OIL AND GAS EXPLORATION & PRODUCTION (E&P) INCENTIVE PLAN DESIGN REPORT

ANALYSIS OF ANNUAL AND LONG-TERM INCENTIVE ARRANGEMENTS AT 100 OF THE LARGEST U.S. E&P COMPANIES

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Contents

INTRODUCTION

Incentive compensation is an integral part of the total compensation package for executives at most large, publicly-traded companies. To understand current annual and long-term incentive compensation pay practices in the oil and gas exploration & production (E&P) sector, Alvarez & Marsal Taxand, LLC's Executive Compensation and Benefits Practice (A&M) examined the latest proxy statements for 100 of the largest E&P companies traded on a U.S. stock exchange.

Key Takeaways

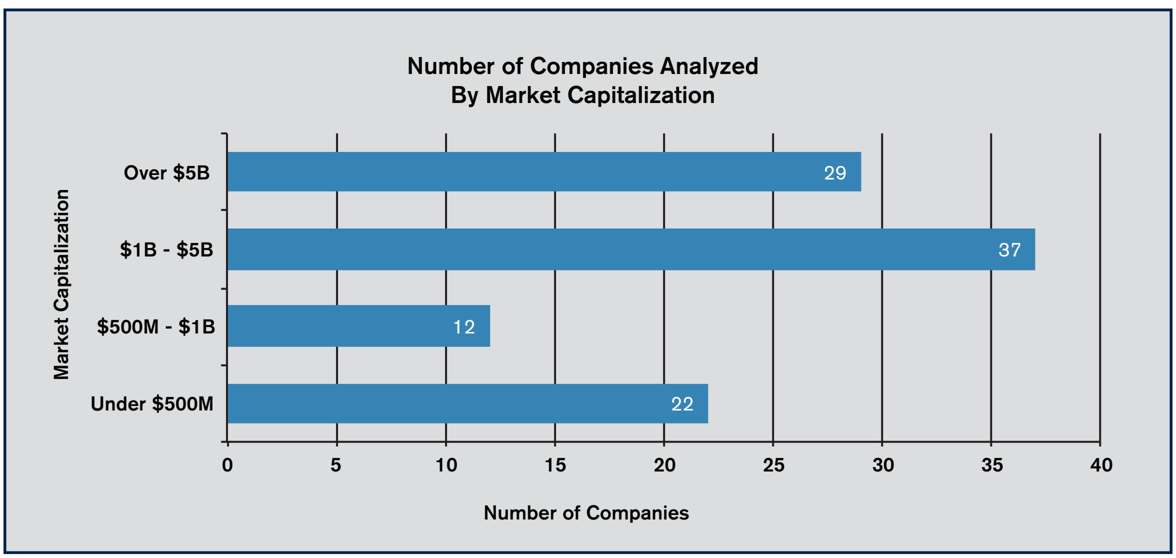
- 72% of companies with market capitalization over $5B utilize annual incentive plans where payout is at least partially determined in a formulaic manner, while only 23% of companies with market capitalization smaller than $500M utilize formulaic performance metrics.
- 83% of companies utilize one or more performance metrics in their annual incentive plan. Production/production growth is the most prevalent metric and is utilized by 87% of such companies.
- 96% of companies grant at least one form of long-term incentive award. The prevalence of awards varies by company size, but time-vesting restricted stock / restricted stock units are the most common form of award granted (used by 83% of all companies).
- 59% of companies grant long-term incentive awards where vesting or payout is determined by one or more performance metrics. Relative total shareholder return is the most commonly used performance metric and is used in 76% of such awards.

Methodology

A&M compiled data on the annual and long-term incentive plan structures for these companies as it pertains to the named executive officers (CEO, CFO and other officers disclosed in the company's proxy statement). Where possible, this analysis only includes companies with revenue derived primarily from E&P activities (i.e., not primarily midstream, refining, etc.), and excludes companies that did not disclose sufficient data on their compensation programs, such as companies that recently went through an initial public offering and did not disclose the structure of their go-forward compensation. The data represents the most up-to-date plan structure disclosed by these companies.

Company Statistics

The companies analyzed for this report are diverse in terms of market capitalization. The chart below shows the distribution of companies analyzed by market capitalization.



ANNUAL INCENTIVE PLANS

As is the case with most industries, companies in the E&P sector generally provide an opportunity for executives to participate in an annual incentive plan (AIP), also commonly called bonus programs. AIPs utilize performance metrics that are generally measured over a one-year period.

