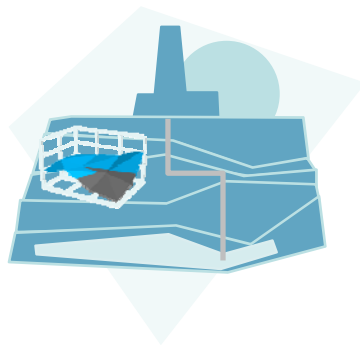


2011 Proxy Season Recap: CEO Pay in the Oil Patch





Our Speakers



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Agenda

- Today's program will offer a recap of the 2011 proxy season for oil & gas companies.
 - **Introduction**
 - *Market Context*
 - **Oil & gas CEO compensation**
 - *Trends in pay level and mix*
 - *Pay and performance*
 - **Say on Pay results**
 - *How oil & gas companies fared*
 - *Impact of ISS recommendations*
 - **Looking Ahead**
 - *Responding to shareholder pressure*
 - *Top 2011 Agenda Items*
 - **Questions**



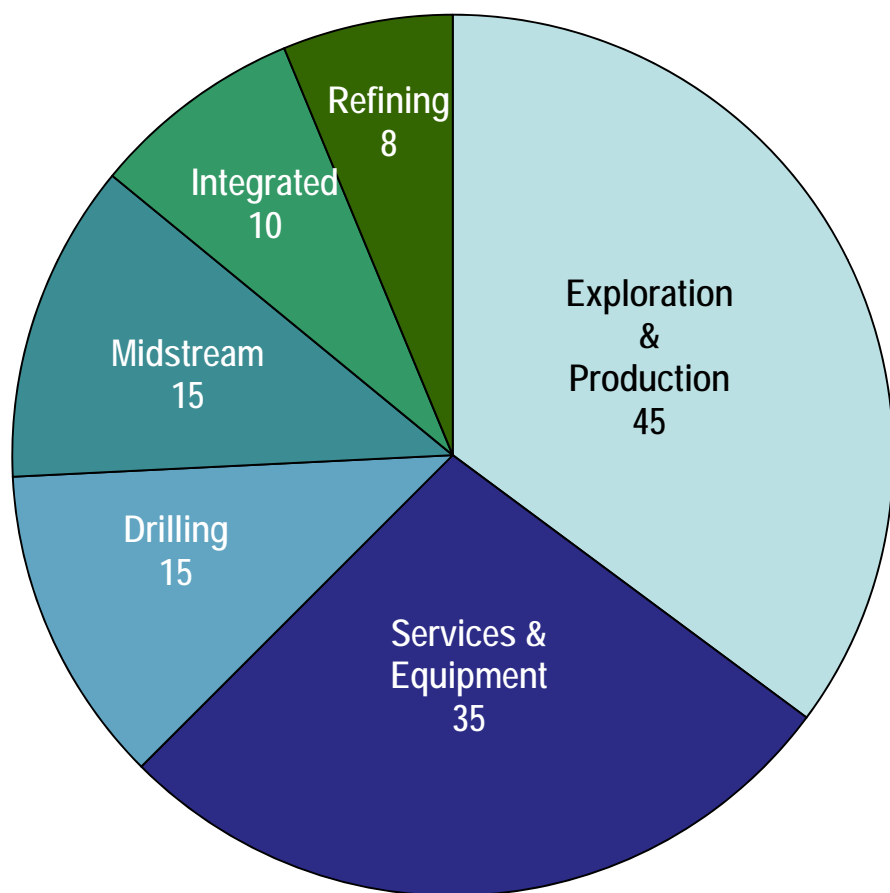
CEO Pay Study Demographics

- **Three years of proxy & annual report compensation data**
- **128 companies across a variety of oil & gas industry subgroups**
 - Exploration & Production
 - Drilling
 - Oilfield Services
 - Midstream
 - Refining & Marketing
 - Integrated Oil & Gas
- **2010 revenues from \$112 million to \$383 billion**
- **Fiscal years ending between 3/31/2010 and 12/31/2010**
- **Pay data filed by the first week of May 2011**
- **Primarily U.S. companies**
 - Several Canadian companies and European “Majors” are included



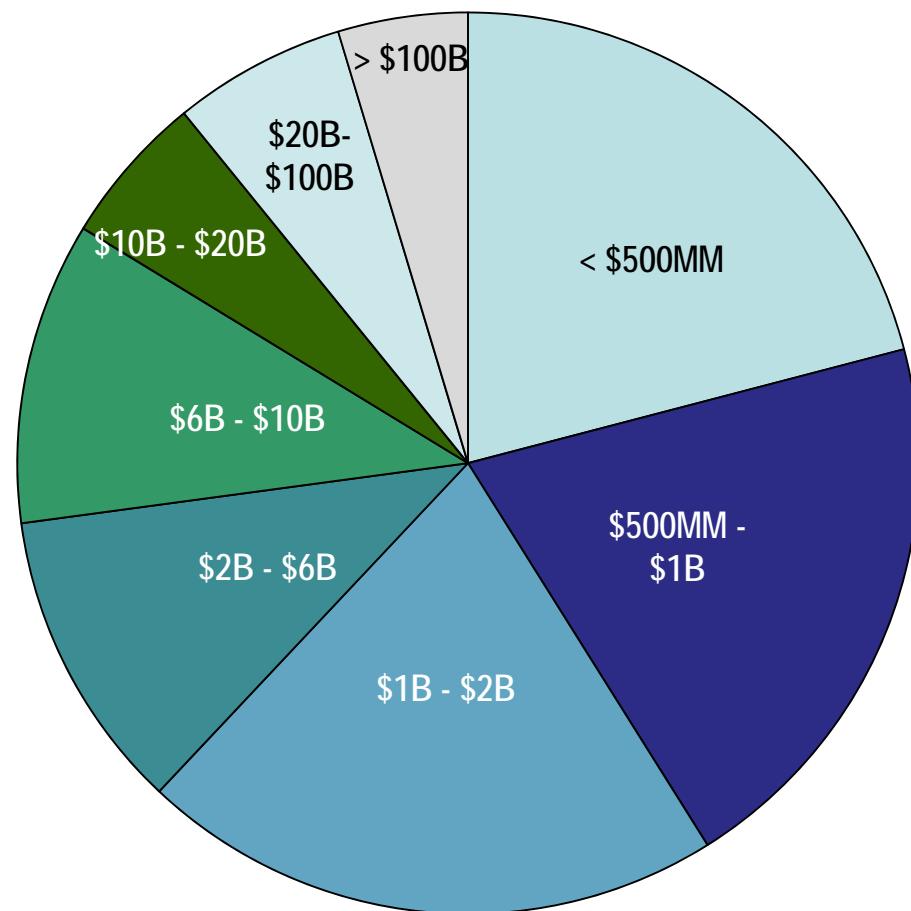
CEO Pay Study Demographics: 128 Companies

Companies By Industry Subgroup



74% of companies Upstream

Companies By Revenue Group



62% of companies < \$2 billion

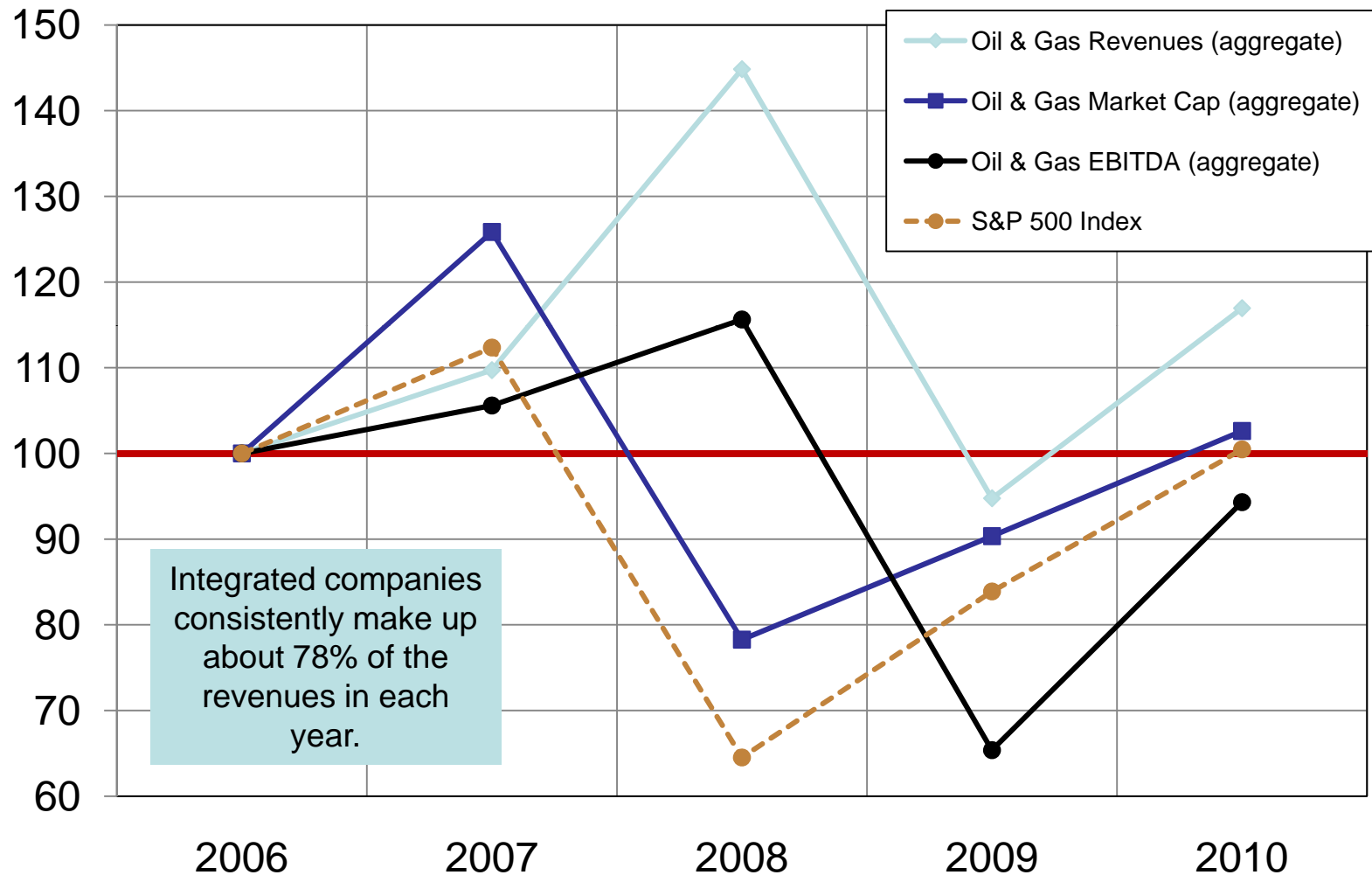


Market Context: *Oil & Gas Still in the Spotlight*

- **Despite a difficult economic environment, the oil & gas industry remains vibrant and extremely competitive.**
 - Developing economies continue to grow steadily
 - Oil prices remain historically high
 - Natural gas is recognized as a “greener” fossil fuel
 - New technology is opening up previously untapped resources



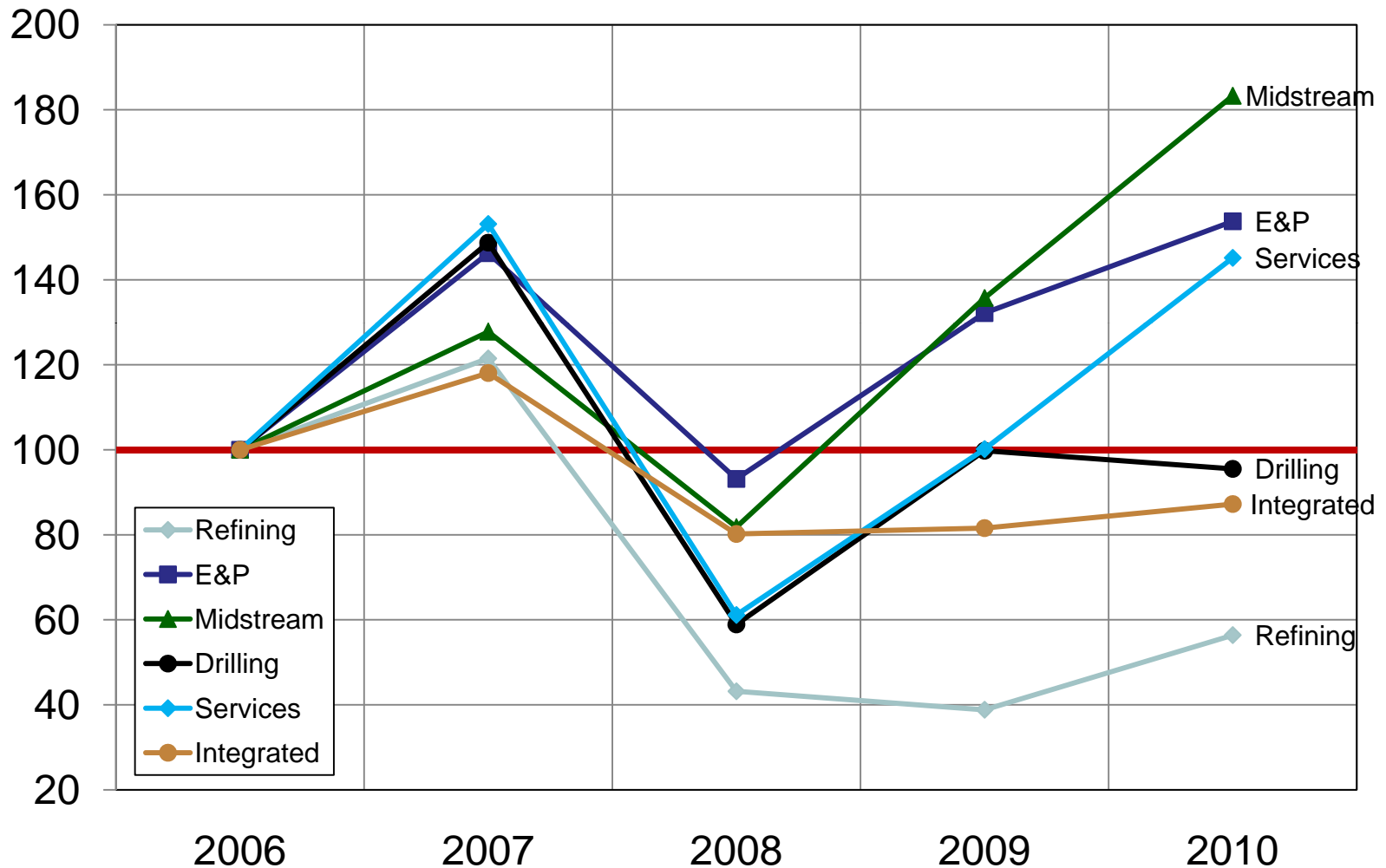
Oil Industry Performance: Aggregate Financial Performance Indexed to 2006



Includes the 128 oil & gas companies in our study



Oil Industry Performance by Industry Subgroup: *Aggregate Market Cap Indexed to 2006*



Includes the 128 oil & gas companies in our study



Market Context: *Oil & Gas Still in the Spotlight*

- At the same time, competition for talent in the oil & gas industry remains strong – putting particular pressure on compensation programs.

