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INTRODUCTION

LONGNECKER & ASSOCIATES (“L&A”) HAS OVER 35 YEARS OF EXPERIENCE IN THE DEVELOPMENT OF REASONABLE AND DEFENSIBLE COMPENSATION PROGRAMS IN BOTH PRE-PETITION AND IN-COURT RESTRUCTURINGS.

Since the Bankruptcy Code change in 2005 required adherence to section 503(c), L&A has been involved in the development of programs which were intended to solve for a variety of issues:

- Retention of key talent in high-risk and/or volatile situations
- Incentivizing employees to achieve goals which are integral to successful emergence or maximization of asset sale proceeds
- Ensuring competitiveness of compensation values while accounting for time, risk and market conditions
- Fit within the cash flow requirement of the company

Recent years have seen the pace of restructurings significantly increase, requiring compensation program development to be a consideration as soon as possible. When properly timed, companies have greater flexibility in program design alternatives.

The U.S. Trustee almost always objects to a Debtor’s compensation programs. L&A’s process of plan development is deeply rooted in transparent market information which provides justification through quantitative assessments on an individualized basis.

L&A has experience in the design of all types of compensation programs through restructuring, including:

- Key Employee Retention Plans (“KERP”)
- Key Employee Incentive Plans (KEIP”)
- Management Incentive Plans (“MIP”)
- Severance/Change-in-Control/Employment Agreements
- Director Compensation Programs

Without the knowledge of these processes and compensation best practices in restructuring situations, the chances of successfully achieving program goals are diminished. L&A walks this talk, as we have also defended restructuring compensation plans in court in over 100 separate instances.

Properly establishing these programs requires significant thought and care. Restructuring situations are often public, fluid and complex. As such, it is important that the compensation programs account for these factors to ensure:

- **Retention and motivation through the preservation of competitive levels of compensation**
- **Gaining approval of programs at the Board, U.S. Trustee, creditors committee and bankruptcy court levels**
- **Protection of the reputational capital of executives and independent directors**
- **Maximization of the value proposition for new shareholders in a post-emergence environment**

RESTRUCTURING PROGRAM SPECIFIC CONSIDERATIONS

Compensation programs in restructuring scenarios are drastically different than “normal course” and require greater care to ensure viability and reasonableness is achieved. This is magnified when it comes to compensation for “insiders”, which is one of the most hotly contested items in the restructuring process.

KERPs

The utilization of a KERP has evolved significantly over the past 5 years. Although the post-filing KERP remains prevalent, many organizations are seeing the benefit of pre-petition KERPs as a means of achieving greater flexibility in design.

Key Considerations:

- Participation level;
- Participation type;
- Total value consideration relative to normal annual compensation levels;
- Anticipated restructuring length;
- Current state of the macro and industry-specific markets; and
- Timing to filing.

CASE STUDY

In 2019, L&A was engaged by a private exploration and production company to enhance the current retention program that was put in place two years prior to considering a restructure. The phantom equity values proved worthless and voluntary terminations rose significantly. The existing retention program was deemed to be ineffective and required significant re-design in order to stem the flow of attrition and focus employees on operating the business up to and through restructuring.

L&A approached this situation by instituting a pre-petition KERP which was paid 100% up-front in order to mitigate bankruptcy court influence on the program. These payments were subject to a 12-month clawback for voluntary terminations, thereby requiring a full year of service and enhancing the retention of talent.

The value of the retention program was based on market competitive values inclusive of certain adjustments to account for both compressed time horizons for value realizations and lower risk of forfeiture associated with guaranteed payments versus incentive-based compensation opportunity. The outcome of this program has resulted in zero voluntary terminations since implementation.

RESTRUCTURING PROGRAM SPECIFIC CONSIDERATIONS

KEIPs

The utilization of a KEIP is most typically reserved for executives or defined insiders in a bankruptcy setting. These programs are usually designed to comply with 503(c) provisions and generate payouts based on the achievement of pre-defined quantitative goals.

Key Considerations:

- Participation level;
- Total incentive target determination;
- Metrics/goal type;
- Ability to project goals on quarterly basis; and
- Scalability and payout potential.

CASE STUDY

In 2017, L&A was engaged by a large public utilities company to develop a blended KEIP and retention program aimed at working employees toward a 363 asset sale transaction. The company entered Chapter 11, thereby requiring the use of a 503(c) compliant plan.

L&A approached this situation by instituting a metric-based incentive program tied to the achievement of quarterly EBITDA and overall sale proceeds. In addition, non-Insiders were provided a retention program which included a performance hurdle. The creditors committee and U.S. Trustee both objected to the plan as providing unreasonable compensation levels relative to the established goals.

