

Pay Ratio Disclosure Rules: The A-Z Training Course

Presentation for:

Executive Compensation Webinar Series
July 13, 2017

Presented by:

Anthony J. Eppert
713.220.4276
AnthonyEppert@AndrewsKurth.com

ANDREWSKURTH
KENYON

andrewskurthkenyon.com

Housekeeping: Technical Issues and Questions

- Technical issues
 - If you are having difficulty viewing this presentation, please call Cisco WebEx Tech Support toll free at 866.229.3239

- Questions during this presentation
 - We encourage questions (even though your audio lines are muted)
 - To submit a question, simply type the question in the blank field on the right-hand side of the menu bar and press return
 - If time permits, your questions will be answered at the end of this presentation. And if there is insufficient time, the speaker will respond to you via e-mail shortly after this presentation

Housekeeping: Recording, CE Credits and Disclaimer

- Recording
 - This presentation is being recorded for internal purposes only
- Continuing education credits
 - A purpose of the webinar series is to provide FREE CE credits
 - To that end, each presentation is intended to provide 1 credit hour in the following areas:
 - CLE: 1 credit hour (Texas)
 - CPE: 1 credit hour (Texas)
 - HRCI: This activity has been approved for 1 (HR (General)) recertification credit hours toward California, GPHR, PHRi, SPHRi, PHR, and SPHR recertification through the HR Certification Institute
 - SHRM: This program is valid for 1 PDC for the SHRM-CPSM or SHRM-SCPSM
 - If you have any questions relating to CE credits, please direct them to Anthony Eppert at AnthonyEppert@AndrewsKurth.com or 713.220.4276
- Disclaimer
 - This presentation is intended for informational and educational purposes only, and cannot be relied upon as legal advice
 - Any assumptions used in this presentation are for illustrative purposes only
 - No attorney-client relationship is created due to your attending this presentation or due to your receipt of program materials

Housekeeping: About Anthony “Tony” Eppert



Anthony Eppert , Partner
Andrews Kurth Kenyon LLP
Tel: +1.713.220.4276
Email: AnthonyEppert@AndrewsKurth.com

- Tony practices in the areas of executive compensation and employee benefits

- Before entering private practice, Tony:
 - Served as a judicial clerk to the Hon. Richard F. Suhrheinrich of the United States Court of Appeals for the Sixth Circuit
 - Obtained his LL.M. (Taxation) from New York University
 - Obtained his J.D. (Tax Concentration) from Michigan State University College of Law
 - Editor-in-Chief, Journal of Medicine and Law
 - President, Tax and Estate Planning Society

Our Compensation Practice – What Sets Us Apart

- Compensation issues are complex, especially for publicly-traded companies, and involve the substantive areas of:
 - Tax,
 - Securities,
 - Accounting,
 - Governance,
 - Surveys, and
 - Human resources

- Historically, compensation issues were addressed using multiple service providers, including:
 - Tax lawyers,
 - Securities/corporate lawyers,
 - Labor & employment lawyers,
 - Accountants, and
 - Survey consultants

Our Compensation Practice – What Sets Us Apart (cont.)

- At Andrews Kurth Kenyon LLP, we have a holistic and full-service approach to compensation matters, that considers all substantive areas of compensation, including:



Housekeeping: Upcoming 2017 Webinars

- Upcoming 2017 webinars:
 - Trends in Designing Performance-Based Equity Awards (8/10/2017)
 - Preparing for Proxy Season: Start Now (Annual Program) (9/14/2017)
 - How to Properly Design a Nonqualified Deferred Compensation Plan (10/12/2017)
 - Navigating Employee v. Independent Contractor Classifications (11/9/2017)
 - Sharing the Dream: M&A Transactions & Retaining Key Employees (12/14/2017)

- Upcoming 2018 webinars
 - To be determined
 - Suggestions welcomed!

Introduction

- From a policy perspective, the pay ratio disclosure rule (the “**Rule**”) is essentially the byproduct of a perceived internal pay disparity/income inequality discussion

- Origins of the Rule
 - The Rule was enacted as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act (Section 953(b))
 - The final Rule was adopted by the SEC on August 5, 2015, and a new Item 402(u) was added Regulation S-K
 - On October 18, 2016, the SEC released new C&DIs (found here at Sections 128C.01-128C.05: <https://www.sec.gov/divisions/corpfin/guidance/regs-kinterp.htm>)
 - Question 128C.01 – If not using annual total compensation to identify median employee, how should the issuer select another “consistently applied compensation measure” to identify the median employee?
 - Question 128C.02 – Exclusively using hourly or annual rates of pay would not be permitted as a permissible consistently applied compensation measure
 - Question 128C.03 – Time period that must be used with respect to a consistently applied compensation measure
 - Question 128C.04 – Addressing furloughed employees when determining the employee population
 - Question 128C.05 – Addressing independent contractors when determining the employee population

Introduction (cont.)

