Vinson&Elkins

Energy Series

Energy Transition

ESG-Related Trends in Executive Compensation

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Today’s Speakers

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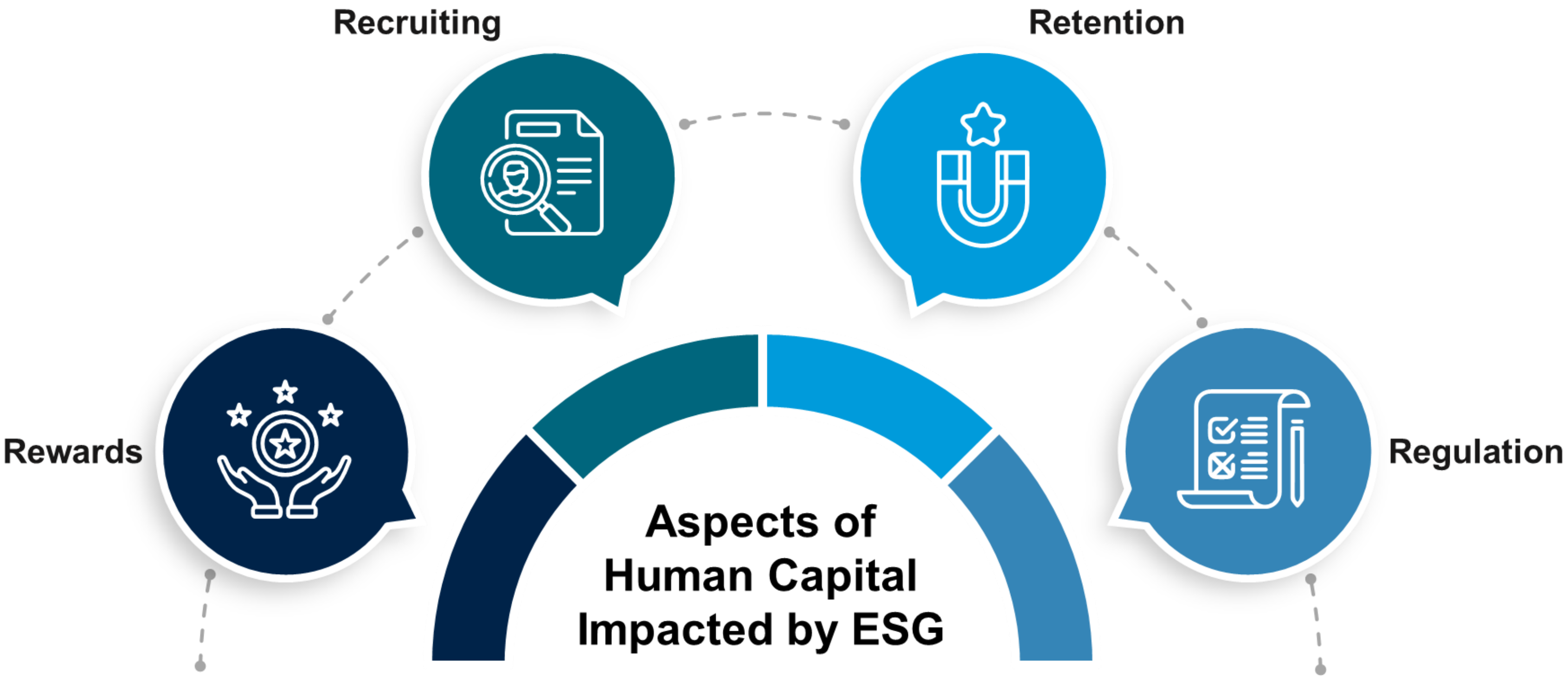
ESG Performance Metrics

ESG's Impact on Compensation

This rise of ESG has dramatic and surprising implications for human capital. Companies are taking a hard look at how investment in diversity, pay equity, executive compensation and human capital governance work to help companies not only function effectively, but thrive sustainably.



‘What gets measured
gets managed’ has become ‘What gets measured **and built into corporate goals and individual KPIs and near- and long-term compensation plans REALLY** gets managed.’

Who? Where?

What? Why?

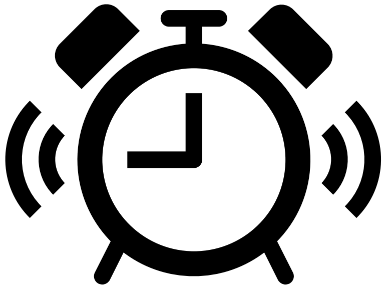
When? How?

