

Energy Recovery, Inc.  
Form DEF 14A  
April 27, 2012

SCHEDULE 14A  
(Rule 14a-101)

INFORMATION REQUIRED IN PROXY STATEMENT

SCHEDULE 14A INFORMATION

Proxy Statement Pursuant to Section 14(a) of the Securities  
Exchange Act of 1934

Filed by the Registrant   
Filed by a party other than the Registrant   
Check the appropriate box:

- Preliminary Proxy Statement
- Confidential, For Use of the Commission Only (as permitted by Rule 14a-6(e)(2))
- Definitive Proxy Statement
- Definitive additional materials
- Soliciting material under Rule 14a-12

Energy Recovery, Inc.  
(Name of Registrant as Specified in Its Charter)

(Name of Person(s) Filing Proxy Statement, if Other Than the Registrant)

Payment of Filing Fee (Check the appropriate box):

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| (4) | Date Filed:                                  |
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Energy Recovery, Inc.

Notice of Annual Meeting of Stockholders  
To Be Held June 5, 2012

Dear Stockholders,

The 2012 Annual Meeting of Stockholders of Energy Recovery, Inc., a Delaware corporation (the “Company” or “ERI”) will be held on Tuesday, June 5, 2012, at 10:00 a.m. Pacific Daylight Time. The Annual Meeting will take place at the Company’s headquarters, located at 1717 Doolittle Drive, San Leandro, CA 94577.

Only stockholders who owned stock at the close of business on April 9, 2012, can attend and vote at the meeting or any postponement or adjournment of the meeting. The purpose of the meeting is:

- the election of Mr. Paul Cook, Dr. Marie-Elisabeth Paté-Cornell, and Mr. Fred Olav Johannessen as Class I directors to serve until our 2015 annual meeting (or until their successors are elected and qualified),
- the ratification of the appointment of BDO USA, LLP as our independent registered public accounting firm for the year ending December 31, 2012,
- an advisory vote on executive compensation,
- approval of the Amended and Restated 2008 Equity Incentive Plan and re-approval of the material terms related to performance-based compensation, and
- other business that may properly come before the meeting and any adjournment or postponement.

These items of business are more fully described in the attached Proxy Statement, which is part of this Notice.

At the meeting, we will also report on our 2011 business results and other matters of potential interest to our shareholders.

By Order of the Board of Directors,

Thomas S. Rooney, Jr.  
President and Chief Executive Officer

San Leandro, California  
April 27, 2012

Whether or not you expect to attend the annual meeting of stockholders in person, you are urged to vote as promptly as possible to ensure your representation and the presence of a quorum at the annual meeting.

Stockholders of record can vote their shares by using the internet or the telephone. Instructions for using these convenient services are set forth on the enclosed proxy card. Stockholders may also vote their shares by marking, signing, dating, and returning the proxy card in the enclosed postage-prepaid envelope.

If you send in your proxy card and then decide to attend the annual meeting to vote your shares in person, you may still do so. Your proxy is revocable in accordance with the procedures set forth in the proxy statement.



## TABLE OF CONTENTS

	Page
<b>PROXY STATEMENT</b>	1
Why am I receiving these materials?	1
How do I vote?	1
How many votes do I have?	2
Can I change my vote after submitting my proxy?	2
What if I return a proxy card but do not make specific choices?	2
Who pays for the expenses related the preparation and mailing of the Proxy Statement?	2
Who can vote at the Annual Meeting?	2
Will there be any other items of business on the agenda?	2
How many votes are required for the approval of each item?	3
What is the quorum requirement?	3
What is a record holder?	3
What is a beneficial owner?	3
How are votes counted?	4
Who counts or tabulates the votes?	4
How do I access the proxy material and annual report via the Internet?	4
<b>PROPOSAL NO. 1 — ELECTION OF DIRECTORS</b>	5
<b>PROPOSAL NO. 2 — RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM</b>	7
Principal Accountant Fees and Services	7
Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm	7
<b>PROPOSAL NO. 3 — ADVISORY VOTE ON EXECUTIVE COMPENSATION</b>	8
<b>PROPOSAL NO. 4 — APPROVAL OF THE AMENDED AND RESTATED 2008 EQUITY INCENTIVE PLAN AND RE-APPROVAL OF MATERIAL TERMS RELATED TO PERFORMANCE-BASED COMPENSATION</b>	9
<b>BOARD AND CORPORATE GOVERNANCE MATTERS</b>	17
Board of Directors	17
Director Independence	17
	17