- The likelihood that legislation will be adopted to repeal the Rule prior to the upcoming proxy season (if at all) is uncertain, and many believe the Rule will not be repealed
 - The Financial CHOICE Act of 2017 included a repeal of the Rule, and this Act was approved by the House of Representatives in June 2017. It remains unknown whether the Senate will approve the Act, and if approved, whether the President will sign it into law, all prior to the 2018 proxy season

- A number of cities and states are attempting to effectuate an added tax on issuers that exceed a certain ratio threshold. For example:
 - Proposed legislation was introduced in the Massachusetts Legislature that would impose a new corporate tax based upon an issuer's compensation ratio, effective January 1, 2018. As a gross overview, if an issuer's compensation ratio exceeds 100, then the issuer will incur an additional 2% excise tax on its net income derived within Massachusetts for the next tax year
 - The city of Portland, Oregon approved a proposal to the city ordinance that would impose a surtax on the issuer's current city business income tax 2.2%
 - 10% surtax if the CEO's ratio is 100 to 250 times the median employee
 - 25% surtax if the CEO's ratio is above 250 times the median employee
 - Bills were proposed in Rhode Island and Minnesota that are similar to the Portland proposal

Overview

- The Rule requires most issuers to disclose:
 - The annual total compensation of their CEO,
 - The median annual total compensation of all employees of the issuer (excluding the CEO) and consolidated subsidiaries,
 - The ratio of the amount determined in the above two items,
 - The date the above was determined (within the last 3 months of the last completed fiscal year), and
 - The methodologies the issuer used to identify the median employee and total compensation

Overview (cont.)

- Effective date
 - Disclosure is required for the first full fiscal year beginning on or after January 1, 2017. This means issuers with fiscal years ending December 31st must include the disclosure within their Form 10-Ks and proxy statements filed in 2018

- Applicable filings
 - Disclosure is required in any filing that requires Item 402 disclosure
 - Thus, not required within a Form S-1 (IPO) or Form 10 (spin-off)

 - Additionally, the following are exempt from having to comply with the Rule:
 - Emerging growth companies (though disclosure is required after the full fiscal year from EGC status terminating),
 - Foreign private issuers, and
 - Small reporting companies (same as EGCs, above)

Overview (cont.)

- Application to IPO companies
 - Required with respect to the first complete fiscal year after the company:
 - Has been subject to Section 13(a) or 15(d) of the Exchange Act for 12 months or more, and
 - Filed at least one annual report

- Application to a target's employees with respect to an M&A transaction
 - The target's employees must be included within the median employee population beginning with the full fiscal year that immediately follows consummation of the transaction
 - With respect to the fiscal year in which the M&A event is consummated, the acquiror is permitted to exclude the target's employees from the median employee population
 - However, any such exclusion will trigger a disclosure requirement for the acquiror (*i.e.*, the acquiror must disclose the identify of the target and the approximate number of employees that were excluded from the median employee population)

Be Prepared: Misleading Comparisons Could Develop

- Comparisons by investors and the market
 - It is highly probable that the market will develop comparisons of an issuer's pay ratio against those of its peer companies or against industry averages

- Comparisons by an issuer's employees
 - Though employees might have an idea of what they make vis-à-vis their CEO, disclosure of the ratio could cause employee disruption since each of the issuer's employees will have a frame of reference to the median employee

- Year-over-year comparisons of an issuer's ratio
 - What if, for example, CEO pay moved up and median pay of the employees moved down from one year to the next
 - Explaining a change in the ratio could prove difficult
 - Consider whether pay ratio will effectively inhibit the granting of special bonuses to an issuer's CEO

Step 1: Select the “Determination Date”

- For purposes of determining “who” is an employee, the issuer is permitted to use any date that is within the last 3 months of the fiscal year
 - Due to the issuer’s flexibility in picking the determination date, an issuer could pick a date within the last 3 months that would otherwise exclude, for example, a seasonal workforce

- The determination date must be disclosed by the issuer, however, disclosure of the underlying rationale for picking such date is not required
 - Notwithstanding the above, any future change in the determination date would require the issuer to disclose the rationale for the change
 - Thus, issuers should consider initially identifying several determination dates when first identifying the median employee, determine the impact of each on the pay ratio, and then pick the determination date that produces the best pay ratio