Why Should ESG Metrics Be Used?

- Organizations across all industries in both the public and private sectors are now adopting ESG-based incentives structured around a number of nonfinancial, or better yet, pre-financial targets.
- Unlike straightforward financial targets, certain ESG incentives can be more difficult to identify and quantify, often resulting in a mismatch of motivation, goals and overall business performance.
- Who’s Watching
    - Investors
    - Shareholder Advisory Firms
    - Regulators
    - NGOs
    - Employees
    - Customers

The 2021 Global Benchmark Policy Survey published by Institutional Shareholder Services (ISS) found that **86% of investors (and 73% of non-investors)** think non-financial ESG metrics are an appropriate measure to incentivize executives.

When Is a Company Ready to Measure ESG?

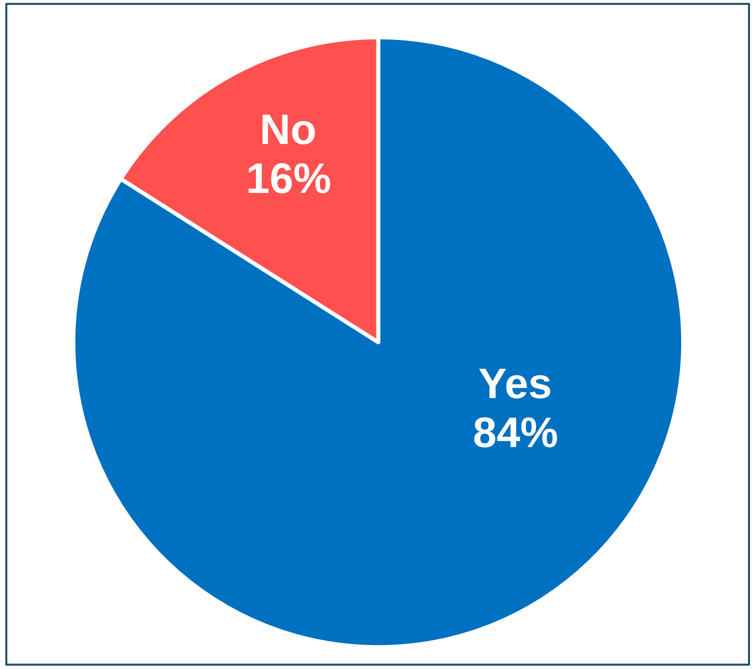


- Important questions to consider before implementing ESG within a compensation plan include:
  - What goals does the company look to achieve?
  - How is ESG part of the management and board-level agenda?
  - What policies and practices are established within the organization?
  - What reporting or data collection mechanisms exist?

Survey Participants

Integrated	Exploration & Production	Oilfield Services	Clean Energy	Midstream
Chevron	Conoco	Schlumberger	Ameresco	Enterprise Products
Exxon	Devon	Halliburton	Clearway	Kinder Morgan
BP	EOG	Baker Hughes	First Solar	MPLX
Shell	Occidental	NOV	NextEra	Williams
Total	Pioneer	Valaris	SunPower	Energy Transfer

Who is Utilizing ESG Metrics?