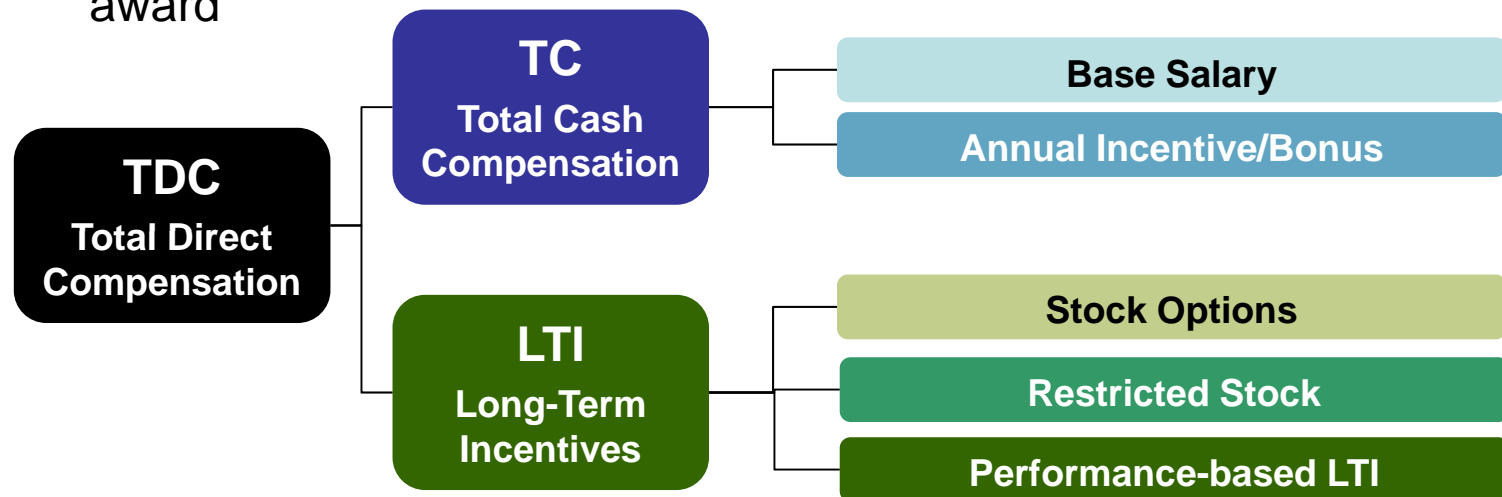
- Also, all industries face growing scrutiny of their governance practices and compensation programs from legislators, regulators, and shareholders (often through advisory proxy firms).
 - **Given the importance of energy to the global economy, oil & gas companies can expect a significant portion of this scrutiny to be directed their way**

CEO Pay Trends: Observations from the 2011 Proxy Season



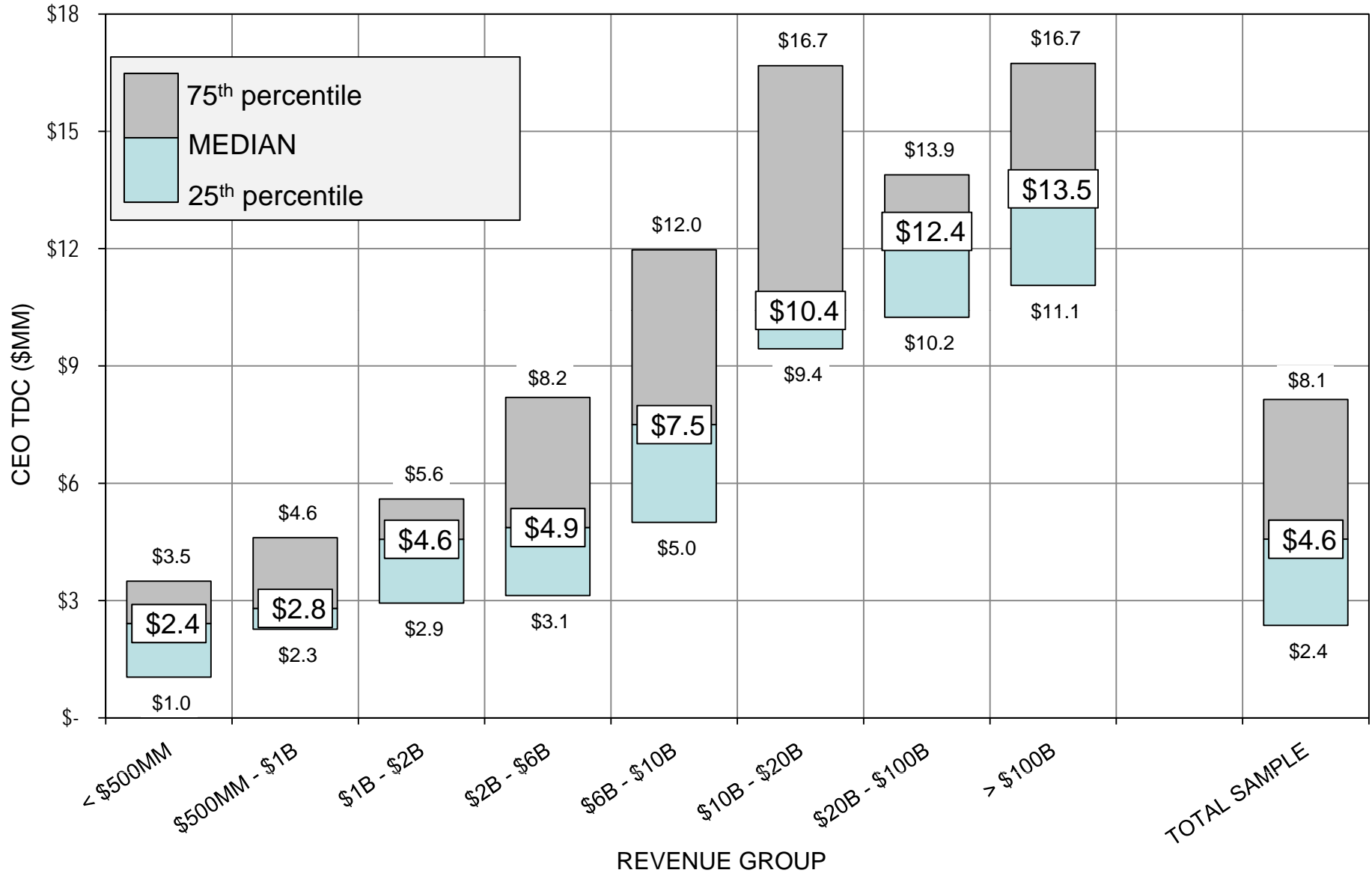
Defining Terms

- **Total Direct Compensation** includes
 - **Salary** as reported in Summary Compensation Table
 - **Annual bonus** including both the “Bonus” and annual portion of “Non-Equity Incentive” columns from Summary Compensation Table
 - **Long-term incentives**
 - Stock Options – grant date expected value
 - Restricted Stock – grant date value
 - Performance-based LTI – grant date present value of target award



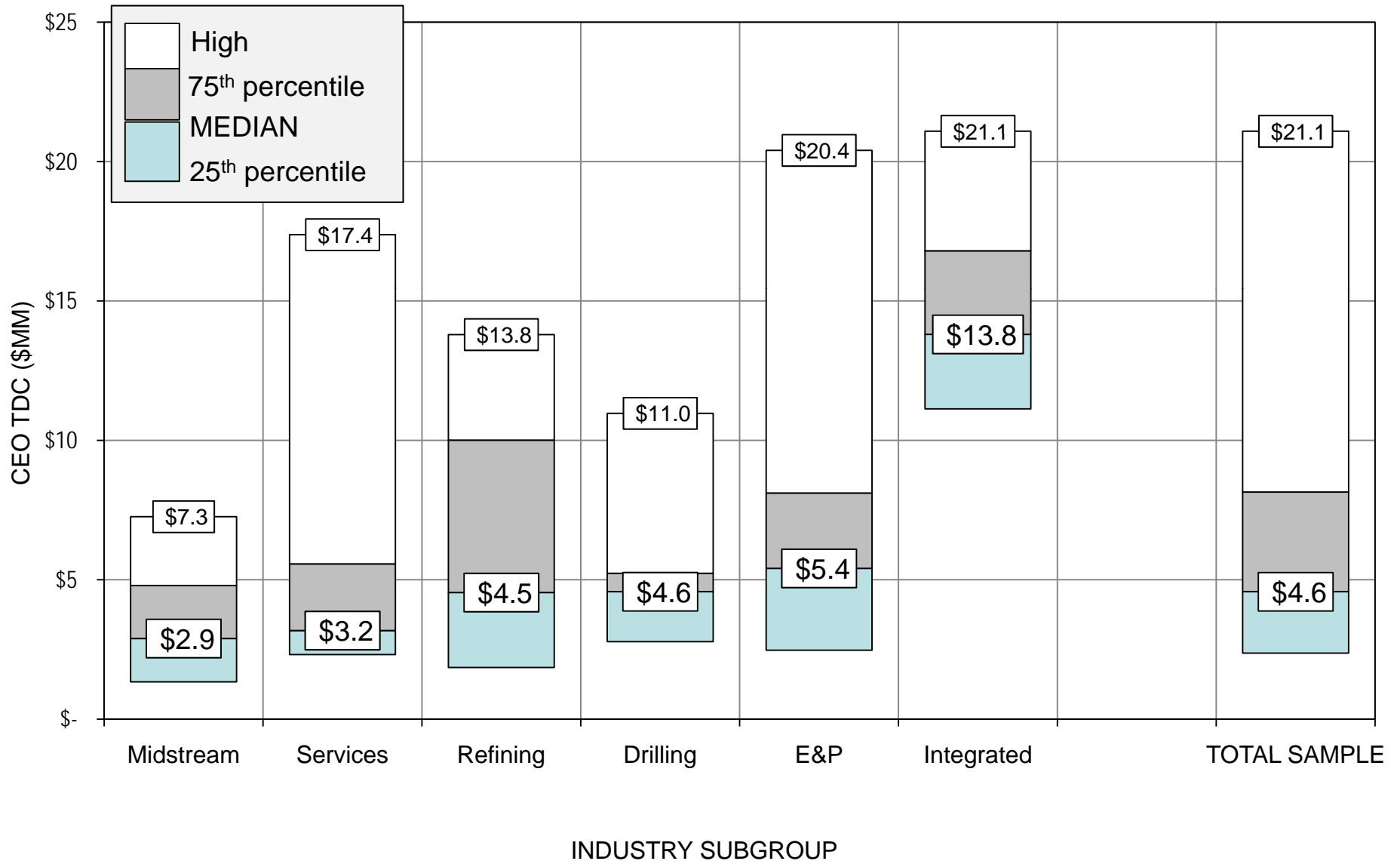


CEO Actual TDC by Company Size (\$millions)



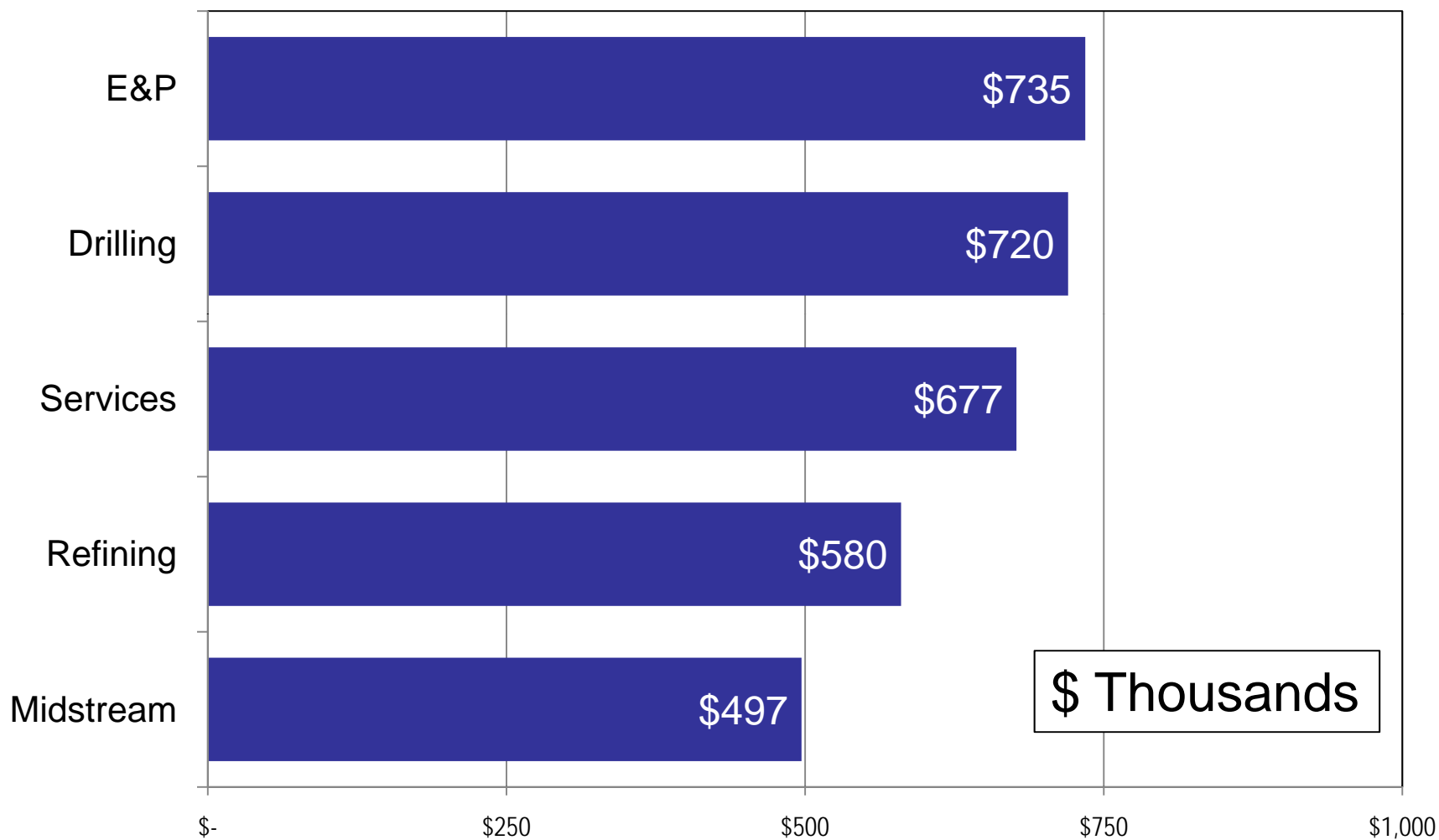


CEO Actual TDC by Industry Subgroup (\$millions)