Step 2: Identify the “Employees” – Inclusions

- As of the determination date, the Rule includes all U.S. and non-U.S. employees (other than the CEO) of the issuer and its consolidated subsidiaries. Such includes:
 - Full-time employees,
 - Part-time employees,
 - Seasonal employees, and
 - Temporary employees
- The foregoing applies equally to furloughed employees (*i.e.*, was the furloughed employee employed by the issuer on the determination date?)
- Notwithstanding the above, the next few slides show that certain employees are excluded from the above

Step 2: Identify the “Employees” – Exclusions

- Exclusion No. 1 applies to employees of non-consolidated subsidiaries
 - Only employees of the issuer’s consolidated subsidiaries are included within the employee population
 - Employees of subsidiaries and joint ventures that are not members of the issuer’s consolidated subsidiaries are NOT included
 - Whether a subsidiary is a member of the issuer’s consolidated subsidiaries is determined pursuant to accounting rules
 - And with respect to employees of the issuer that are seconded to a non-consolidated subsidiary, such employees would be included within the employee population for purposes of this Rule

- Exclusion No. 2 applies with respect to independent contractors and leased employees, but only if (*i.e.*, not an IRS independent contractor test):
 - The worker is employed by an unaffiliated third party to the issuer, and
 - The worker’s compensation is determined by such third party
 - However, the issuer is permitted to specify a minimum amount or rate of pay without destroying this element
 - For purposes of this exclusion and according to C&DI 128C.05, an individual that is an independent contractor may be the “unaffiliated third party” that determines his or her own compensation

Step 2: Identify the “Employees” – Exclusions (cont.)

- Exclusion No. 3 (data privacy exception) applies with respect to non-U.S. employees where their inclusion within the Rule would violate privacy laws
 - The issuer is required to make “reasonable efforts” to comply with applicable foreign data privacy laws. Such efforts would generally require:
 - The issuer to seek (from the applicable foreign agency) an exemption from the data privacy laws;
 - Assuming no exemption is received from the applicable foreign agency, the issuer must obtain a legal opinion concluding that (i) any inclusion of such non-U.S employees within the issuer’s pay ratio calculations would violate such foreign country’s data privacy laws, and (ii) the issuer was unable to obtain an exemption or relief from the applicable foreign agency with respect to such data privacy laws;
 - Such legal opinion must be filed by the issuer as an exhibit to the issuer’s proxy statement or annual report; and
 - For each excluded foreign jurisdiction, the issuer must disclose the approximate number of employees that are excluded under this exemption
- Any exclusion of employees under the data privacy exclusion with respect to a particular foreign jurisdiction would require exclusion of ALL non-U.S. employees in that jurisdiction
- On a personal note, most issuers should have the ability to receive non-descript compensatory data (unless the employee population is small) without violating the data privacy rules of a particular jurisdiction, so the utility of this Exclusion is unknown

Step 2: Identify the “Employees” – Exclusions (cont.)

- Exclusion No. 4 applies in two parts (known as the de minimis exemption):
 - First, the issuer is permitted to exclude its non-U.S. employees if all non-U.S. employees account for 5% or less of the issuer’s total employee population in both the U.S. and non-U.S.
 - Second, applicable in instances where the issuer’s non-U.S. employees exceed the foregoing 5% test, the issuer may exclude up to 5% of its total non-U.S. employees
 - However, any exclusion of employees in a non-U.S. jurisdiction would require an exclusion of ALL employees in such jurisdiction
 - As a result, an issuer would not be able to exclude employees of a certain foreign jurisdiction if the employees in such jurisdiction exceeded the 5% threshold

- It is important to note that Exclusion No. 4 applies AFTER application of Exclusions 1-2 (to the extent applicable)
 - However, any employees excluded from the Rule pursuant to Exclusion 3 (data privacy) would be included within the 5% di minimis test

Step 2: Identify the “Employees” – Exclusions (cont.)

- Issuers relying upon the de minimis exception must disclose:
 - The applicable jurisdiction or jurisdictions that were excluded;
 - The approximate number of employees that were excluded in each such jurisdiction;
 - The total number of employees, segmented between U.S. and non-U.S. employees (this disclosure applies irrespective of the issuer’s reliance on Exclusion Nos. 3 and 4); and
 - The total number of the issuer’s U.S. and non-U.S. employees that were incorporated into the de minimis calculation

Step 3: Determine the Median Employee

- Absent a change in the employee population from year to year, or a change in the compensation from year to year, this Step 3 requires issuers to identify their median employee at least once every 3 years

- To that end, issuers are afforded broad discretion and may determine the subset employee population by:
 - The entire population;
 - Statistical sampling to identify a representative subset of the employee population, and then identify the median employee from such subset;
 - Reasonable estimates; and
 - Any other reasonable method (e.g., exclude the highest and lowest paid workers, and then apply a statistical sampling to the remainder in order to identify the median employee)

- Once the subset or full employee population is identified, the median employee can be identified by using:
 - The annual compensation of the entire subset employee population, or
 - Any other consistently applied compensation measure (e.g., tax and payroll records, annual compensation and base bonus, wages and overtime, etc.)