L&A served as the expert in defense of the objections and ultimately the court approved the programs. The company subsequently succeeded in the asset sale, over-achieving the targeted sales proceeds goal. Executives and employees were paid their incentives and marginal voluntary turnover occurred over the period.

RESTRUCTURING PROGRAM SPECIFIC CONSIDERATIONS

MIPs

Upon entering Chapter 11, the equity value of executives and employees of the Debtor is eliminated, oftentimes resulting in millions of dollars of lost wealth. In addition, when no equity is held by employees of the company, no executive-shareholder alignment exists, creating potentially hazardous situations for new investors.

MIPs are intended to solve this problem by creating an incentive pool to retain and motivate human capital upon successful emergence. Companies will carve out a certain percentage of the shares outstanding in the new entity for issuance to management, employees and/or the board. MIP awards enhance alignment of all stakeholder interests and incentivize the workforce to build long-term value.

Key Considerations:

- Participation level;
- Total dilution to new shareholders;
- Initial MIP allocation; and
- Vehicles and associated vesting schedules.

CASE STUDY

In 2019, L&A was engaged by a public exploration and production company to develop a Management Incentive Plan. Leading up to 2018, many energy industry bankruptcies had come and gone. MIPs established during this time were thought to have set the benchmark for future MIPs. It was quickly determined that was not the case. New investors were displeased with historical MIPs in what they perceived to be an already over-paid industry, believing too much value was transferred to management teams historically.

In reaction, 2018 and 2019 witnessed many MIPs come in with much lower dilution, in many cases half of pre-2018 pool allocations (there was a wave of 5% MIPs following the majority 10%). This created concern for the client, as L&A described the significant issues companies with low MIP pools faced upon emergence.

L&A worked with the company to establish the MIP pool and initial allocations as beginning points for negotiating a stronger MIP. As expected, new shareholders pushed back. L&A was engaged in discussions with these shareholders where the detrimental impacts of a low MIP pool were explained. After extensive negotiations, shareholders increased the percentage allocation by 4%, providing greater flexibility to the company in both delivery of initial shares, as well as future award opportunity.

RESTRUCTURING PROGRAM SPECIFIC CONSIDERATIONS

SEVERANCE/CIC/EMPLOYMENT AGREEMENTS

Severance considerations, as well as the development of new agreements containing competitive change-in-control language, are always hot topics post-petition and often negotiating points with new shareholders. L&A is experienced in providing guidance related not only to publicly-disclosed information for senior management but also non-public information impacting the broader organization.

Key Considerations:

- Total plan cost;
- Payout opportunities under different termination scenarios;
- Severance calculation methodologies; and
- Minimum and maximum payouts associated with employee levels.

L&A has observed a growing trend among recently emerged companies whereby executives receive lower severance and CIC multiples compared to companies that have not experienced a restructuring event. This is indicative of a desire to limit compensation opportunity to management teams that have the perception of diminishing shareholder value, regardless of the reality. Further, this runs counter to the notion that higher CIC multiples for executives will better align them with shareholders in a M&A transaction.

CASE STUDY

In 2020, L&A was engaged by a public energy company to review its severance program, which was deemed by creditors to be overly generous to all employees. Upon review of the program, L&A determined the calculation, payout minimums and payout maximums were each higher than market, and were generating a total plan cost greater than market.

Working with legal counsel and financial advisors, L&A presented an alternative severance program design to both the company and the Board in an effort to re-align the program to normal market levels on a go-forward basis. The intention of the redesign was to limit the perception of overly rich programs and improve the reaction of creditors to the KERP being presented.

Presently, L&A is awaiting feedback on the outcome of this effort.

RESTRUCTURING PROGRAM SPECIFIC CONSIDERATIONS

DIRECTOR COMPENSATION PLANS

The compensation of independent directors in restructuring situations will vary greatly from the normal course, due to the elimination of equity value. Most directors know that despite a ramp up in their time commitments to the affairs of the company, they are likely working themselves out of their board role as they guide the restructuring process. Boards will generally be paid quarterly, creating potential unsecured creditor situations if payments are not current at time of filing. Redesign in restructuring is a normal occurrence.

Key Considerations:

- Total value of compensation relative to normal course;
- Meeting fees or not; and
- Timing of payments.