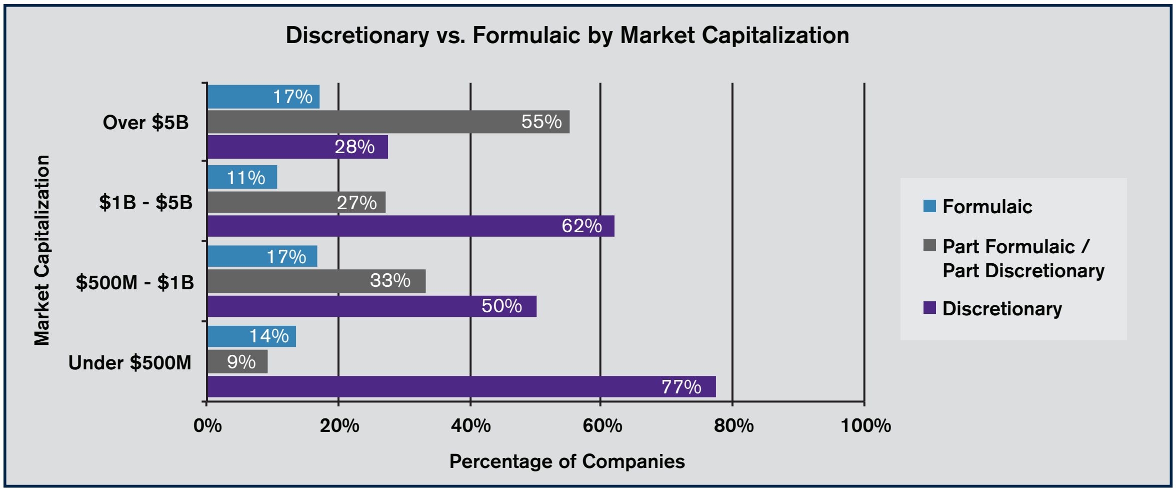
Discretionary vs. Formulaic

For this analysis, we grouped annual incentive plans into the following three categories based on how the annual bonus payout is determined:

- **Formulaic** – the plan utilizes pre-determined performance criteria with established targets that will determine payout and the compensation committee does not have discretion to adjust payouts (other than negative discretion).
- **Discretionary** – the plan may or may not utilize specific, pre-established performance criteria but the compensation committee maintains absolute discretion to adjust payout levels upward or downward.
- **Part Formulaic / Part Discretionary** – The plan utilizes certain metrics where payout is determined formulaically and others where payout is determined at the discretion of the compensation committee.

ANNUAL INCENTIVE PLANS

As shown in the chart below, the majority of E&P companies maintain some form of discretion with respect to their AIP. However, these companies tend to move away from purely discretionary plans as market capitalization increases, as shown below:



Companies may utilize formulaic compensation programs to provide clarity to executives and shareholders on how compensation will be determined and to benefit from favorable tax treatment under the "performance-based compensation" exemption under Internal Revenue Code (IRC) section 162(m). IRC section 162(m) generally disallows a tax deduction for compensation paid in excess of $1 million.

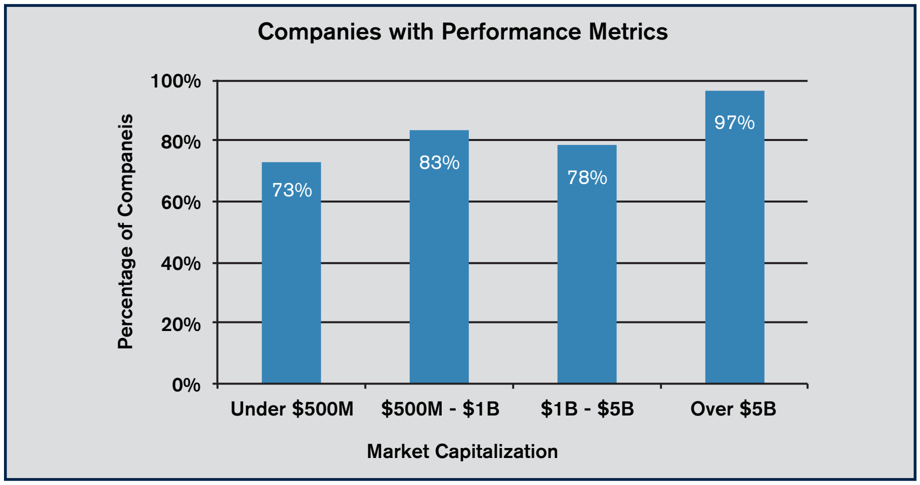
However, when properly structured, performance-based compensation, including payouts under a formulaic AIP, are exempt from the $1 million limit.