Relationships Among Directors or Executive Officers	
Committees and Meetings of the Board of Directors	17
The Audit Committee	18
The Compensation Committee	18
The Nominating and Corporate Governance Committee	19
Board Leadership Structure and Role in Risk Management	20
Compensation Committee Interlocks and Insider Participation	20
Communication between Stockholders and Directors	20
Director Compensation	21
Director Compensation for Year Ended December 31, 2011	21
SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT	23
EXECUTIVE COMPENSATION	26
Compensation Discussion and Analysis	26
Results on Our 2011 Say on Pay Vote	26
Executive Summary	26
Executive Compensation Decision-Making	28
Employment Terms Negotiated in 2011 for our CEO and CFO	30
Base Salaries for Other Named Executive Officers	31
Annual Cash Incentive Compensation	32

2011 Cash Incentive Plan	33
2012 Cash Incentive Plan	35
Equity-Based Incentive Benefits	36
Severance and Termination Compensation	37
Change in Control Severance Plan	38
Tax Deductibility	38
Compensation Committee Report	39
Summary Compensation Table	39
Grants of Plan-Based Awards in 2011	42
Employment Arrangements with Named Executive Officers	43
Outstanding Equity Awards As of December 31, 2011	46
Option Exercises and Stock Vested in 2011	49
Potential Payments Upon Termination or Change in Control	49
Key Defined Terms of the Change in Control Plan	51
Benefits under the Change in Control Plan	52
Additional Benefits Due to Mr. Sanchez-Blanco Under His Employment Agreement	53
EQUITY COMPENSATION PLANS	54
REPORT OF THE AUDIT COMMITTEE	54
DIRECTORS AND MANAGEMENT	55
RELATED PERSON POLICIES AND TRANSACTIONS	59
CODE OF BUSINESS CONDUCT AND ETHICS	59
STOCKHOLDER PROPOSALS	59
OTHER MATTERS	60
Section 16(a) Beneficial Ownership Reporting Compliance	60
Other Matters	60
Form 10-K ANNUAL REPORT	60

APPENDIX A — ENERGY RECOVERY, INC. AMENDED AND RESTATED 2008 EQUITY  
INCENTIVE PLAN (As Adopted April 23, 2012)

ENERGY RECOVERY, INC.  
1717 Doolittle Drive  
San Leandro, California 94577

PROXY STATEMENT

Why am I receiving these materials?

We are inviting you to attend an Annual Meeting of the stockholders of Energy Recovery, Inc. and vote on:

- the election of Mr. Paul Cook, Dr. Marie-Elisabeth Paté-Cornell, and Mr. Fred Olav Johannessen as Class I directors to serve until our 2015 annual meeting (or until their successors are elected and qualified),
- the ratification of the appointment of BDO USA, LLP as our independent registered public accounting firm for the year ending December 31, 2012,
- an advisory vote on executive compensation,
- approval of the Amended and Restated 2008 Equity Incentive Plan and re-approval of the material terms related to performance-based compensation, and
- other business that may properly come before the meeting and any adjournment or postponement.

This year's Annual Meeting will take place on Tuesday, June 5, 2012, at 10:00 a.m. local time. The meeting will be held at the Company's main office at 1717 Doolittle Drive, San Leandro, California, U.S.A.

This Proxy Statement, the accompanying proxy, and our Form 10-K for the fiscal year ended December 31, 2011 (the "2011 Annual Report") were first sent by mail to stockholders on or about April 27, 2012.

How do I vote?

If you are a record holder of our common shares, you can vote either in person at the Annual Meeting or by proxy whether or not you attend the Annual Meeting. If you plan to vote in person, you must bring the enclosed proxy card and proof of identification to the meeting.

To vote by proxy, you must either:

- fill out the enclosed proxy card, date and sign it, and return it in the enclosed postage-paid envelope,
- vote by telephone (instructions for this are on the proxy card), or
- vote by Internet (instructions for this are on the proxy card).

To ensure that your vote is counted, please submit your vote by June 4, 2012.

If your shares are held for you in an account with a broker or other nominee, you will receive voting instructions from your nominee rather than a proxy card. To vote, please follow the voting instructions sent by your broker or other nominee. If you return your voting instructions timely, your broker or other nominee will then include your vote in the appropriate proxy card held by the record holder. If your shares are held in the name of a broker or other nominee,



you cannot vote in person at the Annual Meeting unless you first obtain a legal proxy from your nominee and present it at the Annual Meeting.

