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WHAT TO LEARN FROM SHAREHOLDER ACTIVISM

A Review of Recent Shareholder Activism in the Energy Industry

Posted by Jim Wolf on March 21, 2013

Energy boards and management have paid close attention to activist shareholders this proxy season, including current proxy battles and investor activism at Hess Corporation (Elliott Associates), SandRidge Energy (TPG-Axon Capital) and Nabors (Pamplona Capital). Each has included a discussion of corporate governance and compensation. This Meridian update doesn't take a side in these discussions; instead we find it helpful to monitor these events for what other energy companies might learn.

A review of each company's shareholder activism reinforces some basic fundamentals in corporate governance and executive compensation:

1. **Be Prepared**
   - Any company's stock price performance may lag for extended periods. Trends change and transitions can take time. A healthy defense starts with understanding that today's good performance may not fend off tomorrow's criticism.
   - Also note that investors have never had such ready access to a high volume of performance and pay information in an easy digital format. Third parties can easily build a detailed business case, sometimes with differing conclusions from the company's own disclosures.
2. **Maintain strict governance processes**
   - Process is important – stay current on changing governance standards and review board charters, calendars, and meeting agendas carefully to establish tight compliance.
   - Avoid even the appearance of conflicted interests. Within a close-knit industry it can be difficult to establish "perfect" independence, but boards should recognize that perceived conflicts are difficult to explain away after activists engage.
3. **Tie outsized pay to outsized performance**
   - Activism elevates concern about standing out in periods of relatively poor performance. Companies should demonstrate a consistent and clear connection between pay and performance. Short-term bonuses should align with short-term performance (good or bad), even if current year results lag because of well-regarded long-term investments or transitions.
   - Exceptional compensation should have a direct tie to exceptional stock price performance. Boards should avoid delivering above-normal compensation based solely on subjective or discretionary factors.
   - Director pay can also offer an easy target for activists. Companies should keep director compensation within a reasonable fairway of industry peers.
4. **Generate strong shareholder voting results**
   - Monitor proxy advisor reports even when the recommendation is positive and consider reasonable responses that might improve governance ratings. A history of consistently strong shareholder support (90+% Say on Pay approval) is tough to argue against.

Disciplined governance provides a healthy defense from third-party activists. Boards shouldn't shy away from being different or unique, but a disciplined process and consistent standards help keep companies on firm ground.