



PRENG & ASSOCIATES
The Global Energy Search Leader

THE ENERGY BOARD

Agenda For 2010 And Beyond

The volatility of commodity prices, the collapse of capital markets, and mounting regulatory interventions are testing energy companies and their boards of directors in new and, in some cases, unforeseen ways.

All of these and more occurring at a time when today's energy company directors feel the groundswell of scrutiny on executive compensation and unprecedented shareholder demands for better governance transparency.

Questions such as: 'What is the board doing about risk?'; 'How is the board disclosing its activities?'; and 'How is the board accountable to shareholders?' among others, have become part of the vernacular among institutional and activist shareholders.

Yet these questions arise, not only at a time when external pressures for governance accountability continue to mount, but also at a time when answering them requires a new level of due diligence, a renewed focus on the potential and limits of board oversight, and a commitment to recruiting new, informed voices to the board.

So how will the business lessons of 2009 impact energy company boards in the year ahead? Preng & Associates, The Global Energy Search Leader, expects the following five challenges to unfold as key agenda items for energy company boards in 2010 and beyond:

1. Energy company boards will continue to drill down on how enterprise risk is managed.
2. External forces – regulatory, environmental, transnational, and political – will continue to consume more board agenda time.
3. New energy company directors will need to bring significant skill sets such as global industry experience, a long-range view, and a diversity of perspectives in order to meet mounting industry challenges.
4. Energy boards will be more proactive on “hot button” issues such as executive compensation structure and disclosure, accountability, strategy, risk assessment, transparency, shareholder communications and effective governance structures and practices.
5. Directors will take a deeper dive into management talent to calibrate eventual CEO succession options and drive a rigorous approach to executive talent development.

Preng & Associates – *The Global Energy Search Leader*

www.Preng.com





PRENG & ASSOCIATES
The Global Energy Search Leader

Enterprise Risk Management

To a far greater extent than ever before, there is little cover for boards that can only summon a paltry, “*We didn’t see this coming,*” in answer to media or shareholder inquiries about a breakdown in board governance or an outright failure of management oversight.

Yet, there exists the potential for double jeopardy if any board director – perhaps even during a formal deposition – begins to disclose information that spans an enterprise’s strategy and operations and may be privileged in the first place. For this reason, directors must balance accountabilities for external communication with a need for significant discretion to protect corporate interests.

When it comes to addressing enterprise risk management, energy company boards occupy unique ground. While boards across all industries are focusing on risk oversight, the risks inherent in exploration, drilling and production present significant challenges for energy company boards. Among them the increasing magnitude of capital investments and related timing needed to bring new energy resources into production.

“There’s no other business that could take a \$100 million investment, and, if things go badly, see it worth absolutely zero,” says John R. Butler, chairman and CEO of J.R. Butler & Co., an engineering consulting company in Houston, and a member of the boards of Anadarko Petroleum Corporation and Breitburn Energy. *“Directors need to be aware of the risk profile of the company, but the second-guessing of business tactics, risk strategy and policy – issues that boards are being held more and more accountable for – deters some risk-taking.”*

Butler adds that not all risk-taking is inherently bad, and he suggests that any externally-driven over-reach regarding risk exposure could threaten to tamp down the kind of calculated risks that energy companies, more than most, need to pursue.

Christine B. LaFollette, partner in charge of the Houston office of law firm Akin Gump Strauss Hauer & Feld LLP, and NACD Houston Chapter board member, says boards have put particular focus on enterprise risk management for several years and will invest even more time understanding the complex mix of variables that could impact the business and shareholders.

In the energy business, she adds, directors have taken “quite seriously” the combination of challenges their companies and boards have been forced to wrestle with, from the major swings in commodity prices to financial liquidity and access to investment capital – all of which create a ripple effect felt by every energy company.

“Risk management is an issue where I think you’re going to see changes in board makeup,” contributes Charles J. Pitman, a member of the board of Apache Corporation. *“People who have a greater acumen in terms of managing risk from a financial point of view will be in demand. Directors need to be aware of political and operational risk, yes, but especially when companies are hedging, I think financial acumen is a skill set that boards will be looking to add more in the future.”*

“I see boards taking a continued and closer look at enterprise risk management. It’s definitely front and center for the directors and what we’ve seen is a shift more to the top-down kind of enterprise-wide team approach versus the traditional silo approach to assessing exposure.”