Notwithstanding the favorable tax treatment afforded to formulaic AIPs, some companies maintain discretion over the payout of annual bonus plans in order adjust for events that are unforeseen and / or out of the executive's control.

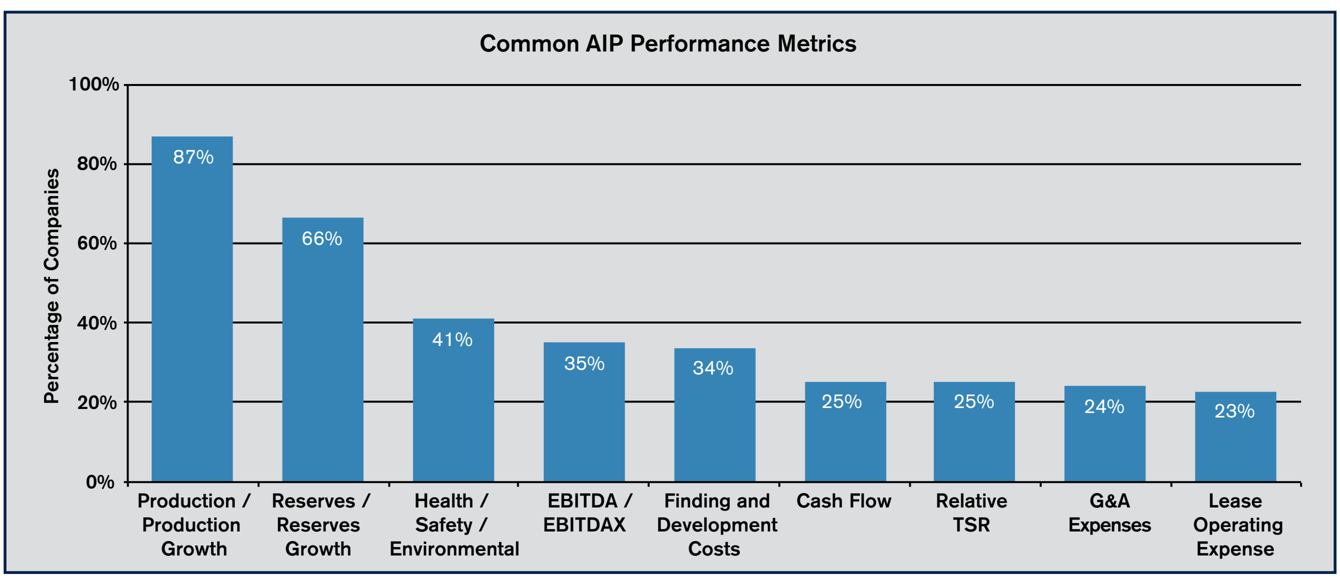
ANNUAL INCENTIVE PLANS

Performance Metrics

Generally, as market capitalization increases, companies have a stronger preference to utilize stated performance metrics, with 97% of companies with market capitalization over $5B utilizing at least one performance metric. It is important to note that simply because a plan utilizes performance metrics, it may not necessarily be classified as "formulaic." Based on the terms of the plan, it may ultimately be classified as "discretionary."



The following chart displays the most prevalent metrics used in AIPs. Production, including production growth, is the most prevalent metric and is used by 87% of companies that utilize performance metrics.



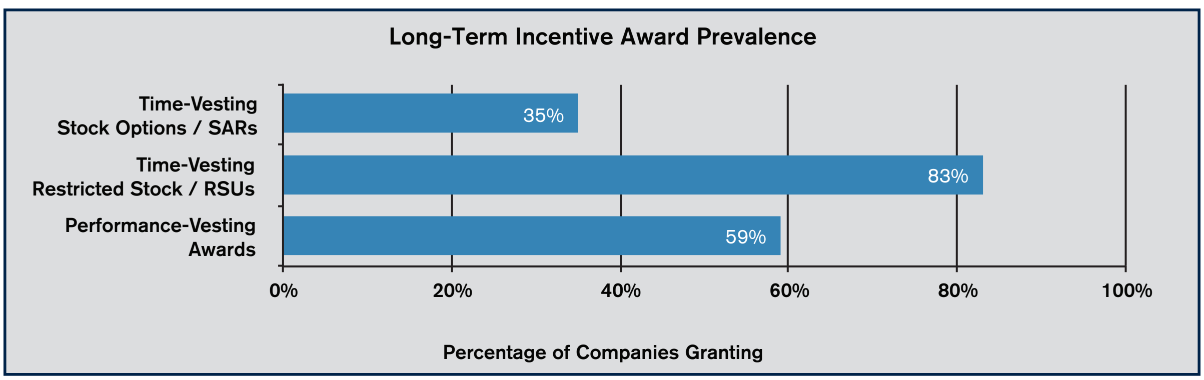
...It is important to note that simply because a plan utilizes performance metrics, it may not necessarily be classified as "formulaic."

