting results and 2018 shareholder returns by oil & gas sub-industry.

	Avg.		ISS Recomendation		ISS		Voting Outcome			Avg.
Sub-Industry	2018 TSR	# Of Comp	For	Against	Negative: Vote %	Positive: Vote %	<50%	50%-90%	>90%+	2019 SOP Vote %
Oil and Gas Refining and Marketing	0.4%	12	12	0	0.0	95.0	0.0%	0.0%	100.0%	95.0%
Oil and Gas Storage and Transportation	-14.4%	10	5	5	70.8	94.7	0.0%	60.0%	40.0%	82.7%
Oil and Gas Equipment and Services	-37.1%	35	32	3	78.2	91.9	0.0%	25.7%	74.3%	90.7%
Oil and Gas Exploration and Production	-35.3%	45	31	14	66.0	95.5	4.4%	31.1%	64.4%	86.3%
Oil and Gas Drilling	-41.3%	6	5	1	56.2	95.1	0.0%	33.3%	66.7%	88.7%

Companies in the Storage and Transportation sector received the highest rate of ISS “against” vote recommendations, with the proxy advisor opposing pay programs at 50% of companies (however, note the relatively small sample size). The sector also had the lowest average vote support with an average of 83%. Despite worse shareholder returns in 2018, companies in the Equipment and Services, Exploration and Production, and Drilling sectors generally fared better in terms of say on pay outcomes.

Common Criticisms of Oil & Gas Industry Pay Practices

Industry pay practices have come under intense scrutiny in recent years due to perceived heavy focus on growth, lack of focus on returns, and general frustration of lagging shareholder value creation. In reviewing ISS reports of oil & gas industry companies, their criticisms were similar to prior years, including:

- Lack of sufficiently "rigorous" goals in short/long-term incentive plan (e.g., lower performance goals from prior year without sufficient rationale)
- Failure to respond to multiple years of low SOP
- Majority of CEO compensation is discretionary
- Outsized time-based grants to new hires
- "Problematic pay practices", including large, one-time equity grants or excessive retirement payments

Through our clients' shareholder engagement efforts this spring, we observed that industry shareholders continue to seek greater capital returns, spending within cash flow, and increased overall performance against broader indices like the S&P 500. These areas likely contributed to the reduced shareholder support for executive pay programs.

This time next year, we would expect to see companies that received less than 80% support disclose the outcomes from shareholder outreach efforts this fall and potential changes to executive pay programs. And with shareholder returns for the industry and oil prices up 10% and 17% year-to-date, respectively, this could potentially result in stronger support levels in 2019.

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