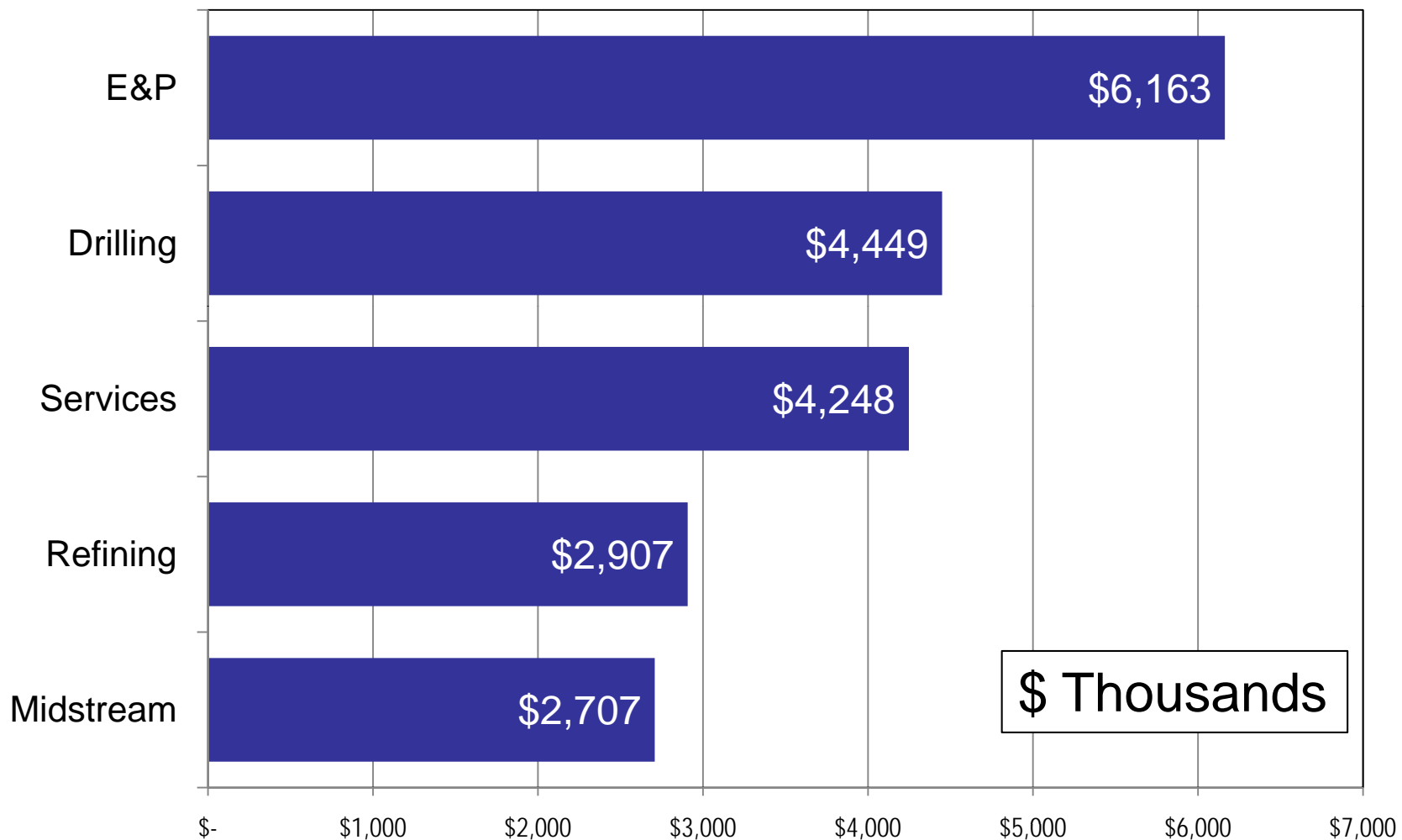
CEO Pay and Company Size: *Predicted Salary at \$2 billion in revenues*



We have not shown results for Integrated companies. The \$2 billion revenue scope falls below the range for integrated companies in the study



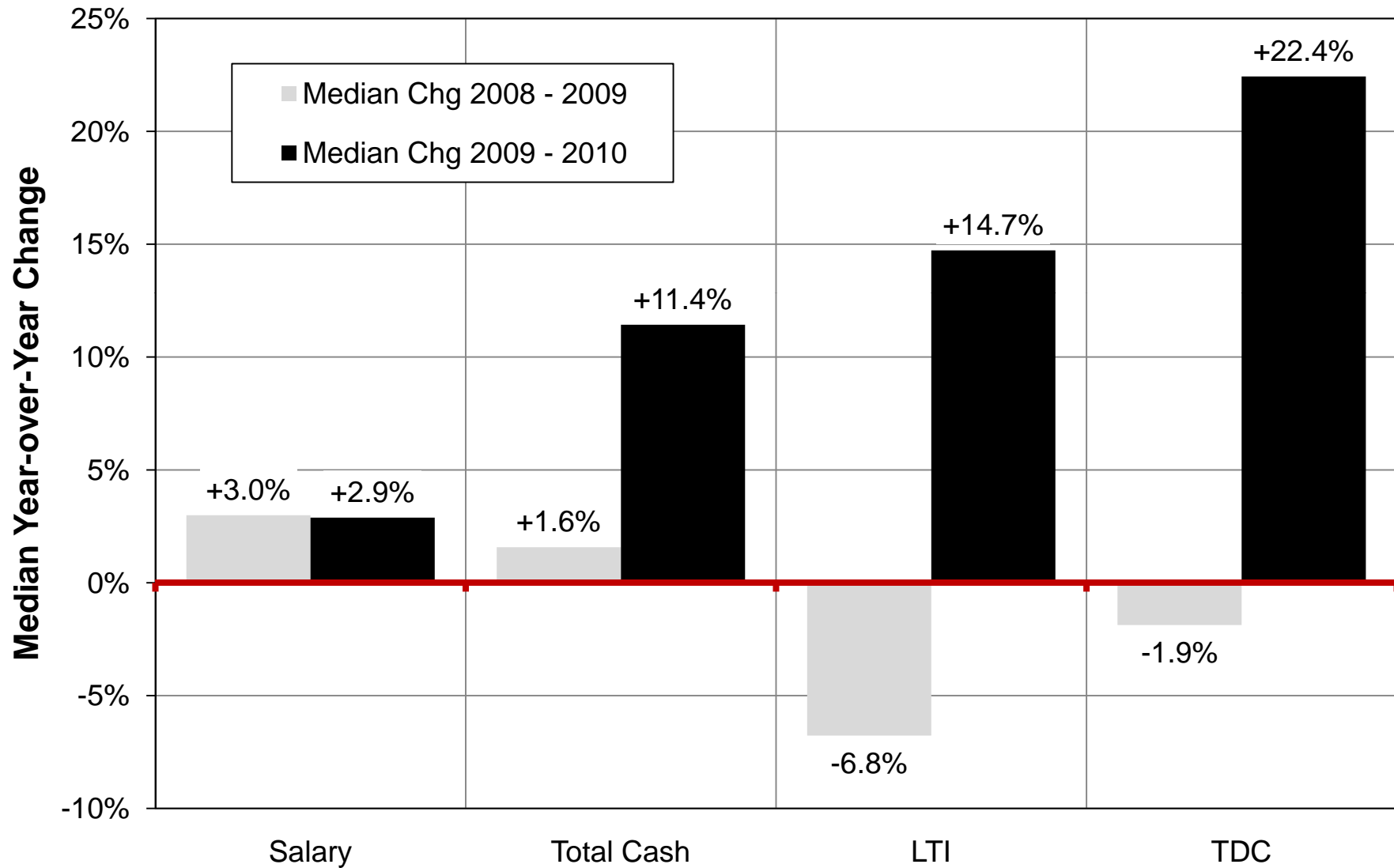
CEO Pay and Company Size: *Predicted TDC at \$2 billion in revenues*



We have not shown results for Integrated companies. The \$2 billion revenue scope falls below the range for integrated companies in the study

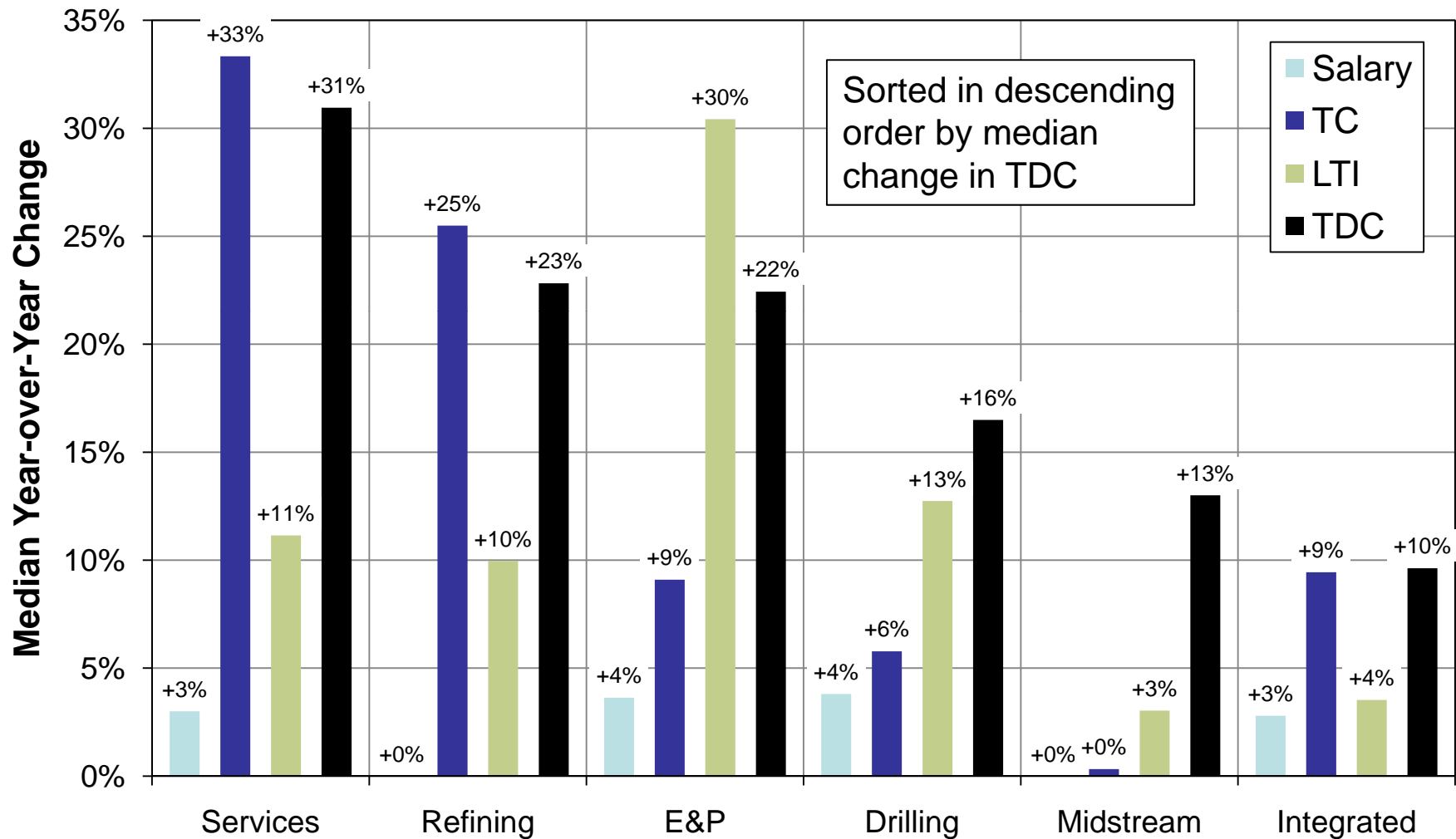


CEO Pay Trends: Median Change in Pay for Continuing CEOs – Total Sample



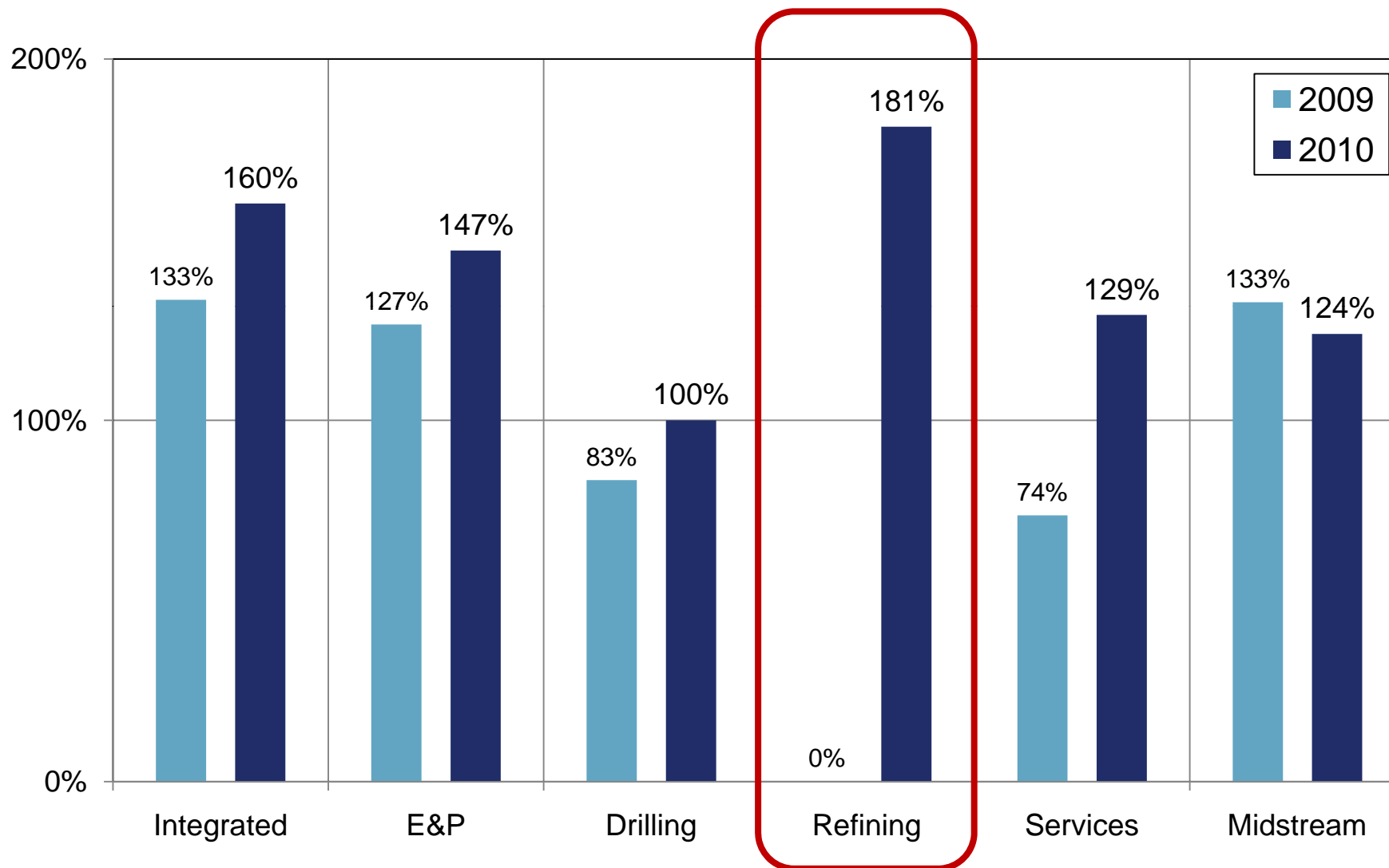


CEO Pay Trends: Median Change in Pay Levels for Continuing CEOs by Industry Subgroup