Step 3: Determine the Median Employee (cont.)

- In determining the median employee, the issuer is permitted to make cost-of-living adjustments
 - The cost-of-living adjustment must be applied uniformly within a particular jurisdiction, but may vary from jurisdiction to jurisdiction

- The issuer is permitted to annualize full-time and permanent part-time employees who were employed for less than the full fiscal year
 - Such annualization is not permitted for seasonal or temporary employees
 - Additionally, it is not permitted to make adjustments in order to project what a part-time employee would make if he/she were a full-time employee

- It is required that the issuer identify an actual employee as the median employee (though no personal and identifiable information of the median employee would be disclosed)
 - If the identified median employee has unusual circumstances (as reasonably determined by the issuer), then the issuer is permitted to substitute with another employee who has substantially similar compensation. However, disclosure that a substitution occurred would be required

Step 3: Determine the Median Employee (cont.)

- Possible cons to statistical sampling
 - The number derived can be volatile from year to year due to the sampling, which could destroy stability in the ratio on a year-over-year basis
 - The data is more trusted and known without statistical sampling

- Issuers that use the same median employee as the prior year must disclose:
 - That its pay ratio calculation uses the same median employee as the prior year, and
 - The basis for the issuer's belief that there have been no practical changes to the employee population or its compensation from the prior year

Step 4: Calculate Median Employee's Annual Total Compensation

- Once the median employee has been identified, this Step 4 requires the issuer to calculate the median employee's total compensation for the last completed fiscal year
 - Such must be applied in a manner that is consistent with the determination of “total compensation” under Item 402 of Regulation S-K (e.g., total compensation within the Summary Compensation Table)
 - Reasonable estimates may be used where appropriate (e.g., estimating the value of pension plan benefits)

Disclosures

- The ratio may be presented numerically (e.g., 75:1) or in narrative form
 - Disclosure in the form of a percentage is not permitted under the Rule

- Issuers are required to disclose the following:
 - What methodology was used to identify the median employee (though consider whether to disclose general information about the median employee's position);
 - All material assumptions, COLAs and consistently applied compensation measures used to identify the median employee or to determine total compensation;
 - The compensation measure used to make the identification (assuming annual total compensation is not used);
 - Any estimates used must be clearly disclosed;
 - Any change to the use or non-use of COLAs; and
 - The determination date

Supplemental Disclosures

- Similar to an Alternative Compensation Table concept, issuers are permitted to provide additional ratios. However:
 - The additional ratios must be clearly identified,
 - The additional ratios cannot be misleading, and
 - The additional ratios cannot be presented with greater prominence when compared to the required pay ratios

- Additional language is also permitted to, for example:
 - Address an issuer's ratio that is substantially different from the issuer's peer group;
 - Address the impact of the issuer having employees residing in low cost jurisdictions;
 - Explain seasonal and part-time employees, and their impact on the ratios;
 - Compare against certain peer companies that such companies only sell the product, whereas the issuer manufactures and sells the product (the latter requiring cheaper labor and causing the ratio to skew upward)

Don't Forget Next Month's Webinar

- Title:
 - Trends in Designing Performance-Based Equity Awards
- When:
 - 10:00 am to 11:00 am Central
 - August 10, 2017

Examples

- The following slides contain sample disclosures
- Please note that the following issuers voluntarily disclosed their pay ratio, and as a result, the following disclosures have not been reviewed by us in terms of their compliance with the Rule (on the contrary, upon a cursory review, many of the examples are not compliant with the Rule, and were not required to be compliant)

Examples – RANGE RESOURCES CORPORATION

- Market cap approximately \$5.39bb

- Placement of disclosure
 - Not in the CD&A
 - Instead the above is contained in the narrative disclosure that accompanies the Summary Compensation Table and the Grants of Plan-Based Awards Table
 - Found here, page 52:
https://www.sec.gov/Archives/edgar/data/315852/000130817917000122/lrrc2017_def14a.htm

- Text of disclosure

“CEO PAY RATIO

As a result of the recently adopted rules under the Dodd-Frank Act, beginning with our 2018 proxy statement, the SEC will require disclosure of the CEO to median employee pay ratio.