CASE STUDY

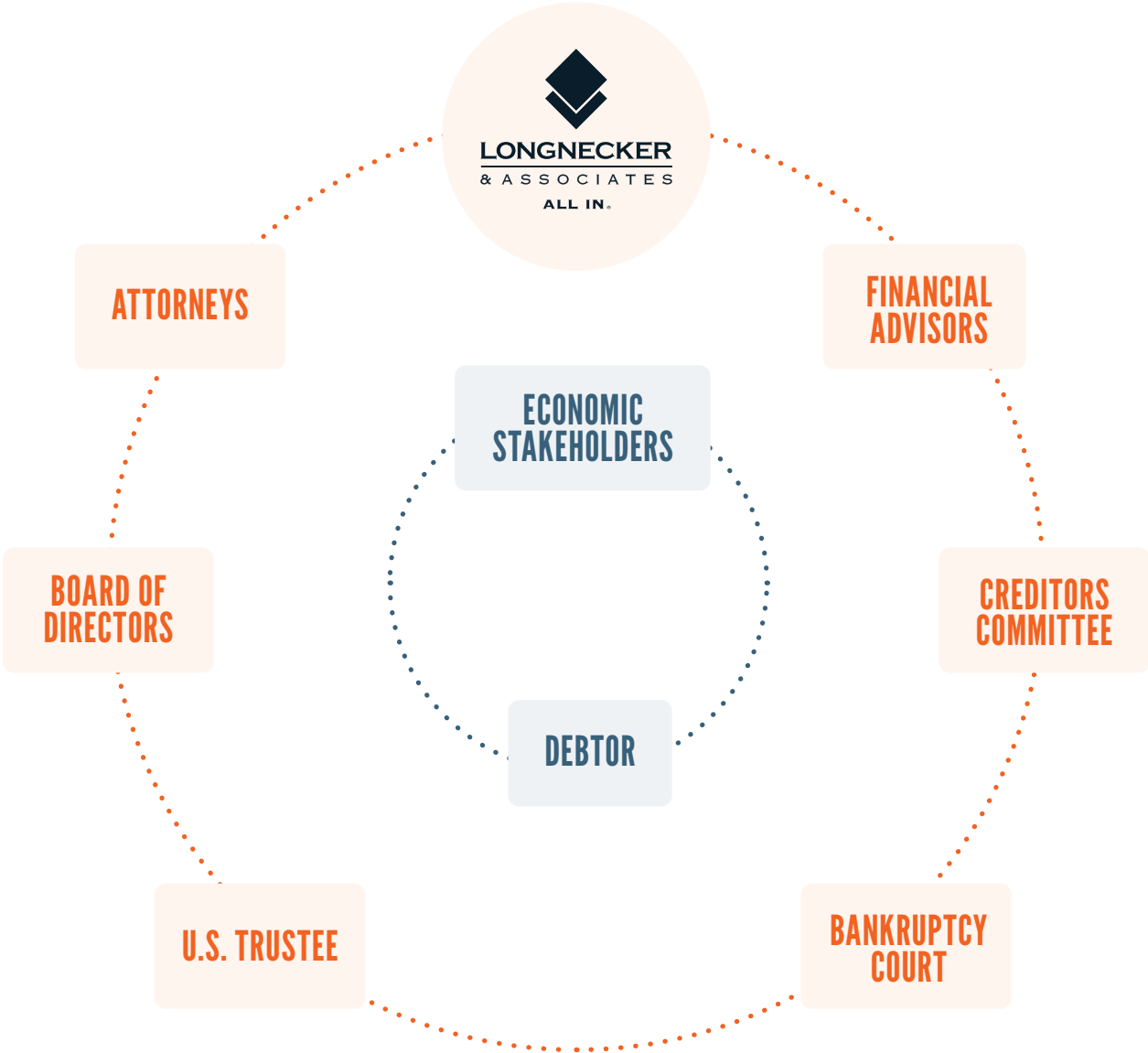
In 2019, L&A was engaged by a public energy services company to redevelop the director compensation program. There was concern related to the amount of hours being worked and the possibility of not being paid once filing occurred. In this particular instance, none of the directors had experienced a restructuring event and lacked an understanding of the nuances and importance of changing the program.

L&A moved the directors to a monthly compensation program that included an enhanced annual retainer and meeting fees that triggered once a meeting threshold was passed. The enhanced retainer was intended to offset a portion of the annual equity award that would no longer be a part of the compensation program.

The program was adopted and utilized until filing.

HOW L&A WORKS WITH YOU

L&A IS BUILT ON THE CONCEPT OF STRONG RELATIONSHIPS. INHERENTLY WE ARE A COLLABORATIVE TEAM THAT ENGAGES WITH ALL THE VARIOUS PARTIES INVOLVED IN THE RESTRUCTURING PROCESS.