CEO Pay Trends: Actual Annual Bonus as a Percent of Target (Median)





CEO Pay Trends: *Prevalence of \$0 awards*

	Percent of Oil & Gas CEOs Receiving \$0	
	Annual Bonus	LTI Grant
2008	7%	12%
2009	14%	9%
2010	8%	9%

■ Annual Bonus

- In 2009, CEOs of 4 of 8 *Refining* companies (50%) and 10 of 35 *Services* companies (29%) received no bonus.
- In 2010, *Refining* was the only industry subgroup in which every CEO received some annual incentive payment or bonus.

■ Long-term Incentives

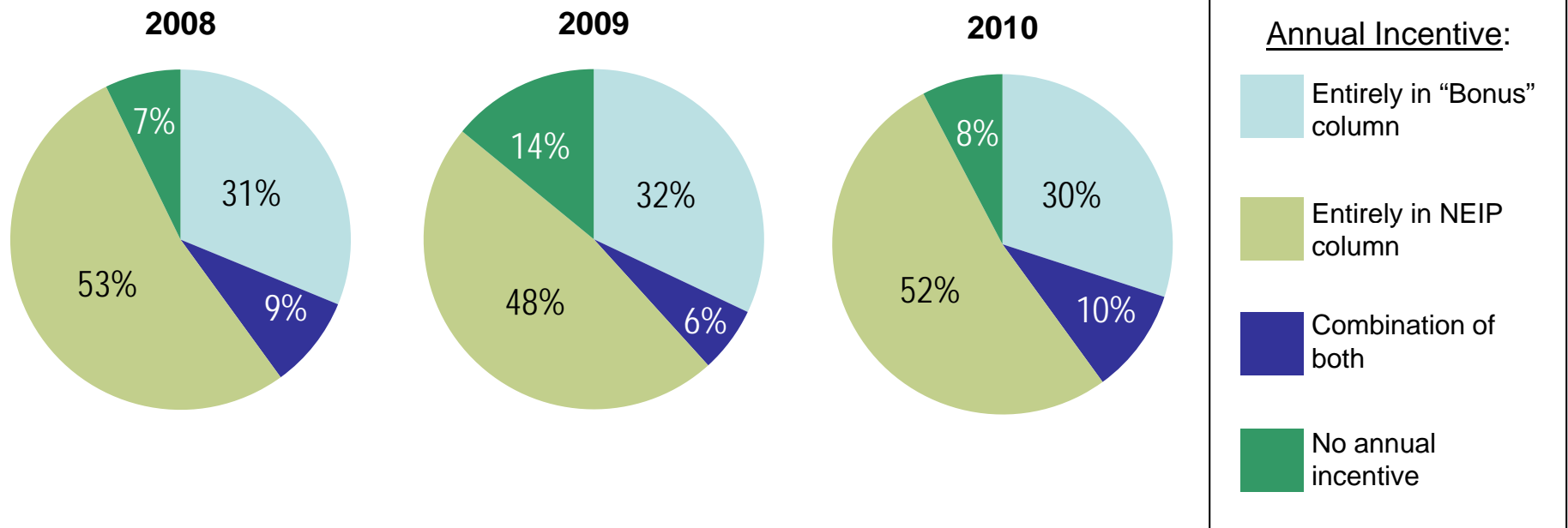
- *Integrated* was the only industry subgroup in which 100% of CEOs received LTI grants every year

■ **3 CEOs each year received no bonus or LTI award**



CEO Pay Trends: “*Bonus*” vs. “*Non-Equity Incentive Plan*” Awards

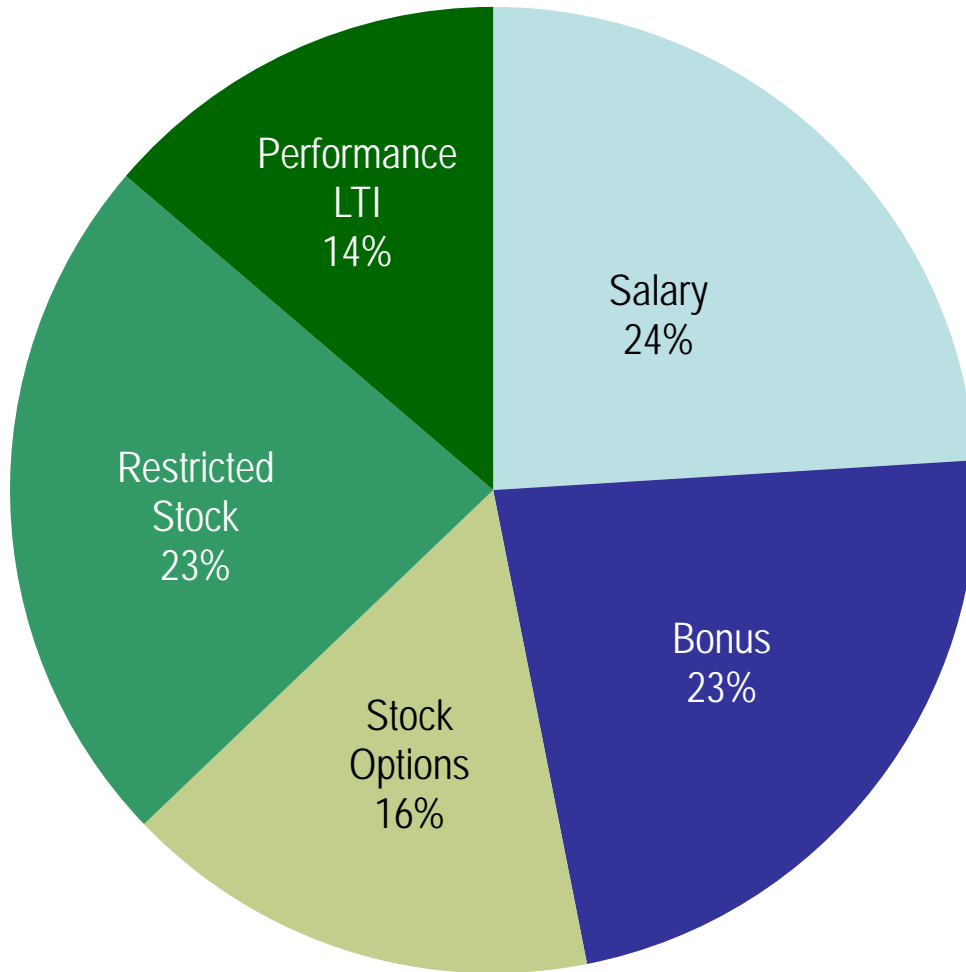
- The portion of total annual incentive dollars showing up as discretionary bonuses (i.e., in the “Bonus” column) has declined since 2008:
 - 2008: 68%
 - 2009: 44%
 - 2010: 40%
- However, there was relatively little change in the number of CEO annual incentive awards that fell 100% in the “Bonus” column (meaning they were about the same number of entirely “discretionary” bonuses)





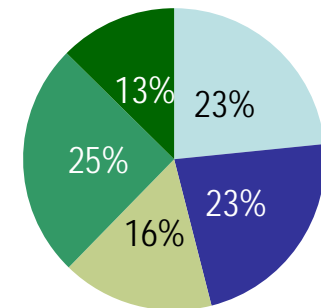
Average Pay Mix – Total Direct Compensation

3 Year Average

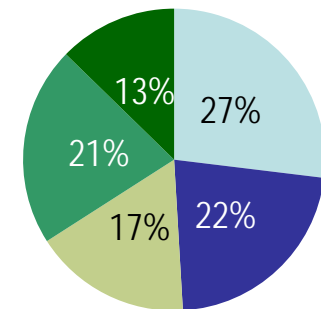


LTI (grant-date value) accounted for 53% of pay on average across our total oil & gas sample