Mr. Ventura had 2016 annual total compensation of \$9,862,925 as reflected in the Summary Compensation Table included in this Proxy Statement. Our median employee’s annual total compensation for 2016 was \$127,938. As a result, we estimate that Mr. Ventura’s 2016 annual total compensation was approximately 77 times that of our median employee.”

Examples – NOVAGOLD RESOURCES INC.

- Market cap approximately \$1.39bb

- Placement of disclosure
 - Not in the CD&A
 - Instead the above is contained in the narrative disclosure that accompanies the Summary Compensation Table and the Grants of Plan-Based Awards Table, and immediately after the Realized and Realizable Pay Table
 - Found here, page 69:
https://www.sec.gov/Archives/edgar/data/1173420/000117184317001728/def14a_032317.htm

Examples – NOVAGOLD RESOURCES INC. (cont.)

■ Text of disclosure

CEO Pay Ratio – 13.5:1

We believe our executive compensation program must be consistent and internally equitable to motivate our employees to perform in ways that enhance shareholder value. We are committed to internal pay equity, and the Compensation Committee monitors the relationship between the pay of our executive officers and the pay of our non-executive employees. The Compensation Committee reviewed a comparison of our CEO's annual total compensation in fiscal year 2016 to that of all other Company employees for the same period. The calculation of annual total compensation of all employees was determined in the same manner as the "Total Compensation" shown for our CEO in the "Summary Compensation Table" on page 64 of this Circular. Pay elements that were included in the annual total compensation for each employee are:

- salary received in fiscal year 2016
- annual incentive payment received for performance in fiscal year 2016
- grant date fair value of stock option and PSU awards granted in fiscal year 2016
- Company-paid 401(k) Plan or RRSP match made during fiscal year 2016
- Company-paid ESPP match made during fiscal year 2016
- Company-paid life insurance premiums during fiscal year 2016
- Auto allowance paid in fiscal year 2016
- Reimbursement for Company-paid executive physical during fiscal year 2016

Our calculation includes all employees as of November 30, 2016. We applied a Canadian to U.S. dollar exchange rate to the compensation elements paid in Canadian currency.

We determined the compensation of our median employee by: (i) calculating the annual total compensation described above for each of our employees, (ii) ranking the annual total compensation of all employees except for the CEO from lowest to highest (a list of 12 employees), and (iii) since we have an even number of employees when not including the CEO, determining the average of the annual total compensation of the two employees ranked sixth and seventh on the list ("Median Employee").

The annual total compensation for fiscal year 2016 for our CEO was \$5,476,244 and for the Median Employee was \$406,170. The resulting ratio of our CEO's pay to the pay of our Median Employee for fiscal year 2016 is 13.5 to 1.

Examples – NORTHWESTERN CORPORATION

- Market cap approximately \$2.88bb
- Placement of disclosure
 - Summarized in the Proxy Summary
 - More detail addressed within the CD&A
 - Found here, pages 2 and 21-22:
<https://www.sec.gov/Archives/edgar/data/73088/000007308817000070/a2017proxystatement.htm>

- Text of proxy summary disclosure

Alignment of Pay with Shareholder and Customer Interests

Our executive pay program is designed to align the long-term interests of our executives, shareholders, and customers. About 77 percent of the compensation of our chief executive officer, or CEO, and about 58 percent of the compensation of our other named executive officers is at risk in the form of performance-based incentive awards that use Board-established metrics and targets, based upon advice from the Board's independent compensation consultant. The performance metrics did not change from the prior year. We also require our executives to retain meaningful ownership of our stock. This structure encourages our executives to focus on short- and long-term performance and provides a reward to our executives, shareholders, and customers when we achieve our financial and operating objectives. ***Our CEO to median employee pay ratio for 2016 was 22:1.*** [Emphasis added]

Examples – NORTHWESTERN CORPORATION (cont.)

- Text of full disclosure

CEO Pay Ratio and Wealth Accumulation

We believe executive pay must be internally consistent and equitable to motivate our employees to create shareholder value. We are committed to internal pay equity, and the Compensation Committee monitors the relationship between the pay our executive officers receive and the pay our non-managerial employees receive. The Compensation Committee reviewed a comparison of CEO pay (base salary and incentive pay) to the pay of all our employees in 2016. The compensation for our CEO in 2016 was approximately 22 times the median pay of our full-time employees.