LONG-TERM INCENTIVES

Most E&P companies analyzed (96%), grant some form of long-term incentive award to executives. Long-term incentives generally consist of stock options, stock appreciation rights (SARs), time-vesting restricted stock or restricted stock units (RSUs) and performance-vesting awards (i.e., awards that vest upon satisfaction of some performance criteria rather than solely based on the passage of time). For purposes of this analysis, due to the similarity between awards, we grouped awards into three categories — (1) time-vesting stock options and SARs; (2) time-vesting restricted stock and RSUs; and (3) performance-vesting awards.

Award Prevalence

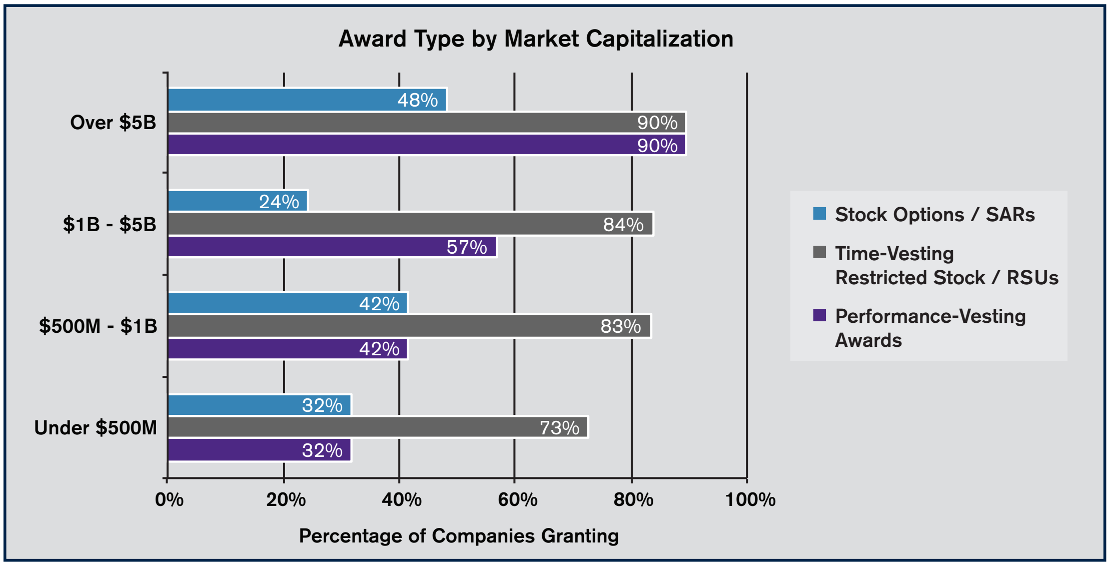
The chart below shows the prevalence of stock options / SARs, time-vesting restricted stock / RSUs and performance-vesting awards for all 100 E&P companies.



Time-vesting restricted stock / RSUs are the most utilized award type followed by performance-vesting awards. Not surprisingly, stock options / SARs are the least prevalent LTI vehicle utilized by U.S.-based E&P companies. Stock options / SARs have declined in popularity due to a change in the accounting treatment for these awards, the overall market shift toward performance-vesting equity, and because of the view of proxy advisors that these types of awards are not "performance-based," even though to receive value from a stock option or SAR, the underlying stock price generally must increase.

Award Prevalence by Market Capitalization

As shown in the chart below, A&M also analyzed whether a company's size (in terms of market capitalization) impacts the prevalence of awards that are provided.