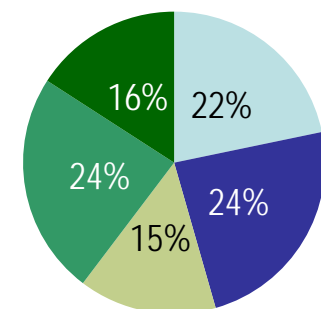
2008



2009

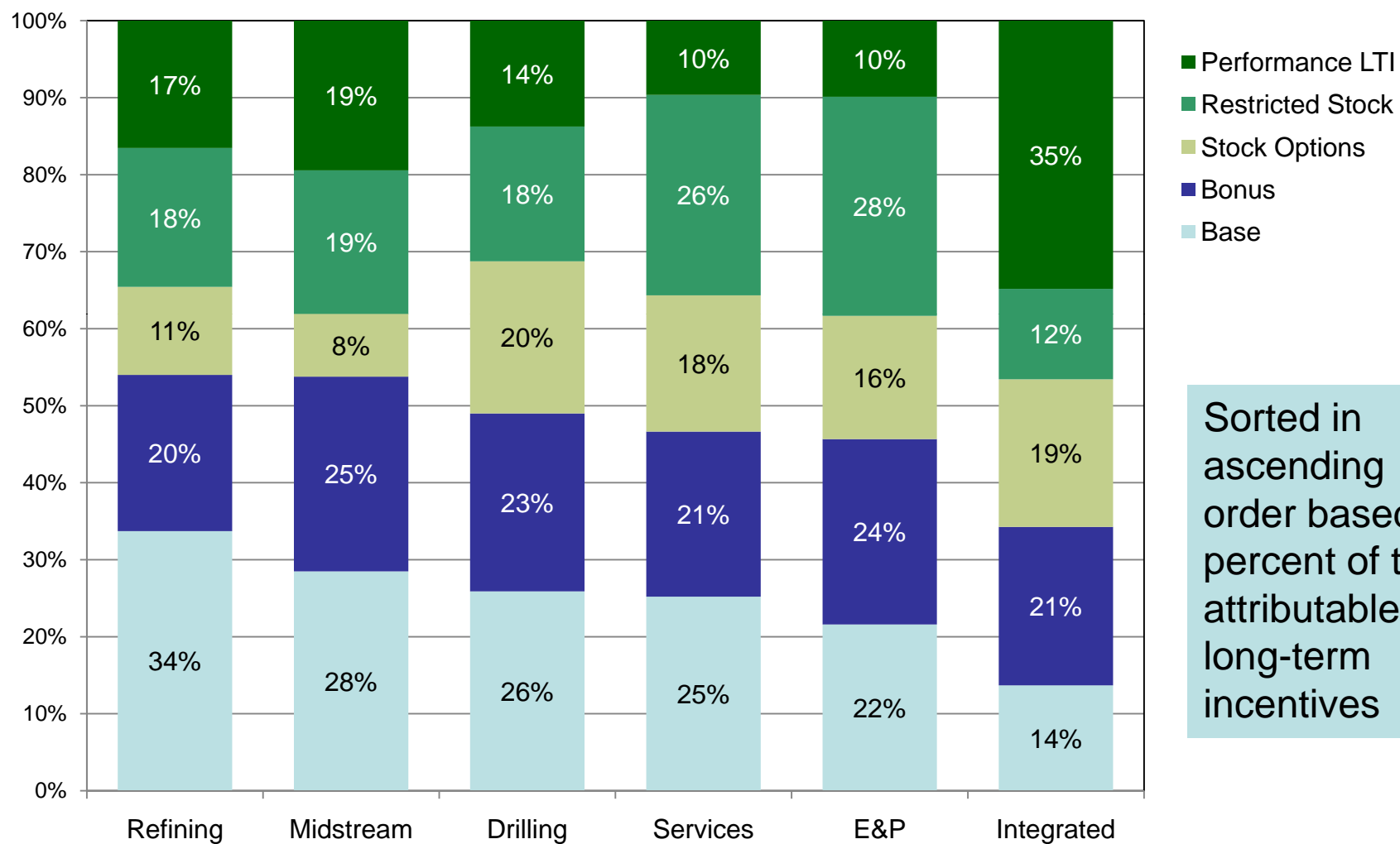


2010





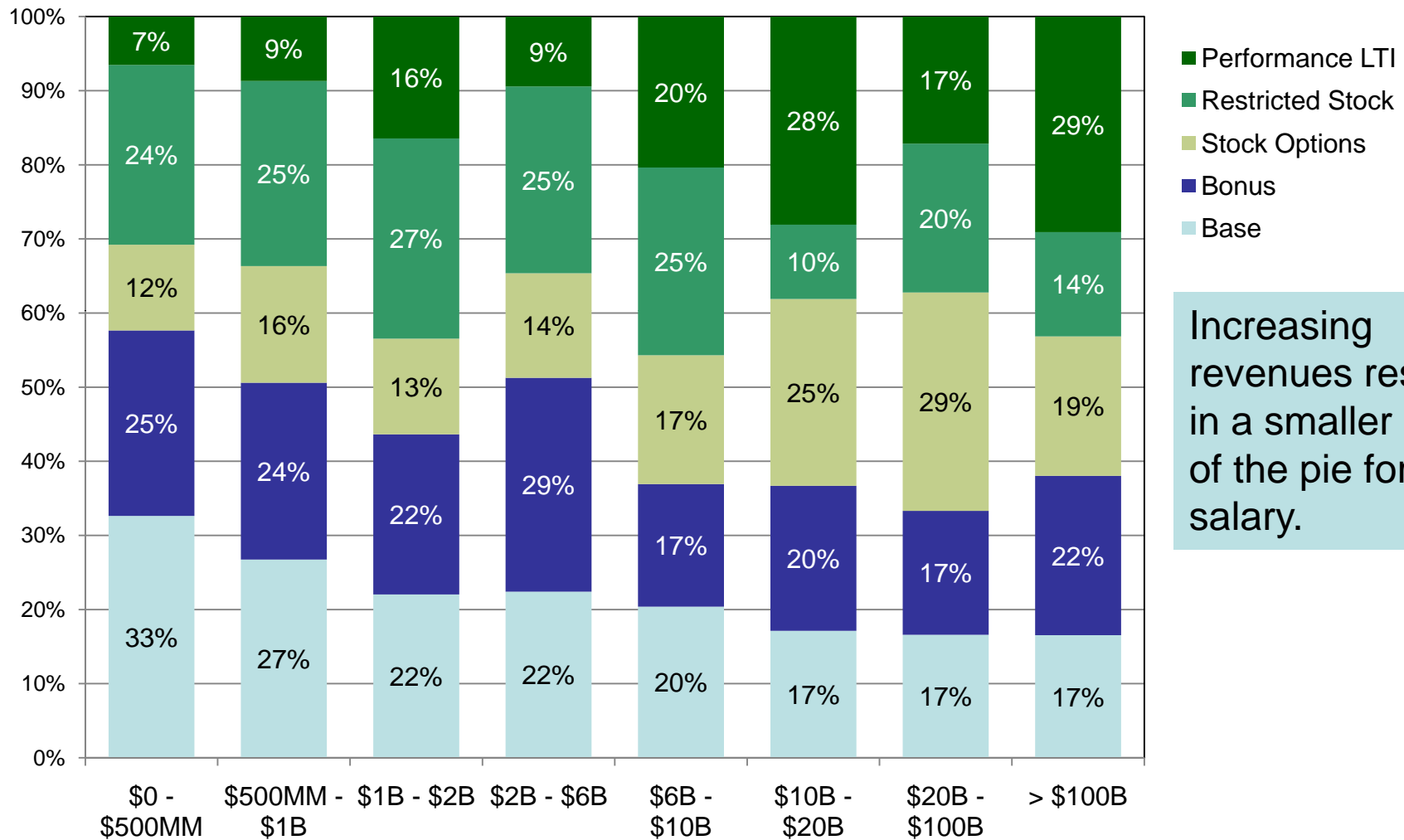
Pay Mix 3 Year Average by Industry Subgroup: Total Direct Compensation



Sorted in ascending order based on percent of total attributable to long-term incentives



Pay Mix 3-Year Average by Revenue Group - Total Direct Compensation

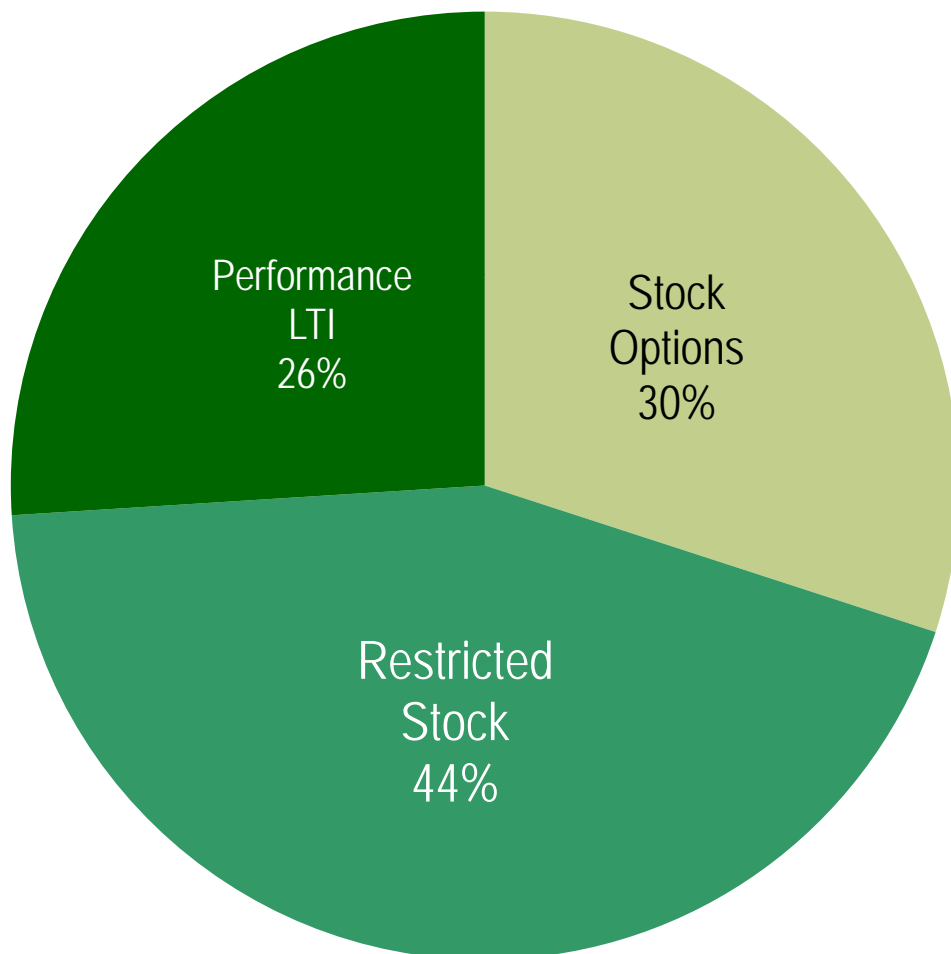


Increasing revenues results in a smaller piece of the pie for salary.



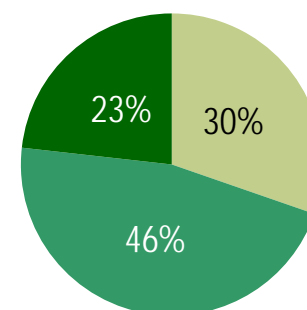
Average Pay Mix – Long-term Incentive Compensation

3 Year Average

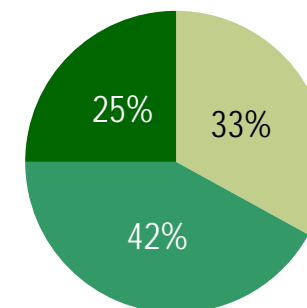


Restricted stock is consistently the largest portion of the LTI “pie” - although there is variation by industry subgroup.

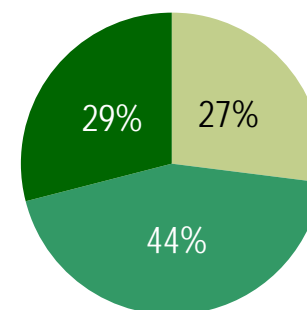
2008



2009

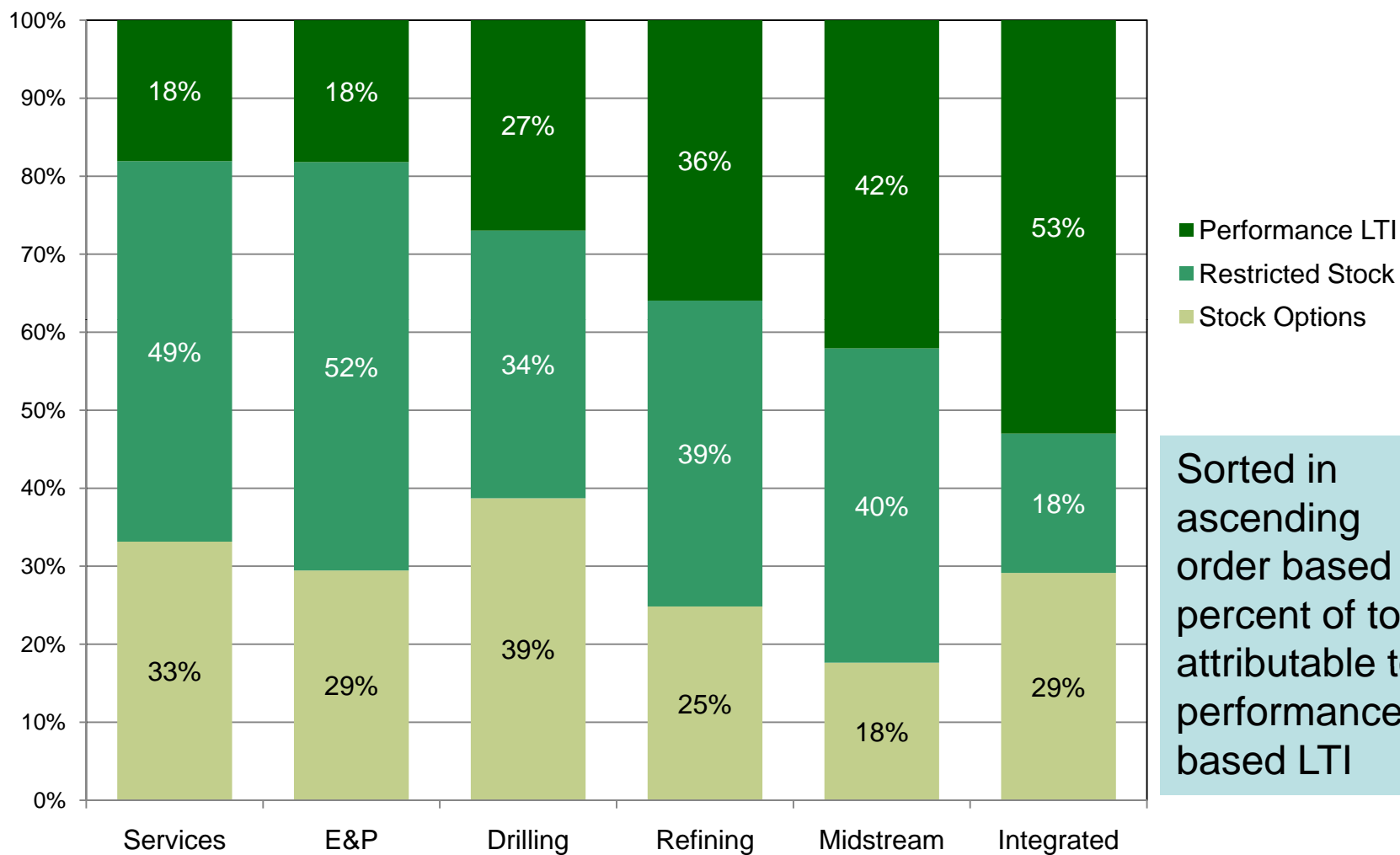


2010



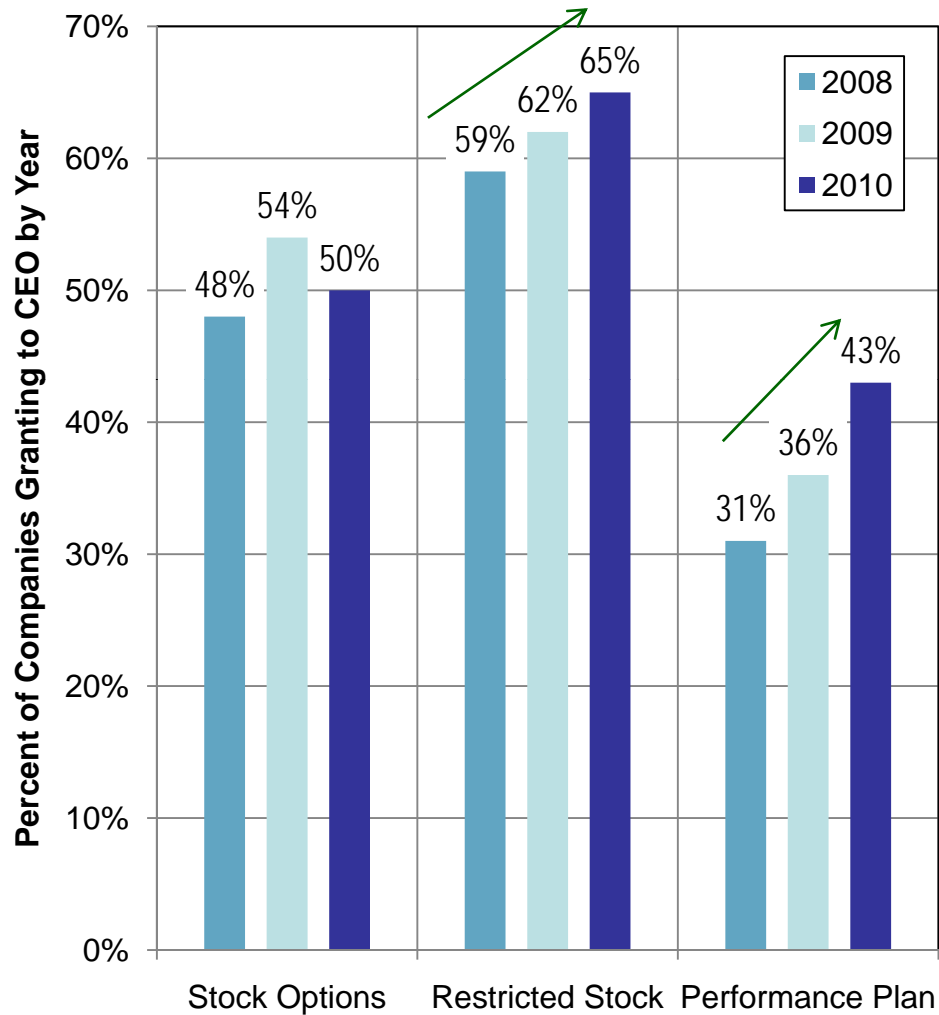


Pay Mix 3 Year Average by Industry Subgroup: *Long-Term Incentives*





Long-term Incentive Award Prevalence: *Percent of Companies Granting to CEO*



Restricted stock remains king of LTI in the oil patch, leading in terms of total value and prevalence...although performance plans are gaining, and practices vary by industry subgroup.