Since 2010, we have voluntarily disclosed our CEO to median employee pay ratio in our proxy statement. Beginning with our 2018 proxy statement, such disclosure will be required under the Dodd-Frank Act.

Our CEO to median employee pay ratio is calculated in accordance with what the SEC will require in our 2018 proxy statement pursuant to Item 402(u) of Regulation S-K. We identified the median employee by examining the 2016 total cash compensation for all individuals, excluding our CEO, who were employed by us on December 16, 2016, the last day of our payroll year. We included all employees, whether employed on a full-time, part-time, or seasonal basis. We did not make any assumptions, adjustments, or estimates with respect to total cash compensation, and we did not annualize the compensation for any full-time employees that were not employed by us for all of 2016. We believe the use of total cash compensation for all employees is a consistently applied compensation measure because we do not widely distribute annual equity awards to employees. Approximately seven percent of our employees receive annual equity awards.

After identifying the median employee based on total cash compensation, we calculated annual total compensation for such employee using the same methodology we use for our named executive officers as set forth in the 2016 Summary Compensation Table later in this proxy statement.

22:1
CEO Pay Ratio

Examples – NORTHWESTERN CORPORATION (cont.)

- Text of full disclosure (cont.)

As illustrated in the table below, our 2016 CEO to median employee pay ratio is 22:1. In 2015 the ratio was 19:1.

	CEO to Median Employee Pay Ratio	
	President and CEO	Median Employee
Base Salary	\$ 590,641	\$ 87,525
Stock Awards	1,454,138	—
Non-Equity Incentive Plan Compensation	538,403	1,086
Change in Pension Value and Nonqualified Deferred Compensation Earnings (1)	68,952	8,211
All Other Compensation	97,933	27,186
TOTAL	\$ 2,750,067	\$ 124,008
CEO Pay to Median Employee Pay Ratio	22 : 1	

(1) These amounts are attributable to a change in the value of each individual's defined benefit pension account balance and do not represent earned or paid compensation. Pension values are dependent on many variables including years of service, earnings, and actuarial assumptions.

Examples – NOBLE ENERGY, INC.

- Market cap approximately \$13.48bb

- Placement of disclosure
 - Contained within the CD&A
 - Found here, page 42 and 43:
<https://www.sec.gov/Archives/edgar/data/72207/000007220717000025/nbl-2017proxydef.htm>

- Text of disclosure

CEO PAY RATIO

For the last three years, we elected to disclose an estimate of the ratio between the pay of our CEO and the median for all of our other employees. A final rule on CEO pay ratio has been adopted by the SEC, with disclosure currently required to be made in the proxy statement for our 2018 Annual Meeting of Stockholders. The Acting Chairman of the SEC has directed the staff to reconsider the implementation of the rule. At this time, the Acting Chairman's directive does not delay the implementation of the pay ratio disclosure requirement. We have attempted to incorporate the methodology of the final rule in our pay ratio calculation for 2016 and, for consistency, have utilized the same median employee for 2015 and 2016.

Mr. Stover had 2016 annual total compensation of \$10,137,682 and 2015 annual total compensation of \$7,253,154 as reflected in the Summary Compensation Table included in this Proxy Statement. Our median employee's annual total compensation for 2016 was \$128,050 and for 2015 was \$139,440. 2015 total compensation for purposes of this comparative calculation included a one-time payment representing the Company's buyout of retiree medical benefits. Taking this into account, we estimate that Mr. Stover's annual total compensation was approximately 79 times and 52 times that of our median employee in 2016 and 2015, respectively.

Examples – GENCOR INDUSTRIES, INC.

- Market cap approximately \$230mm

- Placement of disclosure
 - Contained immediately after the Summary Compensation Table
 - Found here, page 9:
<https://www.sec.gov/Archives/edgar/data/64472/000119312517013736/d295554ddef14a.htm>

- Text of disclosure

CEO PAY RATIO

Mr. E.J. Elliott, who was both Chairman and CEO had fiscal 2016 total compensation of \$606,418, as reflected in the Summary Compensation Table included in this Proxy. We estimate that the median annual compensation for all Gencor employees, excluding our CEO, was \$46,700 for 2016. As a result, Mr. E.J. Elliott's 2016 annual compensation was approximately 13 times that of the median annual compensation for all employees

Examples – TEXAS REPUBLIC CAPITAL CORPORATION

- Placement of disclosure
 - Contained immediately after the Summary Compensation Table
 - Found here, page 11:
<https://www.sec.gov/Archives/edgar/data/1560452/000118518517000901/texasrepub-def14a041017.htm>