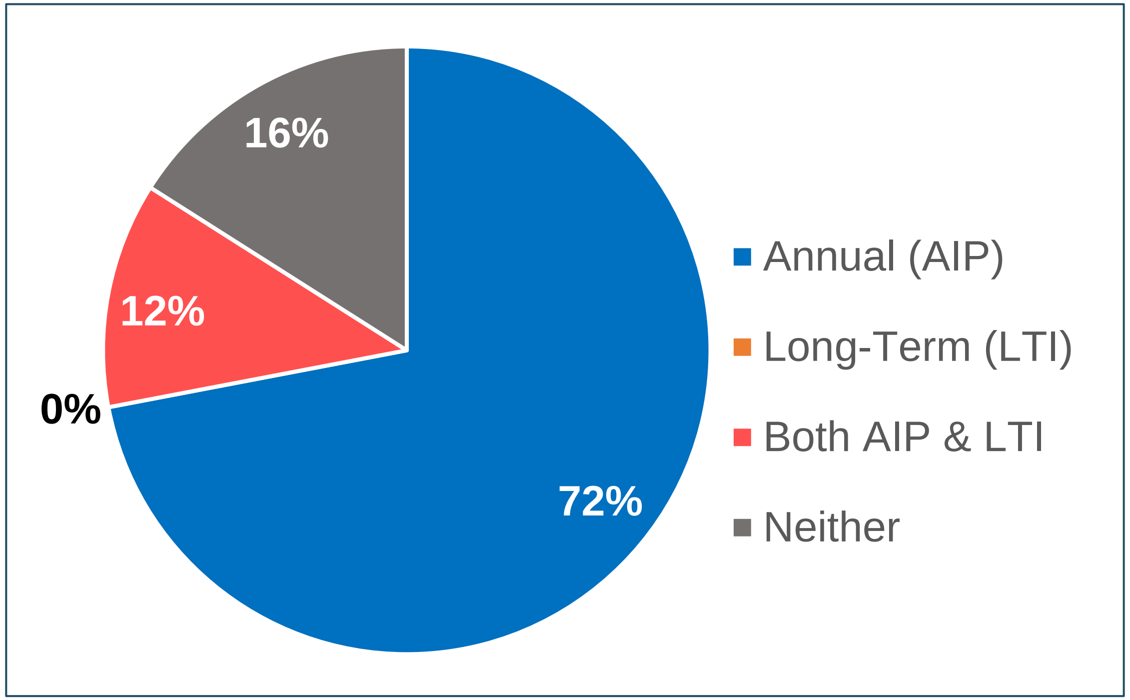


21 out of the 25 survey companies

Sector	Yes	No
Integrated	5	0
E&P	5	0
OFS	3	2
Midstream	4	1
Clean	4	1
Total	**21**	**4**

Where Are ESG Metrics Being Incorporated?

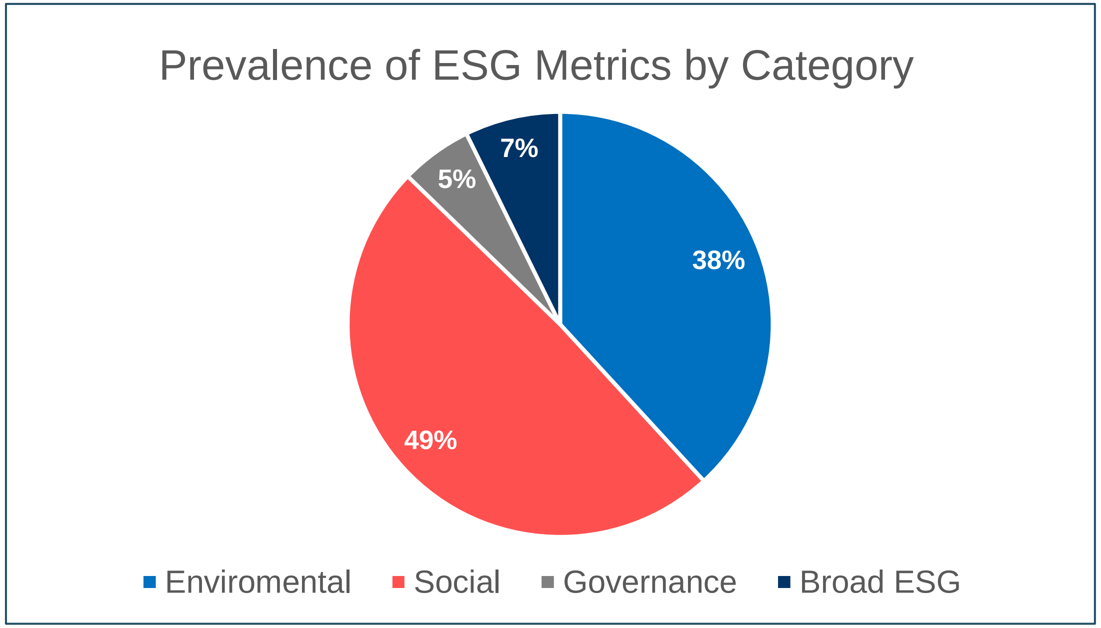
- Annual vs. long-term incentive plans?