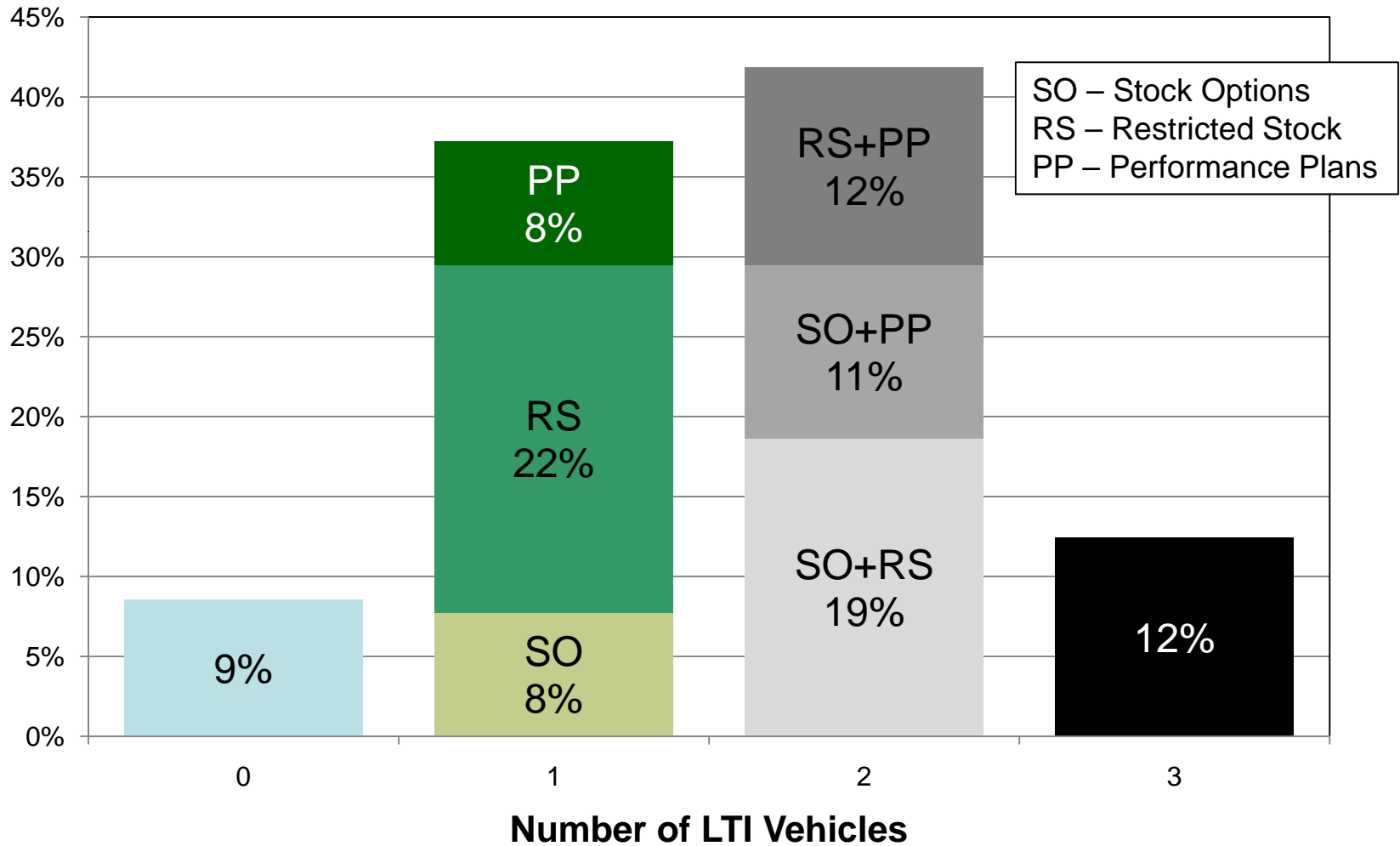
	Prevalence by Industry Subgroup - % of CEOs receiving – 2010 Only		
	Stock Options	Restricted Stock	Performance Plan
Refining	38%	63%	88%
E&P	46%	67%	33%
Midstream	40%	47%	47%
Drilling	73%	60%	60%
Services	49%	86%	31%
Integrated	60%	20%	70%

Most prevalent award type in each industry is highlighted.



Long-term Incentive Award Prevalence

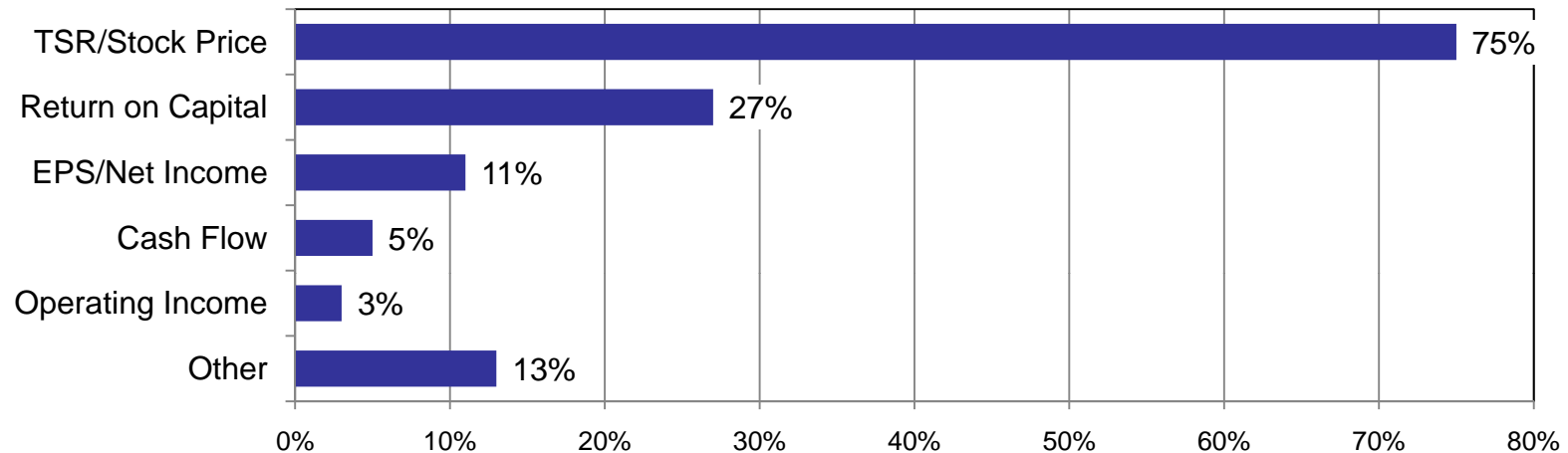
Although a portfolio of two award types was most common, all-restricted stock was most popular overall.





Performance Plan Awards Remain Focused on Relative TSR

Percent of Awards Using Each Measure



- By far the most common performance period remains 3 years (83% of awards in 2010), followed by 4 years (10% of 2010 awards).
- As shown above, relative TSR remains the dominant performance measure.
 - Over 60% of awards use TSR alone.
 - 35% of awards use multiple performance measures, with TSR & Return on Capital the most common pairing.

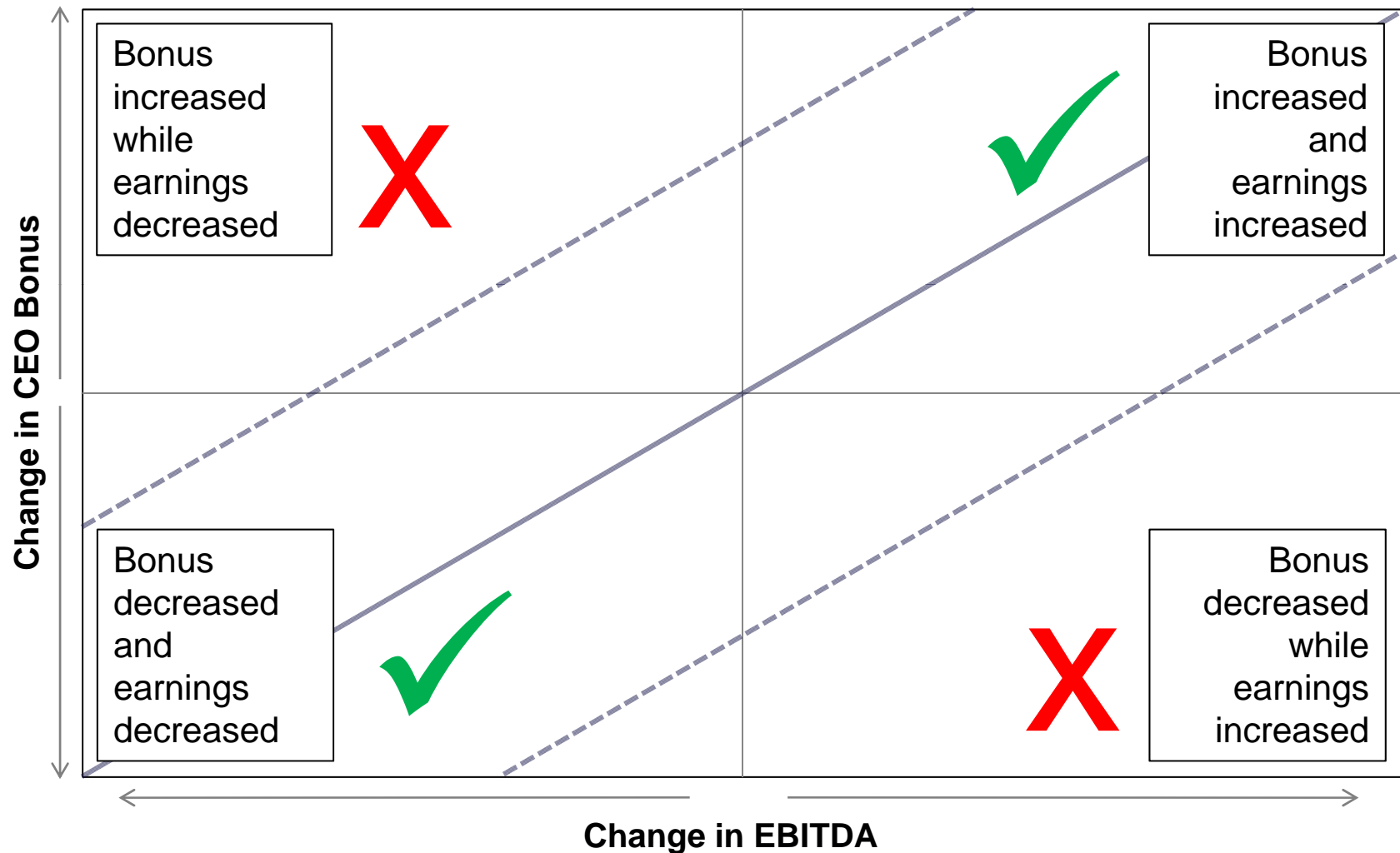


Pay vs. Performance

- Demonstrating a link between pay and performance is more important than ever for public companies to gain support in advisory Say on Pay votes.
- A fairly simple model was applied to our total sample to test the link between annual cash incentive and earnings.
- However, because pay comparisons are most meaningful within a focused peer group, broad assertions regarding performance alignment across our diverse sample are difficult to make.