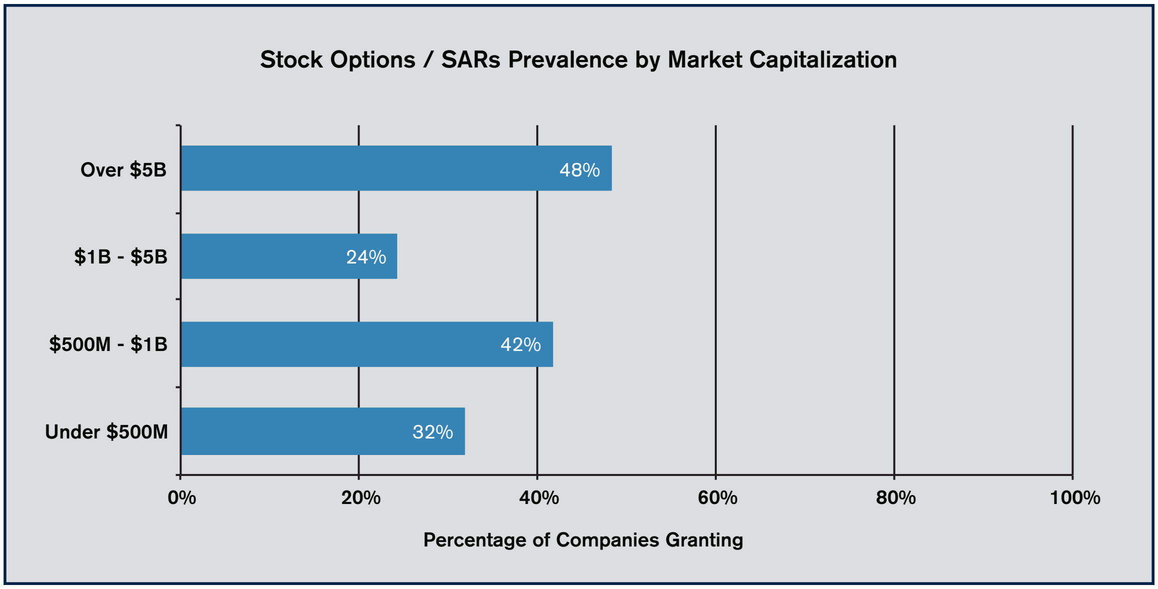


- Stock Options / SARs do not have an apparent correlation to market capitalization.
- Time-Vesting Restricted Stock / RSUs are slightly more prevalent at larger companies.
- Performance-Vesting Awards are significantly more prevalent at larger companies (90% of companies over $5B and only 32% of companies under $500M).

LONG-TERM INCENTIVES

Stock Options / Stock Appreciation Rights

The chart below shows the percentage of companies that grant stock options / SARs by market capitalization. The prevalence is fairly inconsistent, with no apparent correlation to market capitalization.

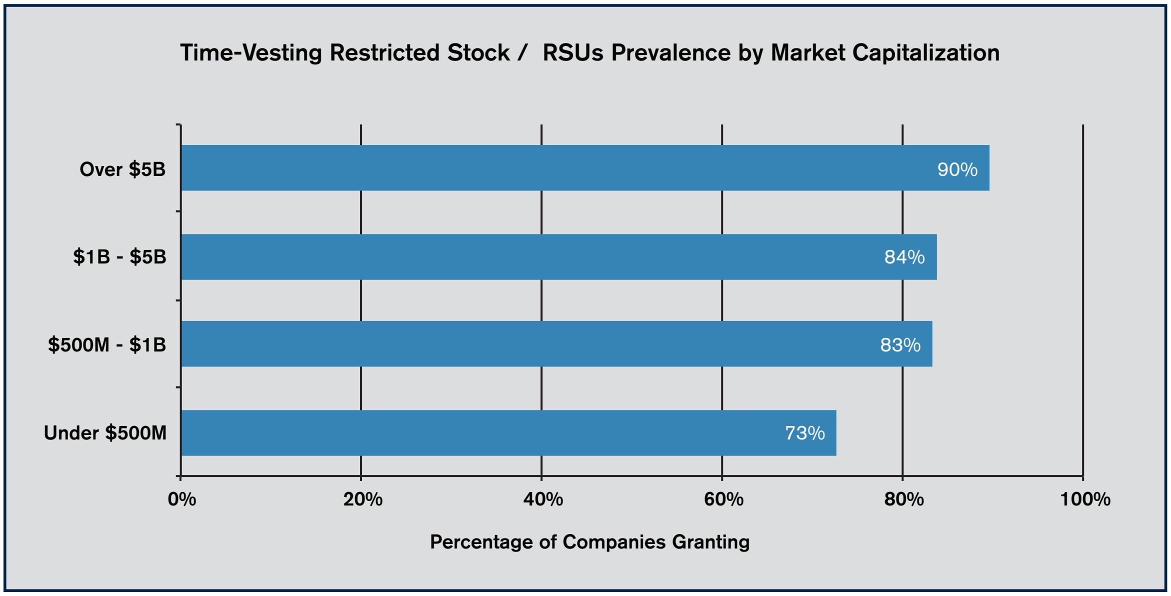


Award Provisions

- Stock option awards predominantly consisted of nonqualified stock options rather than tax-favored incentive stock options.
- Awards generally vest on a ratable basis rather than cliff vesting.
  - Ratable vesting is when a portion of the award vests each year during the vesting period (i.e., 1/3 of the award vests on each of the first three anniversaries of the grant date).
  - Cliff vesting is when the entire award vests at the end of the vesting period (i.e., 100% of the award vests on the third anniversary of the grant date).
- The most prevalent vesting period for stock options / SARs is 3 years (69% of companies), followed by 2 years and 4 years (each used by 11% of companies).
- The most prevalent contractual term for stock options / SARs is 10 years (60% of companies), but a 5 year or 7 year term is also used at many companies (used by 20% and 17% of companies, respectively).