HOW L&A WORKS WITH YOU

L&A typically partners with outside counsel throughout the restructuring process to support Debtor's Motions to approve a KEIP, KERP and/or a Management Incentive Plan.

A typical engagement would include the following activities:

- Benchmark Insider's pre-petition pay opportunities relative to external industry specific benchmarks. Utilizing this information aids in the development of competitive, yet reasonable plans;
- Provide information related to similar programs that were developed pre-petition and therefore unavailable in the public market; and
- Assess relevant bankruptcy approved cases for total cost relativity and program structure.

Where available, L&A will provide recent data from an industry-specific perspective. In addition, we are up-to-date on current macro-economic factors which may impact compensation, as well as industry specific conditions which impact compensation, investor sentiment or any other factors that may impact compensation.

It is important to note that L&A works closely with the Debtor's Board of Directors and/or the applicable board committee's that have oversight on compensation programs leading up to and through the restructuring process. L&A presents all findings and proposals to the appropriate audience.

Furthermore, L&A takes a collaborative approach with all other professional advisers throughout the restructuring process. L&A partners with legal counsel to understand and incorporate their viewpoints on the viability of the program designs from a legal point of view. During Chapter 11 environments, L&A develops declarations in support of compensation-related motions and contributes expertise to assist in response to any objections. L&A will also prepare for and participate in expert testimony, including depositions as well as live testimony, as necessary.

L&A also partners with financial advisors to incorporate their observations on the fiscal viability of program costs given Debtor financial constraints.

WHY USE L&A

EXPERIENCE

- With over 75 years of combined experience, our leadership team offers significant restructure consulting expertise.
- L&A has been involved in hundreds of cases over 35 years and brings a breadth of experience unparalleled in the market.
- Our team has access to not only publicly available data, but also information that is not readily available. Often, this information proves the most valuable.

STRATEGIC THOUGHT LEADERS

Not all compensation consultancies are created equal. Through years of business experience at all levels, the L&A team has built a reputation as strategic thought leaders focused on providing customized recommendations that take into account our clients' cultures, leadership and unique circumstances.

There is no "standard approach" to compensation in a restructuring scenario. At L&A, each situation is viewed as unique and the programs developed are intended to account for nuances of each company.

QUALITY

With our multi-layered, "Big 8" quality control process including partner-level reviews, our L&A team ensures a level of accuracy that is unparalleled in the compensation consulting field.

L&A maintains a consistent database of restructuring compensation programs, with data available across various industries, company sizes and program types.

All programs are developed on the basis of strong, quantitative analyses which is transparently provided in reports. The level of detail provided in these reports provides the statistical support required to defend program designs when needed.

INDEPENDENCE

We conduct an independent process by guaranteeing that all projects will be approved and directed by the necessary members of management/Board. Our process displays sound governance and mitigates any perception of impropriety.

RELATIONSHIPS

L&A is a team-oriented, relationship-focused consultancy that removes the transactional nature of the typical client/consultant relationship. Rather than solely relying on market data to determine our tailored conclusions and recommendations, we focus on clients' needs by conducting personal interviews to understand corporate culture as well as individual goals and objectives.

AWARDS/CERTIFICATIONS

- Forbes' America's Best Management Consulting Firms
- Brent Longnecker - Top 25 Consultants in the U.S. by Consulting® magazine
- Compensation Analyst Credential (CAC)
- Certified Executive Compensation Professional (CECP)
- Certified Compensation Professional (CCP)
- Certified Compensation Analyst (CCA)
- Compensation Committee Certification (CCC)
- Certified Benefits Professional (CBP)
- Global Remuneration Professional (GRP)

RECENT L&A RESTRUCTURING CLIENTS

- Bonanza Creek

 - CARBO Ceramics, Inc.

 - Chaparral Energy

 - Clayton Williams Energy, Inc.

 - Energy XXI Gulf Coast, Inc.

 - EP Energy Corporation

 - Exide Technologies

 - Gastar Exploration

 - Gavilan Resources

 - Goodrich Petroleum Corporation

 - Gulfport Energy

 - Halcón Resources Corporation

 - Jones Energy

 - Key Energy Services
- Magnum Hunter Resources Corporation

 - Miller Energy Company

 - Midstates Petroleum

 - Paragon Offshore

 - PennVirginia Corporation

 - PetroQuest Energy, Inc.

 - RentPath, LLC

 - Resolve Energy

 - Sable Permian Resources

 - Sanchez Energy Corporation

 - SilverBow Resources

 - Unit Corporation

 - Westinghouse Electric Company

 - Whiting Petroleum