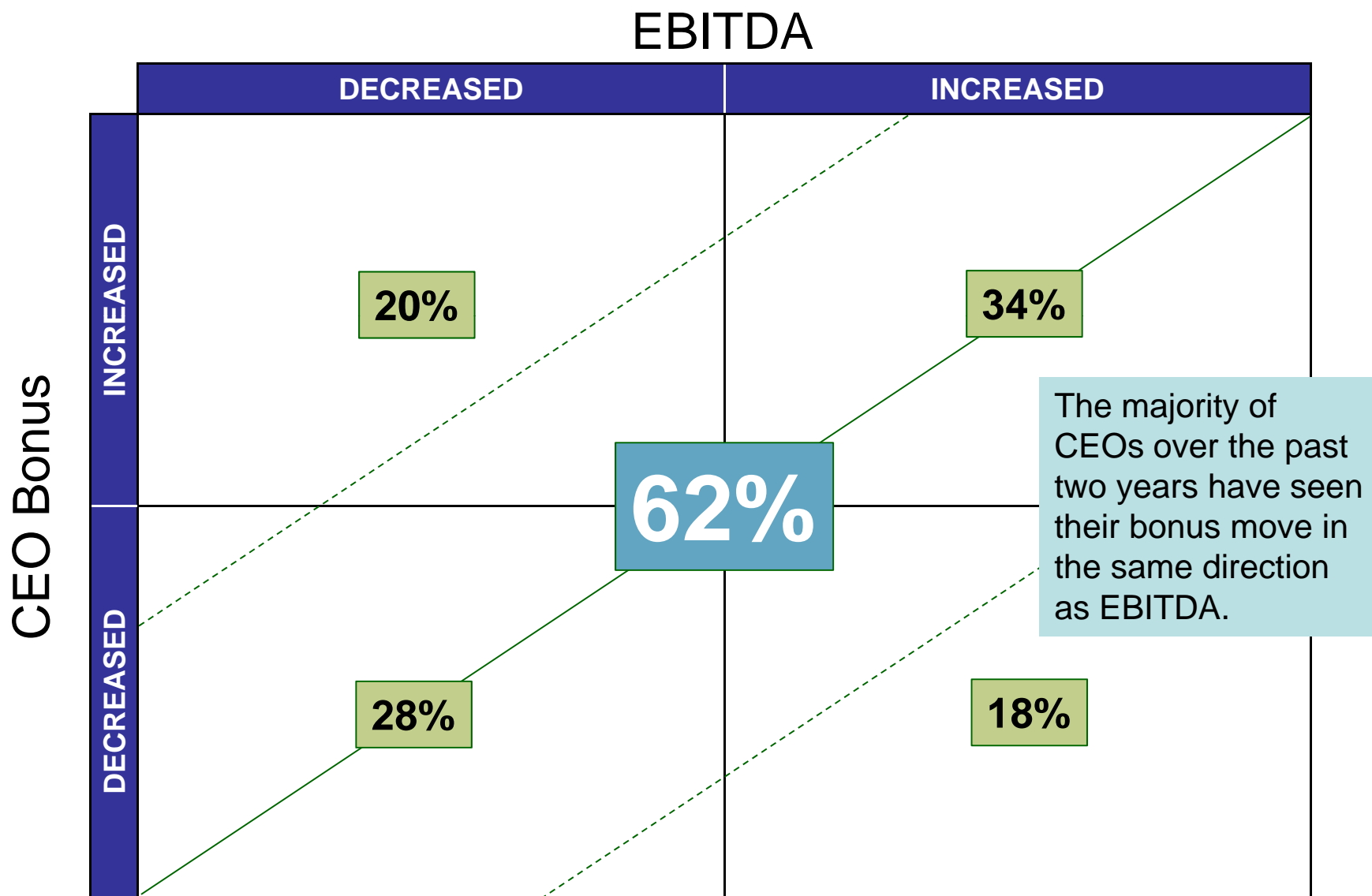


Pay vs. Performance Example Plot – *Change in CEO bonus vs. Change in EBITDA*





Pay vs. Performance: 2009 & 2010 Changes in Bonus vs. EBITDA



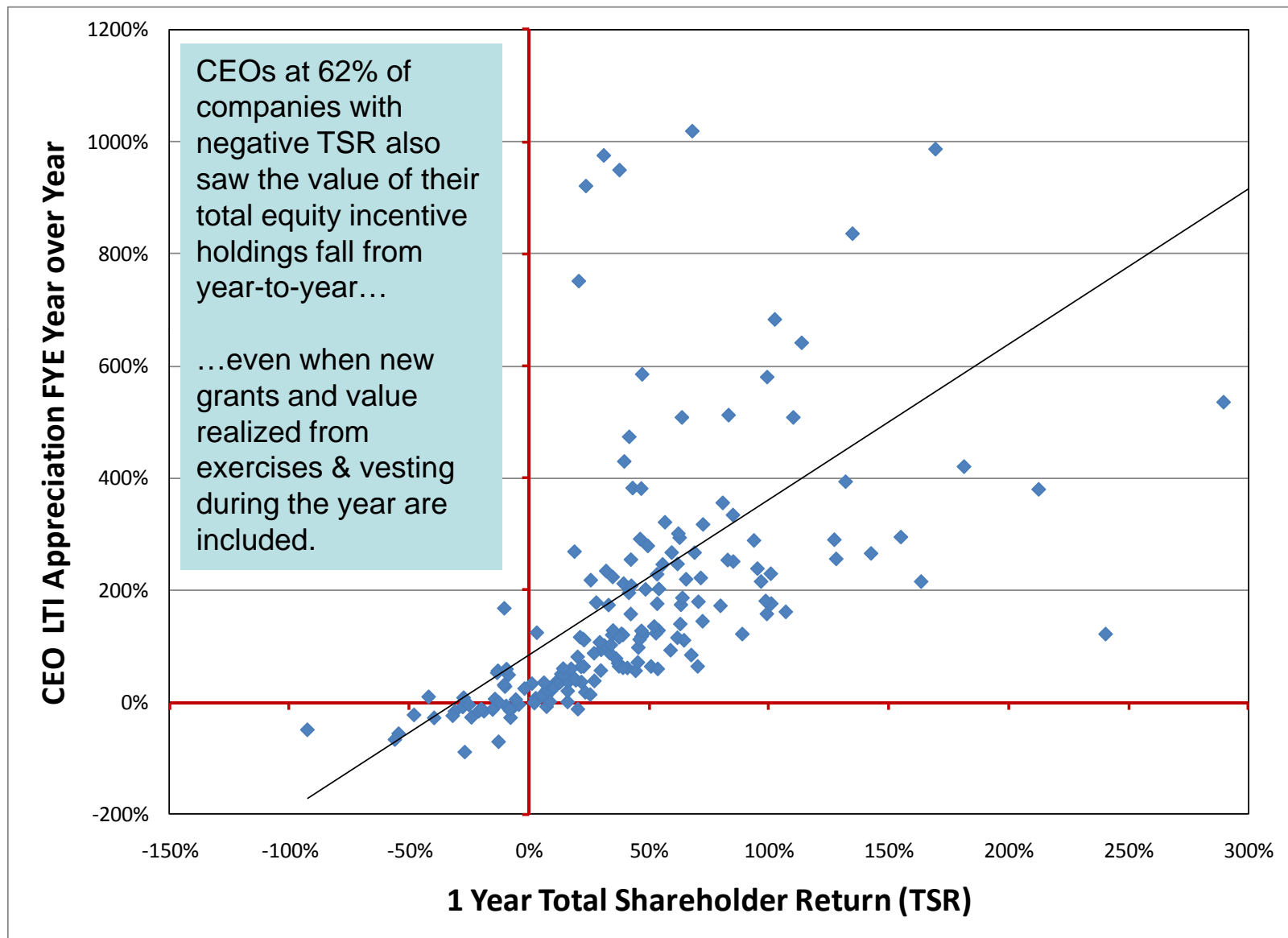


Pay for Performance: CEO Long-Term Incentive “Appreciation” vs. TSR

- We also looked at a measure of realizable accrued CEO wealth from long-term incentive compensation over a one- or two-year period as a percent of the total held equity incentive value at the beginning of the period:
 - Value realized from option exercise, vesting of stock, and payouts from cash-based long-term incentive plans, PLUS
 - Increase/decrease in total value of time-based equity incentives (i.e., unexercised stock options & unvested restricted shares) during the same period .
- This measure is intended to capture the change in total LTI value due to:
 - Changes in the value of existing equity incentive holdings, PLUS
 - Changes due to additional grants.



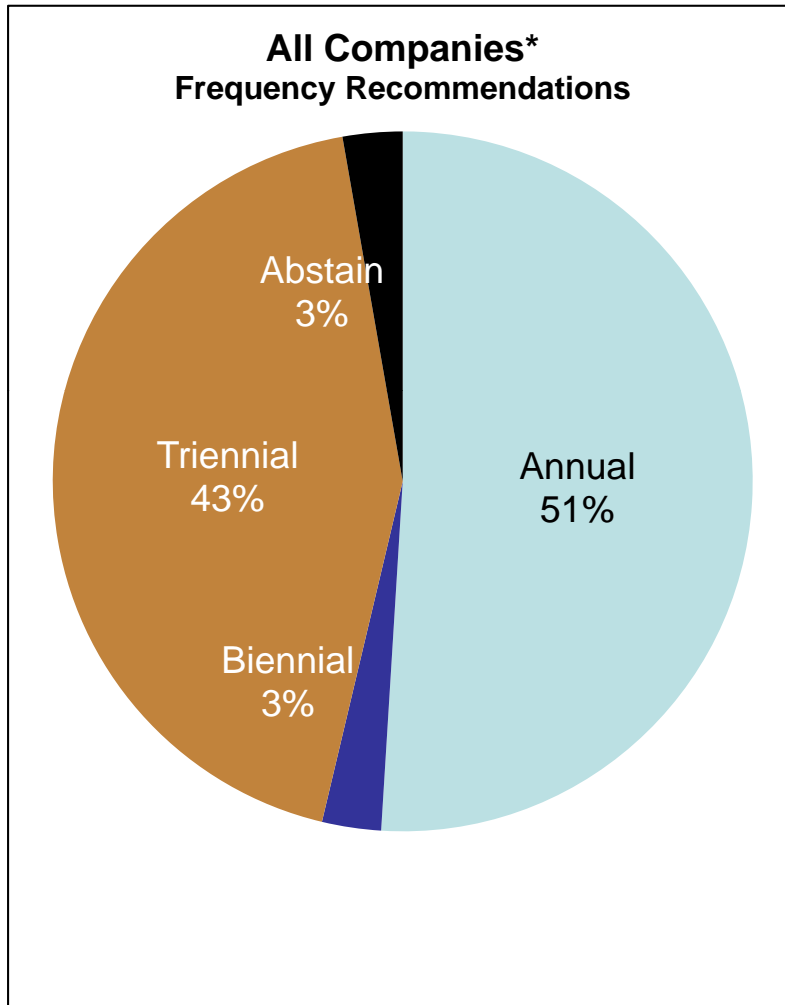
CEO LTI “Appreciation”: *Change in CEO LTI value vs. 1 year TSR 2009 & 2010*



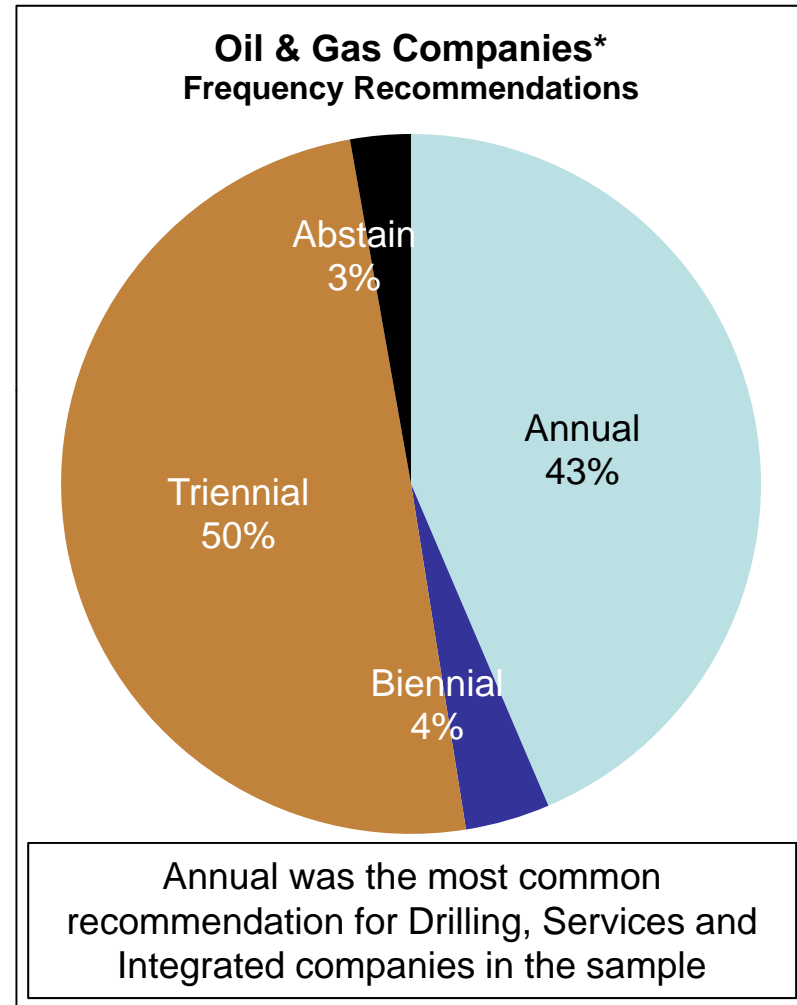
Say on Pay 2011: Season One Recap



Say on Pay: Results Through July 11, 2011



n=2,791



n=181

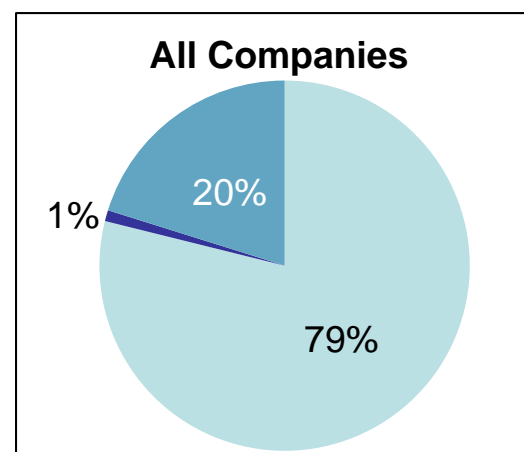
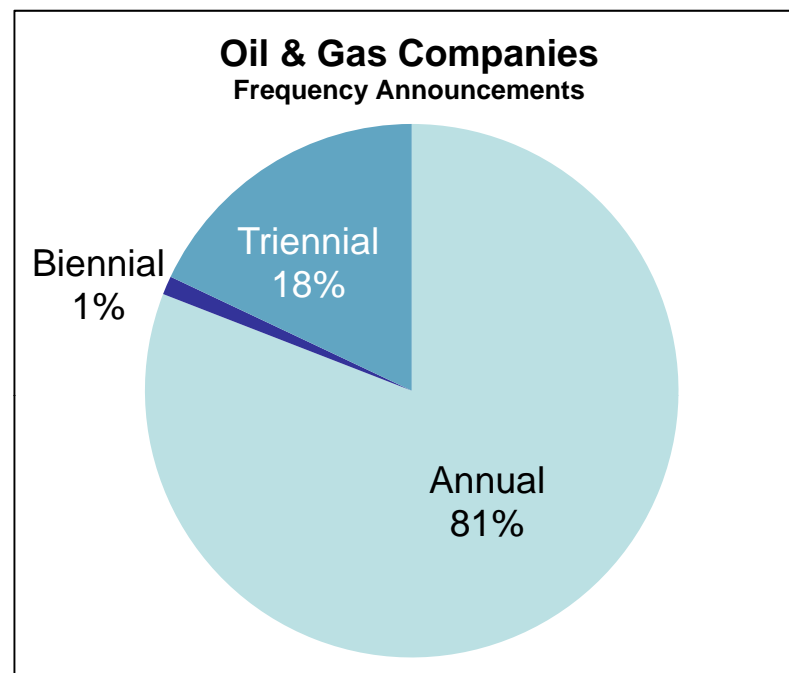
* U.S. Filers Only - The oil & gas sample includes companies beyond those in our CEO pay analysis