- Text of disclosure

2016 Compensation Disclosure Ratio of the Median Annual Total Compensation of All Company Employees to the Annual Total Compensation of the Company's Chief Executive Officer

The 2016 compensation disclosure ratio of the median annual total compensation of all Company employees to the annual total compensation of the Company's chief executive officer is as follows:

Category	2016 Total Compensation and Ratio
Median annual total compensation of all employees (excluding Mr. Miller)	\$ 41,500
Annual total compensation of Timothy R. Miller, President	\$ 252,000
Ratio of the median annual total compensation of all employees to the Annual total compensation of Timothy R. Miller, President	<u>16.47%</u>

Examples – FIRST REAL ESTATE INVESTMENT TRUST OF NJ

- Market cap approximately \$119mm
- Placement of disclosure
 - Contained in the CD&A
 - Found here, page 21:
https://www.sec.gov/Archives/edgar/data/36840/000117494717000241/def14a-17114_frevs.htm
- Text of disclosure

Chief Executive Officer Compensation and Employee Compensation

The table below sets forth comparative information regarding (A) the total compensation of the Chief Executive Officer for the 2016 fiscal year, (B) the median of the total compensation of all other employees of the Trust, not including the Chief Executive Officer, for the 2016 fiscal year, and (C) the ratio of the Chief Executive Officer's total compensation to the median of the total compensation of all other employees (other than the Chief Executive Officer). As of October 31, 2016, the Trust had 42 employees, including 30 full-time employees, 10 part-time and seasonal employees and 2 Executive Officers of the Trust but not including the Chief Executive Officer.

Chief Executive Officer compensation (A)	\$531,826
Median compensation of all employees (not including Chief Executive Officer) (B)	\$35,360
Ratio of (A) to (B)	15.04

Examples – ADAMS RESOURCES & ENERGY, INC.

- Market cap approximately \$175.2mm
- Placement of disclosure
 - Contained in the CD&A
 - Found here, page 11:
<https://www.sec.gov/Archives/edgar/data/2178/000000217817000023/formdef14a.htm>
- Text of disclosure

Pay Ratio Disclosure Rule

In August 2015 pursuant to a mandate of the Dodd-Frank Wall Street Reform and Consumer Protection Act (the “Dodd – Frank Act”), the Securities and Exchange Commission (“SEC”) adopted a rule requiring annual disclosure of the ratio of the median employee’s annual total compensation to the total annual compensation of the principal executive officer (“PEO”). The Company’s PEO is Mr. Smith. The purpose of the new required disclosure is to provide a measure of the equitability of pay within the organization. The Company believes its compensation philosophy and process yield an equitable result and is presenting such information in advance of the required disclosure date as follows:

Median Employee total annual compensation	\$70,057.00
Mr. Smith (“PEO”) total annual compensation	\$400,000.00
Ratio of PEO to Median Employee Compensation	5.7:1.0

In determining the median employee, a listing was prepared of all employees as of December 31, 2016. Employees on leave of absence were excluded from the list and wages and salaries were annualized for those employees that were not employed for the full year of 2016. The median amount was selected from the annualized list. For simplicity, the value of the Company’s 401(k) plan and medical benefits provided was excluded as all employees including the PEO are offered the exact same benefits and the Company utilizes the Internal Revenue Service safe harbor provision for 401(k) discrimination testing. As of December 31, 2016 the Company employed 654 persons of which 434 are professional truck drivers.

Examples – INTER PARFUMS, INC.

- Market cap approximately \$1.11bb

- Placement of disclosure
 - Not in the CD&A
 - Instead contained immediately following the Summary Compensation Table
 - Found here, page 23:
https://www.sec.gov/Archives/edgar/data/822663/000114420416114275/v444585_def14a.htm

- Text of disclosure:

Ratio of CEO's Compensation to Global Median Compensation of All Employees (Excluding CEO Compensation)

We have determined that for 2015, the global median total compensation for all of our employees, but excluding the compensation of our Chief Executive Officer, was \$111,883. The total compensation for our Chief Executive Officer for 2015 as set forth in the Summary Compensation above was \$742,408. Therefore, for 2015, the ratio of the total compensation for our Chief Executive Officer as compared to the global median total compensation to all of our employees excluding the compensation of our Chief Executive Officer is 6.6:1.