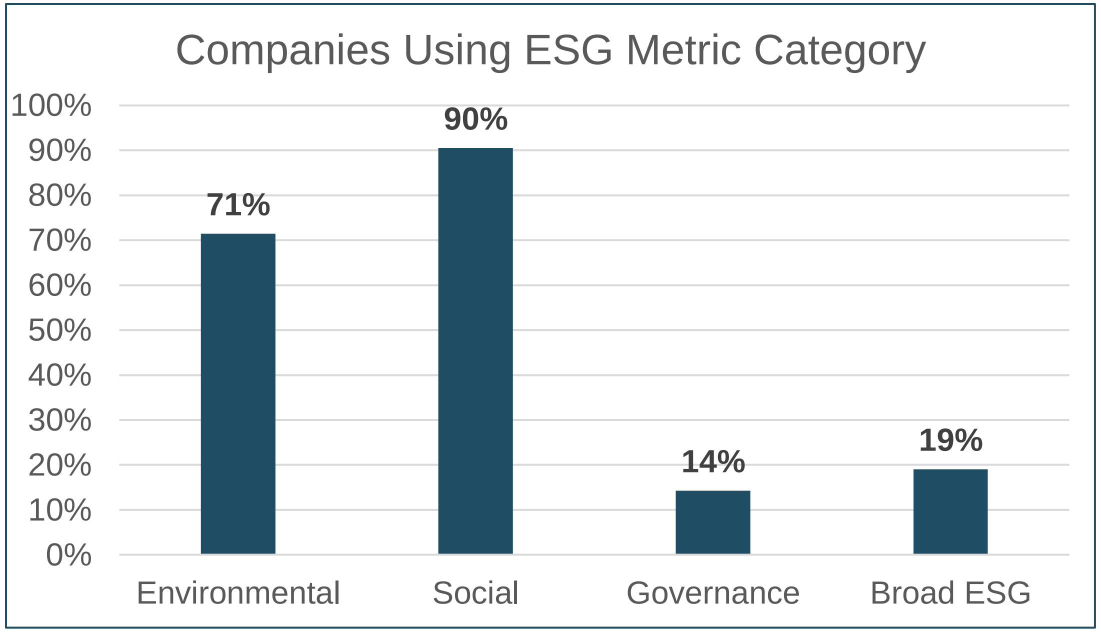


ESG metrics in LTI plans were most common in the **Clean** and **Integrated** energy companies.

What Types of ESG Metrics Should Be Used?