Say on Pay: *Frequency Decisions Announced Through July 11, 2011*

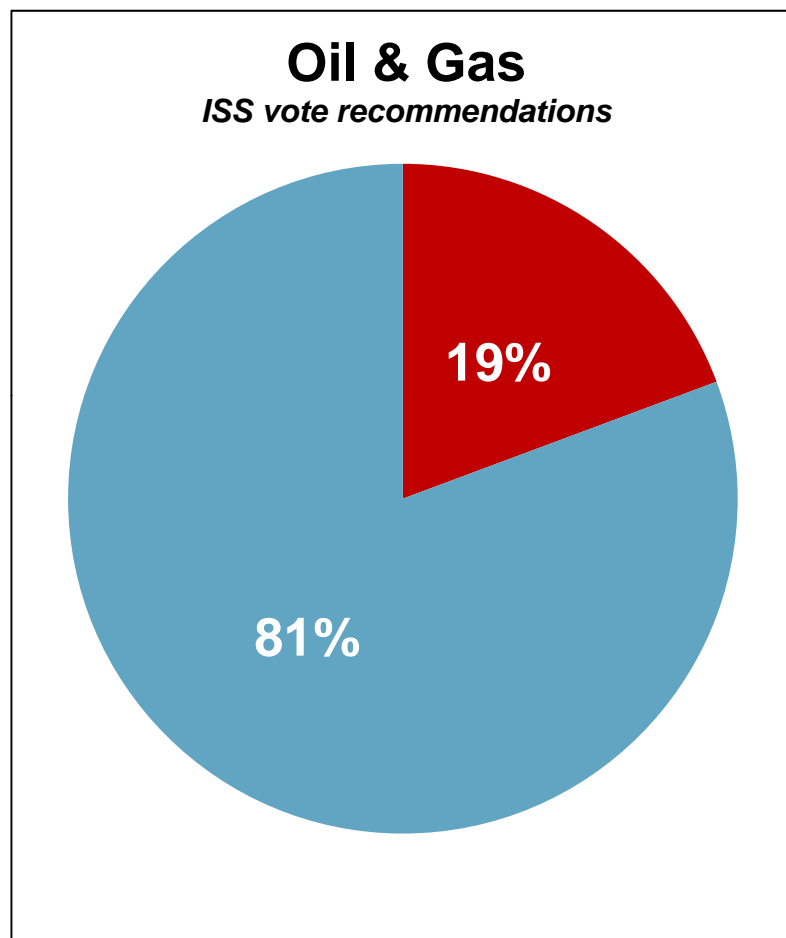
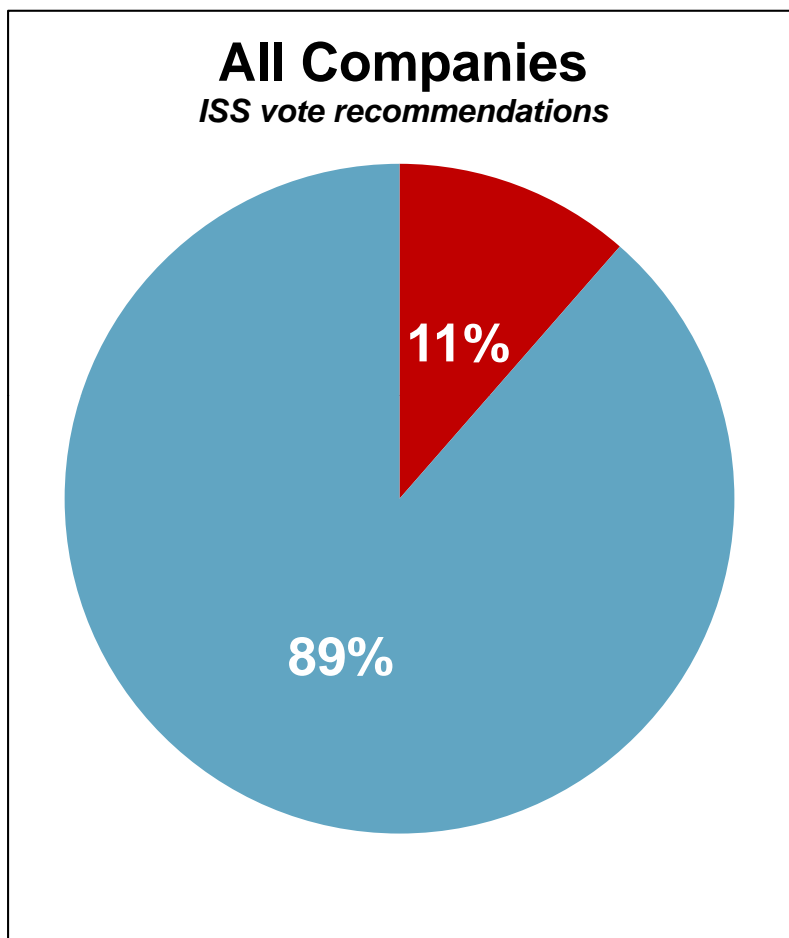
- 73% of all votes were consistent with management's recommendation.
- And about 99% of all companies that have announced their frequency decision have been consistent with their shareholder vote outcome.
- 89 oil & gas companies had announced their frequency decision by July 11.
 - 16 have announced triennial frequency.
- No oil & gas companies in the sample disclosed a frequency decision at odds with their majority shareholder vote.

US Filers Only





ISS Recommendations: *Oil & Gas Companies Were More Likely to Receive an “Against”*



 ISS “For” SOP

 ISS “Against” SOP

US Filers Only



Reasons for ISS Negative Recommendations: *Oil & Gas Examples*

- **CEO pay-for-performance disconnect**
 - 1- and 3-year TSR below “peer” (GICS group) median
 - CEO TDC increasing, primarily due to equity compensation
 - *Some companies were also cited for a lack of sufficiently performance-based annual or long-term incentive compensation.*
- **New or amended NEO contract with a gross-up**
- **New NEO employment contract terms**
 - Additional years of service credited to pension upon hire
- **Excessive “non-performance-based” pay**
 - Expatriate compensation (tax equalization)
 - Compensation for departing NEOs
- **Liberal definition of change-in-control in a new or amended agreement**
- **Above-median benchmarking**

US Filers Only



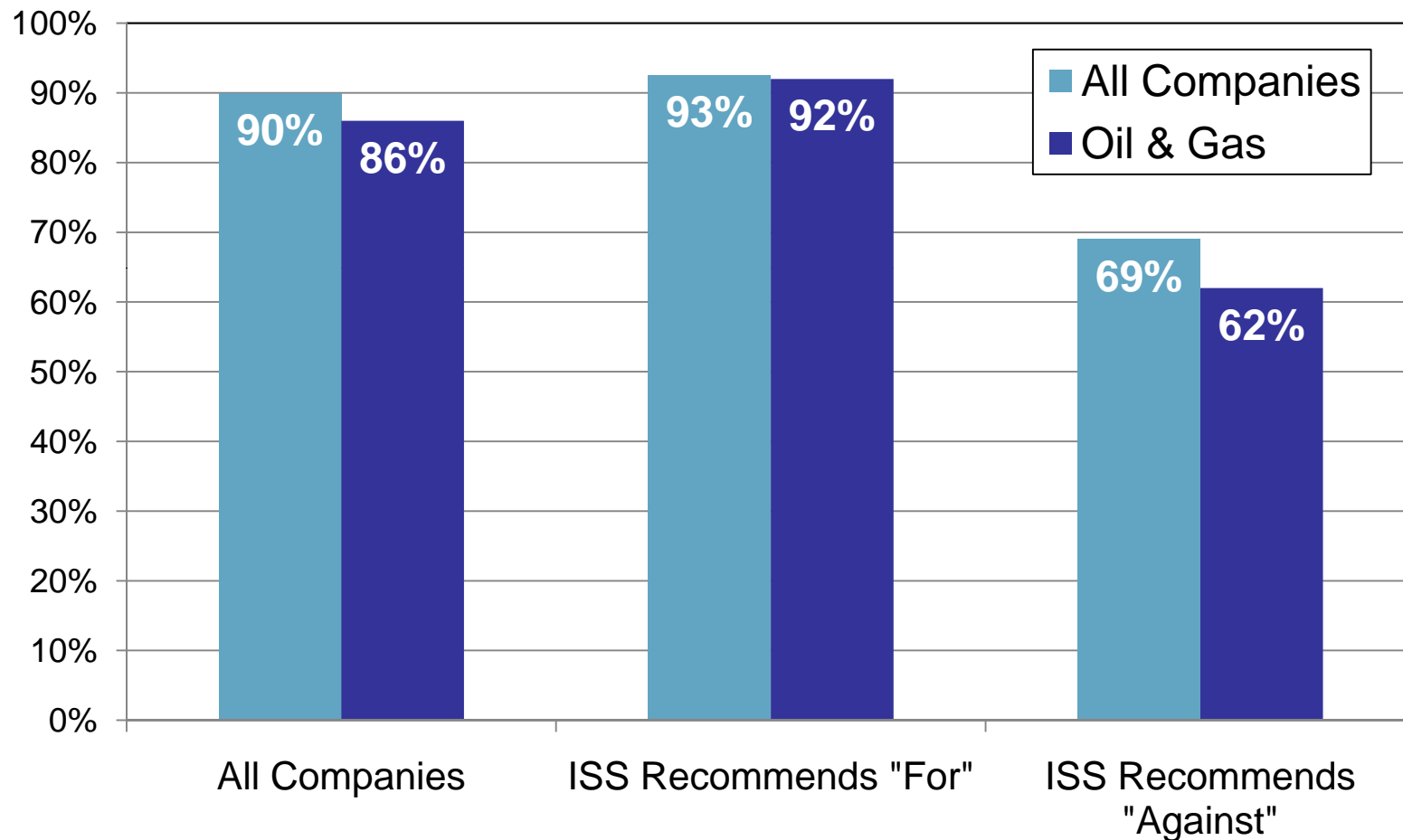
Public Responses to ISS Comments

- **CEO pay-for-performance disconnect**
 - *Inappropriate peer group*
 - *1- and 3-year TSR alone are not sufficient measures of performance*
 - *1- and 3-year performance period is not “long-term”*
 - *Failure to recognize time-vested equity awards as performance-based*
- **Excessive “non-performance-based” pay**
 - *Benefits provided as part of program/policy that applies broadly*
 - *Part of a successful CEO succession plan/process*
- *Timely responses coupled with outreach to key shareholders helped several companies faced with negative ISS recommendations to obtain a positive vote result.*



Impact of ISS Recommendations: An "Against" Recommendation Portends a More Difficult Vote

Average Votes Cast in Favor of Pay Program



Total sample – 2,735 companies

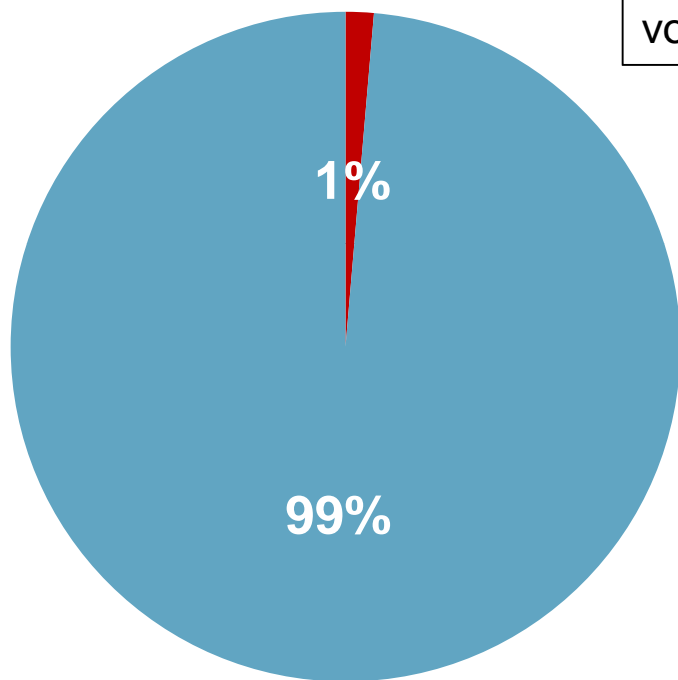
Oil & Gas – 167 companies

US Filers Only



SOP Outcomes Through July 11

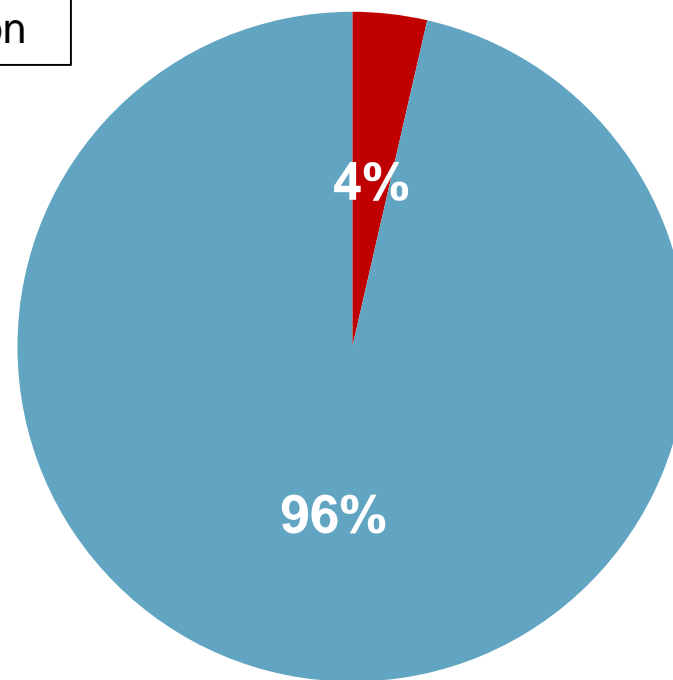
All Companies



37 fails

No company that failed their SOP vote received a positive ISS vote recommendation

Oil & Gas



6 fails



SOP Passed



SOP Failed

US Filers Only



Looking Ahead

- **Shareholder vote outcomes indicate satisfaction with the vast majority of current executive pay programs – but questions remain**
 - Has the overall strong level of support in 2011 raised the bar?
 - Will outcomes be viewed as a simple pass/fail, or will a “low pass” be seen as a call for change comparable to a fail?
 - 2010 was a better year than 2009 for most firms – what will happen following a mostly-down year?
- **Impact of proxy advisory firms**
 - ISS will likely continue to carry the biggest “stick,” with Glass Lewis a distant second.
 - *How much influence these firms continue to wield will depend in part on how well they respond to criticism of their methodologies – and demonstrate an understanding of the programs they’re evaluating.*



Looking Ahead

- **Changes resulting from shareholder pressure:**
 - Greater transparency in proxy disclosure.
 - Companies proactively removing gross-up provisions from contracts that would otherwise renew automatically.
 - The prevalence and weight of performance-based LTI continue to increase.
 - More limited use of discretion in incentive plans.
 - At least one oil & gas company that failed its SOP vote (Helix Energy Solutions), has already added explicit performance criteria to what had been a discretionary annual incentive plan.
- **Still coming from Dodd-Frank – possibly by 2012 proxy season:**
 - Clawbacks
 - Internal pay equity
 - Pay vs. performance



Looking Ahead

- **Top 10 Agenda Items for Compensation Committees in 2011***
 - Validate the alignment of relative pay and performance
 - Balance “target” pay analysis with forward-looking sensitivity analyses
 - Challenge your long-term incentive design
 - Review peer group composition and basis for selection
 - Discuss parameters for using discretion in executive pay programs
 - Assess policies regarding executive & Director share ownership
 - Revisit your executive compensation governance building blocks
 - Pay attention to ISS will evaluate your executive pay program
 - Assess the impact of Say on Pay and Say on Frequency results
 - Prepare for additional new disclosure and governance requirements under Dodd-Frank
- **Oil & gas companies will remain under a particularly bright spotlight.**

*Article available at: <http://www.pearlmeyer.com/top102011>



Key Takeaways

- **2010 was a rebound year for performance and compensation**
 - After a slight decline in 2009 total compensation (-1.9%), compensation levels were up significantly in 2010 (+22.4%)
 - Annual incentives and long-term incentives increased across all industry subgroups
 - Pay and performance exhibit a clear linkage year over year
- **Pay mix remains fairly stable, other than a slight increase in the prevalence of performance-based LTI programs**
- **Say on pay results were largely positive, although marginally less so for oil & gas companies**
 - 96% of Oil & Gas companies passed their say on pay vote compared with 99% of all companies
 - Oil & gas companies were also more likely to receive an “Against” recommendation from ISS.
 - Failures typically resulted from executive contract provisions and non-performance-based pay elements.



QUESTIONS?



Thank You!

A copy of these slides is available, and audio archive will be posted shortly,
at pearlmeyer.com/energy

Follow-up questions can be addressed to either of our speakers:

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