Time-Vesting Restricted Stock / RSUs

The chart below shows the percentage of companies that grant time-vesting restricted stock / RSUs by market capitalization. The prevalence is fairly high (in the 70% to 90% range) for all sizes of companies and is somewhat more prevalent at larger companies.



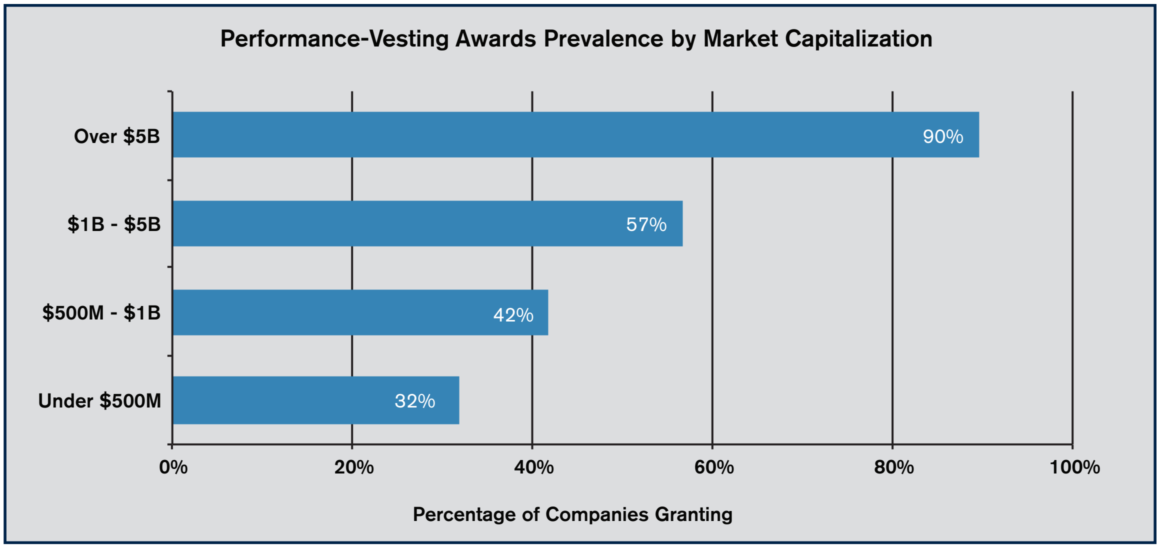
Award Provisions

- Of companies that grant time-vesting restricted stock / RSUs, it is slightly more common for companies to grant restricted stock (58% of companies) compared to RSUs (42% of companies).
- A 3 year vesting period is the most common vesting period (utilized by 72% of companies), while a 4 year vesting period is the second most common (utilized by 15% of companies).
- It is more common for companies to grant awards that vest on a ratable basis (77%) than awards that cliff vest (23%).

LONG-TERM INCENTIVES

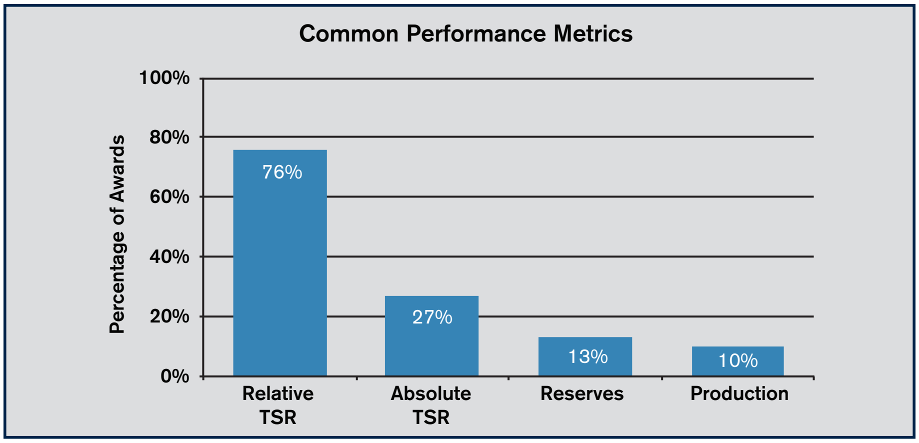
Performance-Vesting Awards

The chart below shows the percentage of companies that grant performance-vesting awards by market capitalization. Performance-vesting awards become significantly more prevalent as company size increases.