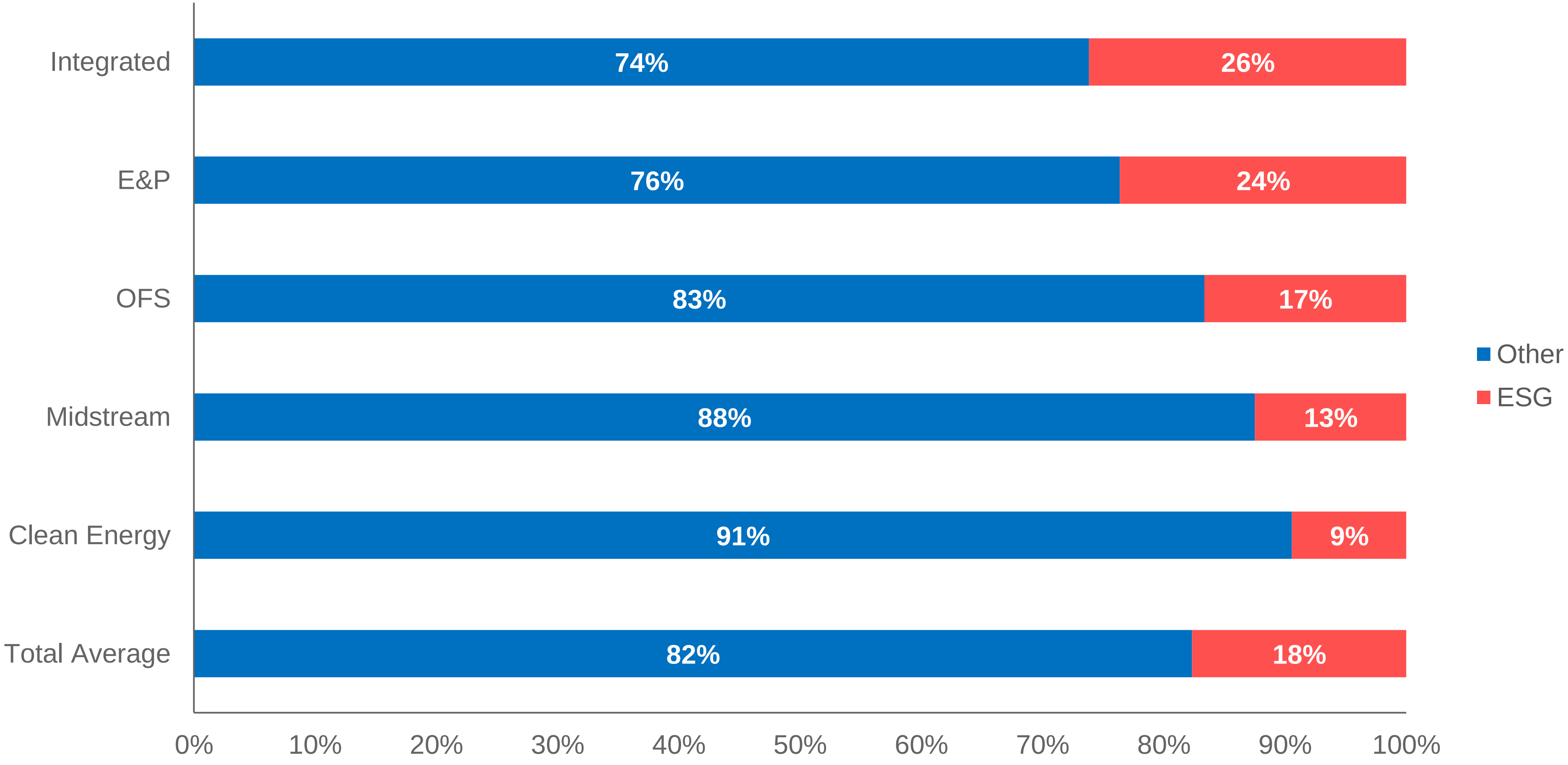
- ESG metrics must be carefully chosen and structured to be sufficiently challenging based on the circumstances of the particular company. Companies also need to consider the number of ESG metrics to utilize and how to weigh them relative to other metrics within the plan. Common ESG metrics used by companies include:
  - Environmental metrics such as greenhouse gas emissions, land protection, water use;
  - Social metrics such as diversity initiatives, health and safety records; and
  - Governance metrics such as risk management and compliance initiatives.





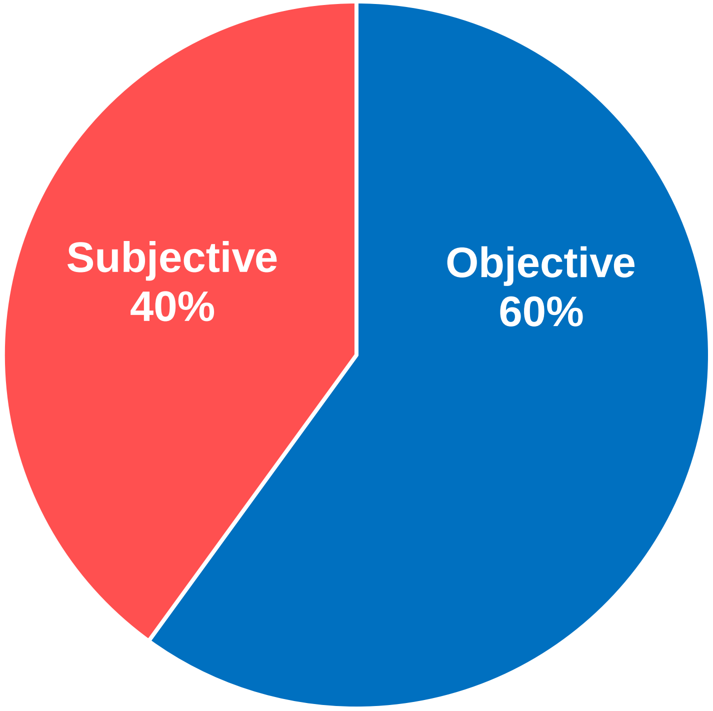
How Do You Measure ESG Performance?

- Weightings vs. other metrics:



How Do You Measure ESG Performance?

- Subjective vs. Objective Goals
  - Difficulties with rigid goals
  - External perceptions



How Do You Apply an ESG Performance Goal?

