Canada's oil and gas sector in 'perfect storm' for more activism – sources

25 November 2019 | 19:20 UTC

• Oil patch activity goes quiet since failed Husky/MEG deal
• Activists may need to take a longer view
• Sector run by a small group that can close ranks to outside

There has been little or no public shareholder activism in Canada's oil and gas sector since the start of 2019 and that may soon change, advisors told this news service.

Investor frustration over not realizing returns on their oil and gas investments in the short term and significant questions about the long term value of these companies are expected to support a pick up of shareholder activism in the sector, said Sarah Gingrich, a corporate lawyer at Faskens office in Calgary, Alberta.

The situation in Calgary is a "perfect storm" and "fertile ground" for activism, she noted.

Low commodity prices, an unfriendly federal government, a failure to build new pipelines, and a growing distaste among foreign investors for Canada's oil and gas sector are expected to support the calls for change, she explained. Investors are "getting restless and starting to talk about what they can do".

Activism in the sector is especially likely to increase, Gingrich argued, if the federal government can not "get us to a place where Alberta feels heard and Alberta feels that there is a viable way forward."

The Western provinces of Alberta and Saskatchewan are known as Canada's oil patch, though hydrocarbons are also produced in the Atlantic province of Newfoundland.

Also potentially fuelling activism is the "large salaries that you're seeing at the management level," Gingrich said. Shareholders are "looking to make a change at the board level, often a minority board stake ... to strike down these say on pay motions."

She added, "They're not going to endorse these very large salaries that … are lingering from ten years ago or even five years ago when the sector was thriving."

Taking the longer view

The oil patch is "extremely quiet" and "really dead," noted Dexter John, President and CEO of Gryphon Advisors. In January of this year, he said, "we had the **Husky** [TSX: HSE] and **MEG** [TSX: MEG] transaction [which] failed; since then, there's been nothing."

He blamed low share prices but noted that institutional shareholders won't become activists until prices hit "rock bottom." When shareholders get desperate, "the sharks will get a bit more excited" and "you'll start seeing [proxy fights]," with hedge funds and activists taking positions in floundering companies.

John argues that it will differ from past oil patch activism, when companies would simply buy 5% of a company and immediately make demands. "Funds and savvy activist investors will get involved for six to eight months in advance, accumulating a position, understanding the company before they come out and make a public comment or start moving things forwards," he said.

"Activism has dropped almost completely out of that space right now" because "a lot of activists and wannabe activists got burned on plays out there" in the past, argued Ian Robertson, an executive vice president at Kingsdale Advisors.

"Coming out of the last boom of activism in that space three or four years ago," he said, "a lot of activists found that when they actually got into the board rooms of these companies, they were stuck with a company that had limited levers to create change." Reforming companies so tightly tied to a commodity price was challenging, he noted, and trying to sell off parts or all of such companies was difficult, given their balance sheets.

Robertson added, "What I do think you're going to see in that space is shareholders who might be more long-term in nature, with smaller, more retail sized shareholders initiating withhold campaigns, campaigns against say on pay votes." He also predicted shareholders putting out "an open call hoping somebody will come take a run at their company."

"We might see more activity for some brave activists in the oil patch," said Jonathan Feldman, a corporate lawyer at Goodmans in Toronto. "I think there's a lot more instability there right now than there was." The instability is coming from both external issues, such as the lack of new pipelines, and internal problems in the industry. "The governance in some of these companies – not the big players but the lesser players – has not been as robust as in other industries and so activists look at it and say there's opportunity here."

John agreed, noting that a lot of midsize and junior companies "are still family owned or closely held ... you still see a lot of nepotism as well, so really what we need to see here is a shakeup." John called for "some diversity on these boards," and predicted that over the next two or three years, "you're going to have a lot more pressure on the midcaps and small caps" to improve governance.

Over the next three to five years, John continued, "ESG is going to have a major impact." If a company is underperforming and has terrible ESG practices, activists will "shake the tables and sing from the mountaintops and the support will be there" from other shareholders, he argued, adding, "What diversity was three years ago, ESG is now."

Tough road gaining shareholder support

Gingrich, John and Feldman all agreed that a challenge for activists is the fact that the oil patch is run by a small, closely-knit group.

Traditionally in Calgary, "a lot has been done by backroom negotiations," Gingrich said. It is "hard for someone who is an outsider to come in and be successful, because Calgary traditionally closes ranks to outsiders."

"They still do deals on handshakes out there," John observed. "It's a very different culture," which poses challenges in getting shareholder support. "Being from Ontario or New York, you are considered an outsider ... so yes, it is a little bit more difficult."

When activists enter the "small community" of the oil patch, Feldman said, "They are walking in with a disadvantage that they might not walk in with in other jurisdictions." He advises outside activists to "team up with people that are on the inside."

The oil sector's biggest challenge is climate change, said Kevin Thomas, Chief Executive Officer of the Shareholder Association for Research and

Education (SHARE). His group assists oil and gas shareholders in seeking ESG improvements, such as emission reduction targets and an end to trade associations that lobby against environmental regulations.

Gingrich downplayed the effect of SHARE and like-minded stock owners. People in Alberta and Saskatchewan believe that "we have some of the cleanest processes in the world," she argued. "If you brought someone in who was solely acting as an activist on a climate platform, they probably wouldn't be very successful."

by Mark Coakley in Toronto

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