Performance Metrics

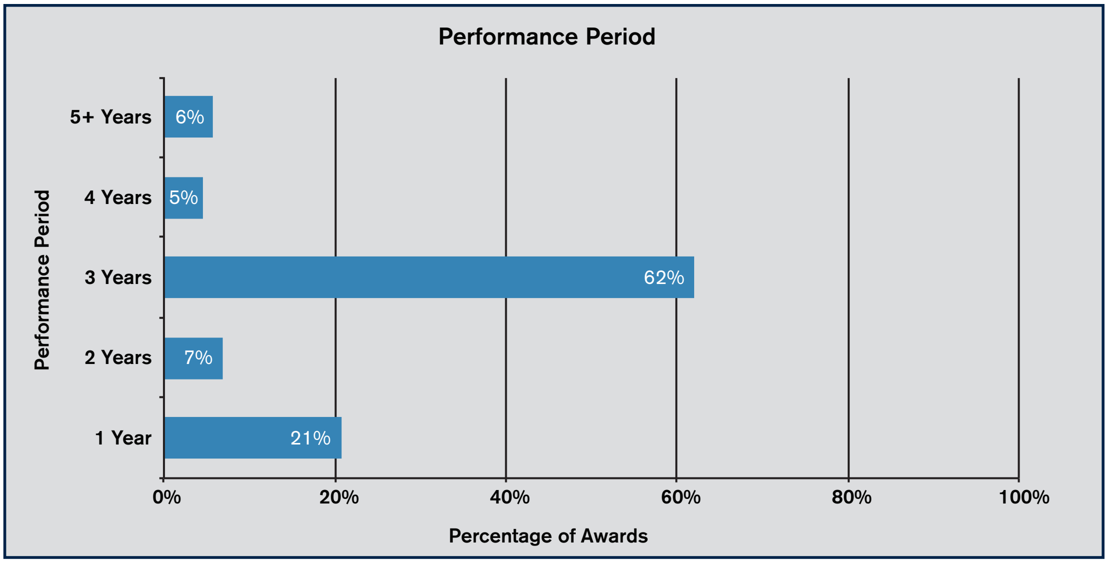
The following chart shows the prevalence of the most common metrics used for performance-vesting awards. The most prevalent metric is total shareholder return (TSR) relative to peer group, which is used for 76% of performance-vesting awards. Many companies also use TSR on an absolute basis either as a standalone metric or as a governor to limit payout if absolute TSR is negative (i.e., if absolute TSR is negative, then the maximum payout is capped at a lower amount). Nearly 1/2 of performance-vesting awards (46%) utilize more than one performance metric.