- There are a few different approaches:

  - **Weighted metric**: a certain percentage of compensation is earned if the applicable ESG metric is achieved
    - Example: 10% based on carbon footprint

  - **Scorecard**: a variety of ESG metrics are generally assessed as part of an overall scorecard used to determine how much compensation is earned
    - Example: 30% based on ESG and other strategic initiatives

  - **Modifier**: the board or compensation committee is authorized to adjust the amount of compensation earned up or down based on ESG metrics
    - Example: Payout adjusted up/down 10% based on ESG metric

  - **Individual**: ESG metrics are part of a discretionary assessment made on an individual-by-individual basis
    - Example: ESG is considered in a broad discretionary assessment, usually in an individual component

- There is no clear consensus as all approaches are used.

Recent Examples

Example #1 (Integrated): Shell

Proxy Statement

2021 annual bonus scorecard measures and weightings

Performance Measures		Weighting	Unit	Threshold	Target	Outstanding	Outcome	Score
Financial delivery 35%	Cash flow from operations [A]	35%	$ – bn	22	**28**	34	45	**2.00**
Operational excellence 35%	Asset management excellence [B]	25%	Availability – %	See note B				**0.77**
	Project delivery excellence [C]	10%	Projects delivered on schedule and budget – %	30/110	**65/103**	100/96	87/104	**1.24**
Progress in the energy transition 15%	Greenhouse gas emissions intensity [D]	10%	Tonne CO_2e intensity	See note D				**0.48**
	Greenhouse gas abatement	5%	Thousand Tonne CO_2e	168	**224**	280	279	**1.98**
Safety 15%	Personal safety	7.5%	Serious Injury & Fatality Frequency (SIF-F) cases per 100 million working hours	9.7	**6.9**	4.1	6.9	**1.00**
	Process safety	7.5%	Number of events	130	**105**	80	102	**1.12**
				Mathematical performance outcome				1.32
				Adjusted outcome				**1.29**

[A] Including working capital adjustments.
[B] Upstream controllable availability: Target: 88.1% (Threshold 86.1%, Outstanding 90.1%), midstream availability: 89.2% (87.2%/91.2%), Downstream (Refining and Chemicals) availability: 95.2% (94.2%/96.2%). Full-year outcomes were 87.8%, 87.3% and 95.6% respectively. Performance assessment is equally weighted between Upstream, midstream and Downstream availability.
[C] Performance assessment is equally weighted between project schedule and budget.
[D] Upstream/midstream (Tonne CO_2 equivalent per Tonne of hydrocarbon production available for sale): Target 0.152 (0.160/0.144); Refining GHG (Tonne CO_2 equivalent per Solomon's Utilised Equivalent Distillation Capacity): Target 1.03 (1.08/0.98); Chemicals (tonne CO_2 equivalent per tonne of steam cracker high-value chemicals production): Target 0.97 (1.07/0.87). Full-year outcomes were: 0.172, 1.05 and 0.95 respectively. Performance assessment is split 4% Upstream/midstream, 4% Refining and 2% Chemicals.

Example #2 (E&P): EOG

Proxy Statement

- Annual Bonus Plan based on the achievement of operational, financial, and strategic goals.
- Beginning in 2020, EOG introduced a separately-weighted ESG-related goal.
- 2021:

Performance Goal	Weight	Assessment	Result
Achieve 35% all-in after-tax rate of return* on total capital expenditures based on premium price deck of flat $40/Bbl WTI oil, $2.50/Mcf HH natural gas and $16/Bbl NGL prices	15%	Achieved a 51% all-in after-tax rate of return*	Significantly exceeded
Achieve double-digit ROCE*	15%	Achieved a 23% ROCE*	Significantly exceeded
Generate free cash flow* of $1.75 billion and reduce net debt-to-total capitalization ratio*	15%	Generated $5.5 billion of free cash flow* and reduced net debt-to-total capitalization ratio* from 11% to – 0.5%	Significantly exceeded
Achieve top-half status in peer group in absolute stock price performance and forward-year cash flow multiple	7.5%	Finished sixth out of nine peers in absolute stock price performance and second out of nine peers in forward-year cash flow multiple	Did not achieve top-half status relative to absolute stock price performance, but exceeded goal relative to forward-year cash flow multiple
Improve strong safety and environmental record, including a reduction in methane, GHG and flaring intensity rates and improvement in wellhead gas capture rate	7.5%	Achieved lowest recordable incident rate, methane and flaring intensity rates and highest wellhead gas capture rate to-date	Exceeded methane and flaring intensity rates, achieved recordable incident rate and wellhead gas capture rate, but did not achieve GHG intensity rate (in each case, based on preliminary estimates of 2021 metrics)
Strategic and other operational goals	40%		Overall, exceeded

- For 2022, EOG increased the weighting of the ESG-related goal from 7.5% to 10%.