Christine B. LaFollette

Akin Gump Strauss Hauer & Feld LLP, and NACD
Houston

Bottom-line, LaFollette observes, *“Most board members view their role as one of oversight of the operation, not day-to-day operation, and they strive to help a company make sure they are looking at the risks that company faces and addressing them properly.”*

Staying current with the company’s risk profile and being proactive when it comes to assessing potential liabilities has become best practice for today’s boards and will remain a mandate in 2010.

David Preng, director of Cal Dive International, board member of the Houston Chapter of NACD and leader of the board search practice of Preng & Associates, says board composition is one of the key variables that determines an effective governance structure.

“The right board with the right chemistry, skills and information should be equipped to ensure that risks are identified and matched with the strategy and business model as well as continually qualified, quantified and monitored,” Preng says.



PRENG & ASSOCIATES
The Global Energy Search Leader

External Forces

Energy boards should expect even more pressure from external forces in 2010 than they have seen in recent years and the increasing politicization of a variety of issues that were once the exclusive domain of boards.

The United States Senate and House of Representatives continue to churn through legislation concerning a wide range of board governance issues, from proxy access and disclosure practices relating to strategy, pay, plurality versus majority voting, as well as tenure and staggered versus annual board terms.

The volume of governance-related bills in the Congress and the implications of their passage suggest energy company boards will need to work diligently to understand compliance issues and identify areas that may call for adjustment from Washington. The Dodd Bill, for example, sponsored by U.S. Senator Christopher Dodd (D-Conn.), chairman of the Senate Banking Committee, includes corporate governance provisions that would require a majority voting standard in uncontested elections of directors, enable shareholders to nominate directors using a company's proxy materials, and, among other reforms, require companies to explain why they have chosen either to separate or not to separate the roles of chairman and CEO.

In light of an increasingly litigious environment, Butler contends, the federal government will exert more pressure on energy companies on issues ranging from taxation and natural resource access to permitting and drilling.

Whether it relates to the reduction of federal lease terms, pay practices and related disclosures, or regulatory maneuvers that have the effect of forcing up the cost of domestic production, Butler adds, *"The government is getting more and more into our business...and I think it's a little more uncomfortable for U.S. energy company board members."*

Further, Butler questions whether the domestic oil and gas industry isn't being put at a significant disadvantage when it comes to competing on the global stage. For example, he says, *"We used to dominate the seismic industry. Today there are no major U.S. seismic companies. Now they're Norwegian, French and Chinese, and there are some Canadians, but there are really no big players based in the United States."*

And when it comes to access to land and natural resources, Butler adds, other countries again have a competitive advantage. *"As a result, I think more market leadership in the future will probably come from foreign companies, like the Russians, Brazilians and the Chinese."*

Add to that the on-again; off-again political focus on the "tremendous profitability" of U.S. energy companies, and one begins to realize the full panoply of pressures on energy company boards and directors. This, he says, in a country that has led the world in energy exploration, discovery, production, refining and all aspects of the oil and gas industry, including service companies that have been leaders in their fields.

Butler comments one has to wonder whether the United States is slowly seeing its competitive edge erode, much in the same way the U.S. automobile business has in recent decades.

For his part, Pitman acknowledges that energy companies, like others, have had to increase spending on compliance with governance issues relating to Sarbanes-Oxley, and have had to add new staff to tackle environmental reporting necessities. Some companies, however, haven't had to change the management of their business drastically to counter the increase in regulation.

But others may concede that regulatory-related delays and new reporting requirements add a layer of domestic bureaucracy that puts them at a global disadvantage when it comes to finding, producing and delivering natural resources to their end users.

The Energy Director Profile

To appreciate how the bar on board director talent and responsibility is rising, consider that the energy industry, like others, has learned from the harsh lessons that have unfolded from governance debacles in other sectors of the economy.





PRENG & ASSOCIATES
The Global Energy Search Leader

There is a broad consensus in governance circles that management should have a much more balanced eye with regard to meeting short-term versus long-term objectives. That is especially true for energy company boards.

The much maligned management-by-quarterly-numbers approach to running a business and reporting corporate financial results to Wall Street has been revealed as a way to enrage shareholders and arrange the kind of compensation payouts that set governance activists abuzz.

Energy company boards have watched other companies' mistake in this regard, and, from Anadarko director John R. Butler's point of view, although energy companies may be less susceptible to short-view management because of the dynamics of permitting, exploration and other factors, it would be unwise not to stress the value of the board's long-range stewardship role.

"The Street kind of rewards your production profile today rather than long-dated successes," Butler observes, but nonetheless, they are vital to drive shareholder value. *"The net of it is you have to have people around for the long term who understand this long-term time horizon that energy companies, particularly, exploration companies, are involved with."*

Akin Gump's Christine B. LaFollette concurs. *"For the health of any business, you can't focus on near-term or long-term. It has to be both. It has to be a balance."* She says the energy company board is like a mosaic, with each board member bringing an important piece to the table.