FIRM LOCATIONS

AUSTIN

111 Congress Avenue
Suite 1700
Austin, TX 78701
P +1.512.320.9200
F +1.512.320.9292

BEIJING

Room 2007, Capital Mansion
No. 6 Xin Yuan Nan Lu
Chao Yang District
Beijing, China 100004
P +86.10.8486.2699
F +86.10.8486.8565

DALLAS

1717 Main Street
Suite 3700
Dallas, TX 75201
P +1.214.659.4400
F +1.214.659.4401

DUBAI

Andrews Kurth Kenyon DMCC
45th Floor
Mazaya Business Avenue, BB2
Jumeirah Lakes Towers
P.O. Box 118273
Dubai, UAE
P +971.4.567.0767
F +971.4.567.0768

HOUSTON

600 Travis Street
Suite 4200
Houston, TX 77002
P +1.713.220.4200
F +1.713.220.4285

LONDON

Andrews Kurth Kenyon (UK) LLP
16 Old Bailey
London EC4M 7EG
United Kingdom
P +44.20.3053.8300
F +44.20.3053.8299

NEW YORK – BATTERY PARK

One Broadway
New York, NY 10004
P +1.212.425.7200
F +1.212.425.5288

NEW YORK – MIDTOWN

450 Lexington Avenue
New York, NY 10017
P +1.212.850.2800
F +1.212.850.2929

RESEARCH TRIANGLE PARK

4505 Emperor Boulevard Suite
330 Durham, NC 27703 P
+1.919.864.7200

SILICON VALLEY

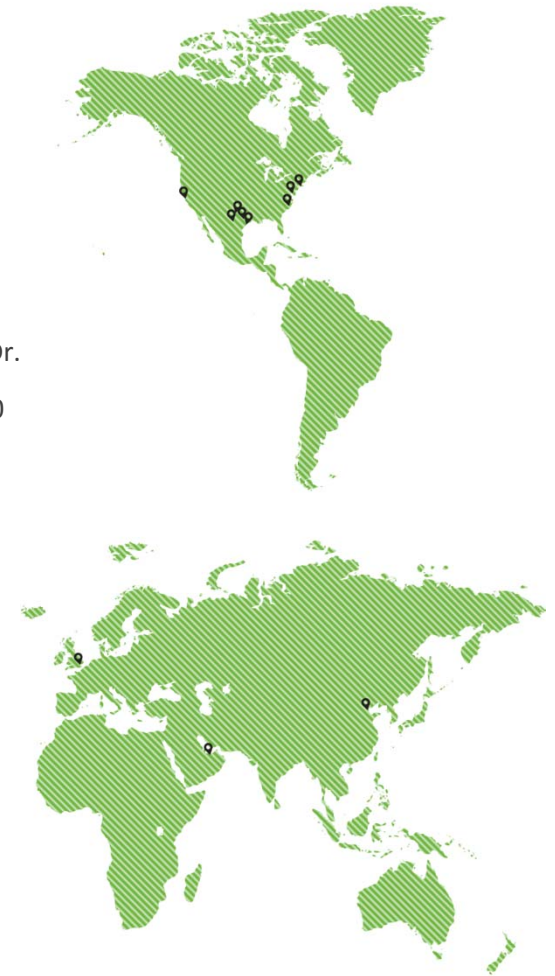
1801 Page Mill Road
Suite 210
Palo Alto, CA 94304
P +1.650.384.4700
F +1.650.384.4701

THE WOODLANDS

Waterway Plaza Two
10001 Woodloch Forest Dr.
Suite 200
The Woodlands, TX 77380
P +1.713.220.4800
F +1.713.220.4815

WASHINGTON, DC

1350 I Street, NW
Suite 1100
Washington, DC 20005
P +1.202.662.2700
F +1.202.662.2739



Copyright © 2017 Andrews Kurth Kenyon LLP. Andrews Kurth, the Andrews Kurth logo, Straight Talk Is Good Business and Intelligent Energy are registered service marks of Andrews Kurth Kenyon LLP. Andrews Kurth Kenyon and the Andrews Kurth Kenyon logo are service marks of Andrews Kurth Kenyon LLP. All Rights Reserved. This presentation has been prepared for informational purposes only and does not constitute legal counsel. This information is not intended to create (and receipt of it does not constitute) an attorney-client relationship. Readers should not act on this information without seeking professional counsel. A past performance or prior result is no guarantee of a similar future result in another case or matter. Andrews Kurth Kenyon LLP is a Texas limited liability partnership. Andrews Kurth Kenyon (UK) LLP is authorized and regulated by the Solicitors Regulation Authority of England and Wales (SRA Registration No.598542). Andrews Kurth Kenyon DMCC is registered and licensed as a Free Zone company under the rules and regulations of DMCCA. Attorney Advertising.

**ANDREWSKURTH
KENYON**
andrewskurthkenyon.com