Example #3 (OFS): Baker Hughes

Proxy Statement

- Annual short-term bonus based on achievement of financial metrics (weighted 70%) and achievement of strategic priorities (weighted 30%)

Overall weighting

70% Financial Metrics

30% Strategic Blueprint Priorities

Financial metrics

1. Revenue
2. Adjusted EBITDA—adjusted for restructuring, separation & other charges
3. Free cash flow

Strategic Blueprint priorities

1. Safety & compliance
2. Growth & capital allocation
3. ESG & Leadership
4. Shareholder returns

	2021 Performance Expectation	Achievements
Safety & Compliance	• Improvement in HSE metrics versus 2020 • Compliance first culture & ERM operationalization	• Perfect days up 4 days and progress on leading indicators • Implemented global ERM cadence and enterprise monitoring
		2021 Assessment: Met Objectives
Growth & Capital Allocation	• Organic EBITDA & FCF conversion accretion • Develop systematic approach to identify new areas of growth • Redeployment of existing funds to higher returns • Execute on portfolio strategy - inorganic and returns	• EBITDA margin 1.7 point expansion and FCF/EBITDA conversion of 68% • Developed systematic approach to identify new growth areas • Investment in Industrial Energy Technology increased as a percentage of total Baker Hughes year over year • Investment in ARMS, Augury and new energy and executed JV with MH Wirth
		2021 Assessment: Met Objectives
ESG & Leadership	• Diversity and inclusion growth • Deliver training, baseline emissions & waste • Revamp organization and compensation and benefit models	• Increased year over year female representation • Launched Carbon Out Program and enhanced ESG data quality • Supported future of work, improvement in compensation and benefits models
		2021 Assessment: Met Objectives
Shareholder Returns	• TSR and ROIC improvement above peer benchmarks • Active portfolio management	• 2021 TSR up 19%, lower than peers and OSX index • 40% growth in non-US shareholders
		2021 Assessment: Missed Objectives
		Total Weighted Payout: 87.5% of Target

Example #4 (Clean Energy): Ameresco

Proxy Statement

- 2021 Annual Incentive Program based on achievement of the following goals:

Goal	Target (2021)	Result (2021)	Achievement percentage contribution
Financial Performance			
Revenue	$1.1 billion	$1.2 billion	20%
Adjusted EBITDA[(1)]	$140 million	$153 million	25%
Operating expenses[(2)]	$125 million	$125 million	5%
New Contracts			
Project Sales	$825 million	$1.5 billion	10%
Asset Sales (PPA)	140 MW	60MW	—%
O&M and EaaS total contract value	$80 million	$80 million	5%
New Awards			
Project Awards - ESPC/EPC	$825 million	$1.7 billion	10%
Assets Awards (PPA)	160MW	649MW	10%
O&M and EaaS total contract value awards	$100 million	$142 million	5%
Strategic Initiatives			
Successful equity raise ($)	$150 million	$170 million	5%
ESG Goals			5%
Total			100%

Example #5 (Clean Energy): SunPower

Proxy Statement

- Performance-based equity awards granted in 2021 based on: (1) an annual safety metric (TRIR), (2) an annual profitability metric (Adjusted EBITDA), and (3) an annual cash generation metric (adjusted cash from operations)
  - TRIR is a measurement of the total number of fatalities, permanent disability cases, occupational lost-time accidents, restricted work cases, and medical treatments divided by the number of worked hours, and then multiplied by 1 million

Each eligible named executive officer would earn (i) 10% of his or her target performance-based restricted stock units based on safety performance; (ii) 45% of his or her target performance-based restricted stock units based on profitability, and (iii) 45% of his or her target performance-based restricted stock units based on cash generation. The payment for each target was determined based on the performance metric achieved relative to minimum, target, and maximum performance levels, as shown in the table below.