It is clear, from a board succession perspective, that new directors for energy companies will have to understand the company and know their fellow board members more intimately than ever before. If they are to earn the trust of fellow board members, new energy company directors will need to bring deep industry experience as well as an inquisitive manner to help the board surface potential risks and problems before they grow out of control.

New board directors will need not only to bring an appreciation for long-term capital investment and returns, but also an understanding of how the business cycle and other forces impact the business. Further, they will require a clear vision into the company's financial background and risk profile as well as an appetite for digging into operations, regulatory affairs, and cash flow to provide meaningful management oversight.

"Today, directors are taking the time to understand what makes good governance and transparency, and because they can understand the strategy and the risks, they can be a confidant and mentor for the CEO and senior management and really help the company reach its potential."

David Preng
President
Preng & Associates

Butler confirms it still takes a number of years for a board member from outside the energy industry to come up to speed and make a real contribution, far longer than someone who knows the business, the challenges and the risks. For that reason alone, he suggests, energy companies will likely defer to the kind of known energy-industry leaders when it comes to filling seats on their boards.

But lest anyone think it is business as usual when it comes to energy board succession, consider the increasingly recognized need for a broader range of perspectives, diverse views and informed voices from wherever they hail.

"We're also looking for people who have a broad international perspective, who are world-wise and who can weigh operational issues outside a strictly U.S. business context," says Apache Corporation director Charles Pitman. *"You need board members who know the world, and you need diversity. Unquestionably, women and minorities can make important contributions to board effectiveness."*

David Preng, president of Preng & Associates, the global energy search leader, says the use of a skills matrix helps identify the qualifications and experience of existing directors, the gaps, and the resulting needs of today's energy company boards.

"Before the crises at Enron and WorldCom, friends and business associates were asked to serve on energy company boards because they were good people, they were known to the CEO and other board members, and often could opine on issues, assess business operations and anticipate risk," Preng says. *"But because they tended to go along with what the CEO wanted, they weren't always the right people to have on the board when it came to governance."*



PRENG & ASSOCIATES
The Global Energy Search Leader

After the passage of Sarbanes-Oxley, Preng recalls, the pendulum swung the other way, and energy boards moved to recruit outsiders who could focus on governance and accountability. Yet these directors had trouble assessing strategy and risk because their learning curve on the energy industry was just too steep.

Today, independent directors with the time to commit to a board and its committees are taking the time to attend NACD programs and university-sponsored director education programs and they're combining the knowledge gained from such programs with their industry knowledge and objectivity.

More directors, he adds, are becoming certified directors and are contributing to compensation, governance and risk management transparency to provide shareholders with the data they need.

"You have to look at and ask what the director of today is going to bring to the table," Preng says. "In addition to the quality of their knowledge of governance, accountability, transparency and compensation, they are bringing an industry background and the ability to assess and influence strategy. This again underscores the opportunities that exist to build the right board with the right chemistry and the right skill sets."

Getting Ahead Of "Hot Button" Issues

"There's not a company in America that hasn't had to deal with the anger about Wall Street and the public reaction to hefty bonuses that raised taxpayer, shareholder and the Administration's focus on governance and how that reality meshes with economic reality," LaFollette says.

A variety of "hot-button" issues relating to perceptions of excessive risk taking and compensation have fueled public debate about practices relating to executive severance, perks, tax gross ups, golden parachutes and the re-pricing of stock options. *"It's prudent for Compensation Committees to review their practices in light of that,"* LaFollette explains, especially in light of the 'withhold the vote' campaigns that marked the 2009 proxy season.

Steering clear of these hot button issues requires a simple yet sustained commitment to company stewardship before issues arise that call corporate governance into question and threaten to damage corporate reputations.

What the Boy Scouts hold as their motto will serve energy company boards and directors well when it comes to avoiding unnecessary and potentially damaging dustups with media, shareholders and employees. That is, "Be Prepared."

"The issues about which boards have felt so much heat often trace back to a sheer lack of open communication and continuous dialogue between boards and shareholders, but how this is accomplished is a delicate, tricky issue," Preng says.

Managing CEO Succession And Executive Talent Development

Preparation, forethought and careful planning will also serve energy company boards and directors well in 2010 as they confront increasing workforce concerns relating to a potential shortage of specialty-skilled talent and experienced senior management to replenish a graying energy workforce.