LONG-TERM INCENTIVES

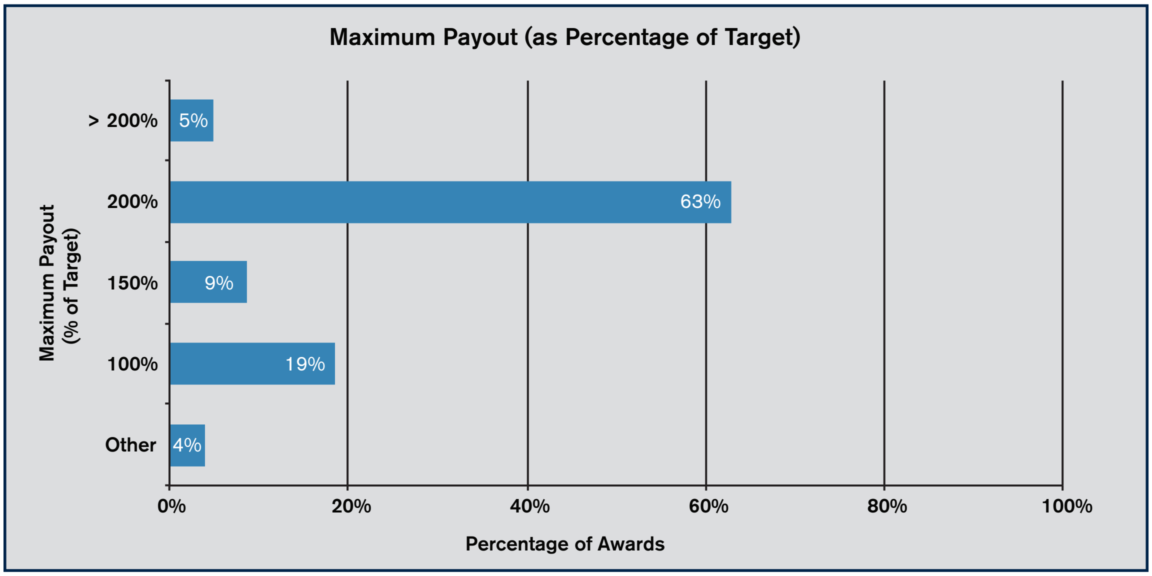
Performance Period

The performance period is the duration over which the applicable performance metrics are measured. As shown in the chart below, the most prevalent performance period for performance-vesting awards, by a wide margin, is 3 years (62% of awards) followed by 1 year (21% of awards).



Maximum Payout

Oftentimes, performance-vesting awards provide for a range of payouts. For example, if the threshold level of performance is achieved, 50 shares of stock will be granted, if the target level of performance is achieved, 100 shares of stock will be awarded, and if the maximum level of performance is achieved, 200 shares of stock will be awarded. As shown in the chart below, a majority of performance-vesting awards granted by E&P companies provide for a maximum payout equal to 200% of target.



COMPANIES ANALYZED

Abraxas Petroleum Corporation
American Eagle Energy Corporation
Anadarko Petroleum Corporation
Antero Resources Corporation
Apache Corporation
Approach Resources, Inc.
Athlon Energy, Inc.
Atlas Resource Partners, L.P.
Bill Barrett Corporation
Bonanza Creek Energy, Inc.
BPZ Resources, Inc.
BreitBurn Energy Partners L.P.
Cabot Oil & Gas Corporation
Callon Petroleum Company
CAMAC Energy Inc.
Carrizo Oil & Gas, Inc.
Chesapeake Energy Corporation
Cimarex Energy Co.
Clayton Williams Energy, Inc.
Cobalt International Energy, Inc.
Comstock Resources, Inc.
Concho Resources Inc.
ConocoPhillips
Contango Oil & Gas Company
Continental Resources, Inc.
Denbury Resources, Inc.
Devon Energy Corporation
Diamondback Energy, Inc.
Eagle Rock Energy Partners, L.P.
Emerald Oil, Inc.
Energen Corporation
Energy XXI (Bermuda) Limited
EOG Resources Inc.
EP Energy Corporation
EQT Corporation
EV Energy Partners, L.P.
Evolution Petroleum Corporation
EXCO Resources, Inc.
Forest Oil Corporation
FX Energy, Inc.
Gastar Exploration Inc.
Goodrich Petroleum Corporation
Gran Tierra Energy Inc.
Gulfport Energy Corporation
Halcón Resources Corporation
Harvest Natural Resources, Inc.
Hess Corporation
Hydrocarb Energy Corporation
Isramco, Inc.
Kodiak Oil & Gas Corp.
Kosmos Energy Ltd.
Laredo Petroleum, Inc.
LINN Energy, LLC
LRR Energy, L.P.
Magnum Hunter Resources Corporation
Marathon Oil Corporation
Matador Resources Company
Memorial Production Partners LP
Mid-Con Energy Partners, LP
Midstates Petroleum Company, Inc.
Miller Energy Resources, Inc.
Murphy Oil Corporation
Newfield Exploration Company
Noble Energy, Inc.
Northern Oil and Gas, Inc.
Oasis Petroleum Inc.
Occidental Petroleum Corporation
Panhandle Oil and Gas Inc.
PDC Energy, Inc.
Penn Virginia Corporation
PetroQuest Energy, Inc.
Pioneer Natural Resources Company
PrimeEnergy Corporation
QEP Resources, Inc.
QR Energy, LP
Quicksilver Resources Inc.
Range Resources Corporation
Resolute Energy Corporation
Rex Energy Corporation
Ring Energy, Inc.
Rosetta Resources Inc.
RSP Permian, Inc.
Sanchez Energy Corporation
SandRidge Energy, Inc.
SM Energy Company
Southwestern Energy Company
Stone Energy Corporation
Swift Energy Company
Synergy Resources Corporation
TransAtlantic Petroleum Ltd.
TransGlobe Energy Corporation
Triangle Petroleum Corporation
Ultra Petroleum Corp.
U.S. Energy Corp.
VAALCO Energy, Inc.
Vanguard Natural Resources, LLC
W&T Offshore, Inc.
Warren Resources, Inc.
Whiting Petroleum Corporation
WPX Energy, Inc.

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- Executive Compensation Advisory Consulting
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- Benefit Plan Evaluation, Design and Implementation
- Global Incentive Compensation Advisory Services

A&M Taxand

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