Percentage of Performance Target Achieved	Grant of Restricted Stock Units as Percentage of Target
Below minimum	No restricted stock units earned
At minimum	50% of target restricted stock units (minimum award for minimum achievement)
Between minimum and target	Prorated on a straight-line basis, between 50% and 100%
At target	100% of target
Between target and maximum	Prorated on a straight-line basis, between 100% and 150%
At or above maximum	150% of target

Example #6 (Midstream): MPLX

Proxy Statement

- 2021 Annual Cash Bonus Program emphasized pre-established financial (80%) and ESG (20%) performance measures.

	Performance Metric	Target Weighting	Threshold 50% Payout	Target 100% Payout	Maximum 200% Payout	Result	Performance Achieved
80%	**FINANCIAL**						
	Operating Income Per Barrel	20%	5th or 6th Position	3rd or 4th Position	1st or 2nd Position	1st or 2nd Position (200% of target)	40%
	Adjusted EBITDA per Share	20%	$5.28	$6.60	$7.92	$11.81 (200% of target)	40%
	Distributable Cash Flow at MPLX per Unit	20%	$3.62	$4.02	$4.22	$4.66 (200% of target)	40%
	Refining Operating Costs (in millions)	20%	$5,495	$5,338	$5,076	$5,175 (162.21% of target)	32.44%
20%	**ENVIRONMENTAL, SOCIAL & GOVERNANCE**						
	Greenhouse Gas Intensity	5%	24.0	23.4	22.5	23.1 (133.33% of target)	6.67%
	Process Safety Events Rate	5%	0.50	0.33	0.25	0.41 (76.47% of target)	3.82%
	Designated Environmental Incidents	5%	80	60	30	55 (116.67% of target)	5.83%
	Diversity, Equity & Inclusion	5%	External hires are at least (Women/BIPOC): 28% / 27%	30% / 30%	34% / 34%	23% / 32% (75% of target)	3.75%
100% TOTAL TARGET WEIGHTING						Total Achieved:	173%

ESG Performance Metrics

Summary

- Don’t overdo it!
    - Avoid overcommitting
    - Realistic goals
    - Realistic timeframes

Other ESG Considerations

Gender/Racial Pay Equity

- New state laws and focus in the marketplace make pay equity a high-stakes issue.
  - Employers should proactively review their compensation philosophies for red flags.
  - Violations can result in significant monetary and reputational consequences.
- Even generally vigilant companies may have liability lurking in their compensation programs.
  - Recommend implementing guidelines and/or a verification process to flag unusual situations that may result in unfair pay practices.
- Too much discretion in compensation programs without oversight / consideration of internal equity can cause trouble in an otherwise compliant company.

Practical Steps to Analyzing Pay Equity

INITIAL DIAGNOSTIC

Start with a diagnostic of the company's payroll data to determine any irregularities between gender and/or race. Involve legal counsel to protect any attorney/ client privilege.

DEEPER DIVE INTO IDENTIFIED ISSUES

If potential issues are identified, take a deeper look at those data points to determine whether there is a reasonable explanation for the differences.

CORRECTIVE ACTION

If discrepancies still exist, evaluate the various ways to correct the issue while mitigating their potential legal and financial exposure.

Key Considerations for Pay Audits

DATA GATHERING

Ensure adequate data is captured, such as:

- Job Title
- Gender
- Race
- Highest Education
- Years of Experience
- Performance Evaluations
- Department
- Seniority Level
- Base & Bonus Pay
- Equity Compensation

TIMING

Employees come, go, and change roles, so it is a best practice to conduct an audit every year. Even if you fix a problem, it can creep up again!

The annual compensation review is a good time to implement changes, but beware that the process can take time so give yourself plenty of runway.

SCOPE CREEP

When initially conducting these analyses, they can often uncover the need for more related work (that has nothing to do with corrective actions for the issue), such as:

- Market compensation analyses for certain roles
- Salary band adjustments
- Revised job descriptions
- Education of managers

Internal Pay Equity

- There has also been a renewed interest in evaluating internal pay equity as the pandemic may have exacerbated an already wide divide between rank-and-file workers and the C-Suite.
  - Some organizations are considering expanding who is eligible for incentive bonuses and equity awards that had historically been reserved for top management.
  - Ultimately, employees who do not feel that they are both part of a diverse team and compensated equitably in relation to their peers often underperform and/or leave.
  - Ensuring diversity and fair pay at all levels of the organization is paramount when considering the long-term success of a company.

Questions?

THANK YOU

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