"The recruitment of people for the board itself has become an increasing challenge because our pool of technically trained leaders does not appear to be growing," says Anadarko director Butler.

Apache Corporation director Pitman agrees. *"Finding and retaining people is an area that will have greater emphasis at the board level. It's a corporate issue in the energy sector. Figures on the average age of employees in the sector point that out very clearly."*

Prime among the board's leadership responsibilities is the effective creation of succession planning for the Chief Executive Officer.

"I think energy companies – as other companies do – rank CEO succession as a very important issue for them to address...I see directors taking a more active role on succession in the energy business," says Akin Gump's LaFollette. *"I think boards appreciate they have to have these critical discussions*



PRENG & ASSOCIATES
The Global Energy Search Leader

about succession. You have to have good management to deal with unexpected events, commodity swings or perhaps a well blow out. Today, it is an environment that requires a lot of forward-looking strategy for long-term growth, and part of that is identifying the talent and skills you need in your next CEO."

Though it may sometimes be uncomfortable to talk about CEO succession, LaFollette adds, especially if a company has a well- or high-performing CEO, it really is incumbent on the board to engage in an in-depth discussion of CEO succession at least once a year to ensure that potential succession candidates are identified and a succession process is in place should it be needed. The reduced tenure of management leaders alone, she points out, suggests more succession due diligence on the part of the board.

"We can have an unfortunate accident and lose a CEO due to an untimely death or opportunity that presents itself to the CEO and he or she decides to go somewhere else," LaFollette says. "This is an industry that requires good management and serious director interaction with management to assess strategy and react to changes quickly, so you need to have a process in place. All of what we've gone through in the general economy has made us even more appreciative of that planning process."

While CEO succession remains an imperative, there is increasing recognition that boards and directors in the energy industry also have to take a deeper look at the development of management talent for the future.

"I think energy companies are going to have to work extremely hard at creating bench strength. I think the pool for CEO talent that's out there, if you're going to recruit from the outside, is pretty thin. Companies of size better be attendant to creating their succession plans internally," Butler says.

Given the shortened tenure of leaders in a host of management roles, boards will have to provide more rigorous succession planning oversight to provide a continuum of governance stewardship in the event of more accelerated management turnover.

"We're constantly looking at our CEO succession in general and really the depth of our bench. The tenure of CEO's is getting shorter and shorter, and that's especially consequential in the energy business because we have to be long-term oriented. The industry has been created by people who were very entrepreneurial and who've had to live with their successes and their failures."

John R. Butler
Chairman, CEO
J.R. Butler & Co.

Apache's Pitman adds: *"Getting and retaining people and developing people you have for more senior management roles is really important because you have to have bench strength. The principal responsibility there is management's, but the board's role is to make sure there's an adequate leadership development process in place ahead of having to make decisions about top leadership roles."*

"It is time," Preng offers, "to ensure, if it isn't being done, that the CEO provide a detailed succession plan to the board on an annual basis, so directors can assess potential succession risk factors and the extent to which current management is preparing for effective leader transition in the future."

Preng adds: *"Now more than ever, the board must be versed in compensation and succession planning and committed to creating the right fit, the right compensation package and the right structure for the CEO today to help land a successful candidate, whether he or she be from the outside or within."*

In 2010 and likely for years to come, the board's continual oversight of nominating, talent development and succession practices across the enterprise will set the stage – in so many ways – for effective governance and transparency as well as meaningful shareholder disclosure and mutual trust.





PRENG & ASSOCIATES
The Global Energy Search Leader

About Preng & Associates

For nearly three decades, Preng & Associates has earned its reputation as the world's most accomplished executive search firm specializing in meeting the unique management leadership requirements of the energy and natural resources industries. Working from offices in Houston, London, and Moscow, our consultants possess global search expertise, comprehensive industry knowledge and experience, a commitment to service and a dedication to deliver consistently exceptional executive recruiting results across the energy value chain. We can be found online at www.Preng.com and invite you to learn more about our global recruiting capabilities.

HOUSTON

2925 Briarpark, Suite 1111
Houston, Texas 77042
USA
Tel: +1 713 266 2600
Fax: +1 713 266 3070
Email: Houston@Preng.com

LONDON

42 Brook Street
Mayfair, London, England W1K 5DB
Tel: +44 (0) 207 958 9445
Fax: +44 (0) 207 958 9090
Email: London@Preng.com

MOSCOW

4th Dobryninsky Street
Office C-1302, Building 8
119049, Moscow
Tel: +7 495 987 1554
Email: Moscow@Preng.com