How many votes do I have?

On each matter to be voted upon, you have one (1) vote for each share of common stock you own as of April 9, 2012 (the "Record Date").

Can I change my vote after submitting my proxy?

If you are the record holder of your shares, you can withdraw or revoke your proxy at any time before the final vote at our Annual Meeting by:

- delivering to the Company (to the attention of Alexander J. Buehler, the Company's Secretary) a written notice of revocation or a duly executed proxy bearing a later date,
- submitting a new proxy via the Internet or telephone in accordance with the instructions on your original form of proxy, or
- attending the Annual Meeting and voting in person, in which case you must specifically revoke any previously returned proxy before you vote in person. Attending the Annual Meeting in person will not by itself revoke any prior proxy.

What if I return a proxy card but do not make specific choices?

If you return a signed and dated proxy card without marking any voting selections, your shares will be voted "FOR" our three director nominees and "FOR" the other proposals made in this Proxy Statement. If any other matter is properly presented at the meeting, the Company representative authorized to vote on your behalf as your proxy will vote your shares using his or her best judgment.

Who pays for the expenses related to the preparation and mailing of the Proxy Statement?

The Company will bear the costs of soliciting proxies, including the costs for the preparation, assembly, printing, and mailing of the Proxy Statement and related proxy materials. In addition, the Company will reimburse brokerage firms and other nominees representing beneficial owners of shares for their expenses in forwarding solicitation materials to beneficial owners of those shares. Proxies may be solicited by certain of the Company's directors, officers, and regular employees, without additional compensation, either personally, by telephone, facsimile, or telegram.

Who can vote at the Annual Meeting?

Only stockholders of record at the close of business on April 9, 2012, the Record Date, will be entitled to notice of, and to vote at, our Annual Meeting. On the Record Date, the Company had 52,091,396 shares of common stock outstanding.

Will there be any other items of business on the agenda?

We do not know of any business to be considered at the meeting other than the proposals described in this Proxy Statement. However, the proxy holders (who are management representatives named in the proxy card) may vote using their discretion with respect to any other matters properly presented for a vote at the meeting.



How many votes are required for the approval of each item?

- For the election of three directors in Proposal No. 1, the candidates who receive the greatest number of votes cast at the Annual Meeting will be elected, provided a quorum is present; and
- The affirmative vote of a majority of the shares of the Company's common stock present and entitled to vote is required to approve Proposal No. 2, ratification of the appointment of our independent registered public accounting firm, to approve on an advisory basis Proposal No. 3, the advisory vote on executive compensation, and to approve Proposal No. 4, approval of the Amended and Restated 2008 Equity Incentive Plan and re-approval of material terms related to performance-based compensation, provided a quorum is present.

What is the quorum requirement?

A "quorum" of stockholders must be present for us to hold a valid meeting of stockholders. Stockholders representing a majority (more than 50%) of the voting power of our outstanding common stock as of the Record Date, present in person or represented by proxy, constitute a quorum for the transaction of business at the Annual Meeting.

Your shares will be counted towards the quorum only if you submit a valid proxy or if you vote in person at the meeting. Shareholders who submit signed and dated proxies without specifying their votes and broker "non-votes" described below will be counted towards the quorum requirement. If there is no quorum, the chairperson of the meeting or a majority of the votes present at the meeting may adjourn the meeting to another date.

What is a record holder?

If your shares are registered directly in your name with our transfer agent, American Stock Transfer & Trust Company, you are considered a "record holder" of those shares. In this case, you will receive a form of proxy card for record holders along with the other proxy materials.

What is a beneficial owner?

If your shares are held in a stock brokerage account or by a bank or other nominee, those shares are registered with American Stock Transfer & Trust Company in the "street name" of the brokerage account, bank, or other nominee, and you are considered the "beneficial owner" of those shares. If you are a beneficial owner, your broker or other nominee will send you a form of voting instructions (rather than a proxy card) along with the other proxy materials.

As a beneficial owner, you have the right to direct your broker, bank, or other entity on how to vote your shares by using the voting instruction form included in the mailing or by following the instructions on the voting instruction card for voting via the Internet or telephone.

If there are multiple beneficial owners in the same household, your broker or other nominee may send only one copy of the proxy materials to your household. If you would like a separate copy of either document, please contact Zeny Cembrano at (510)746-2594 or at 1717 Doolittle Drive, San Leandro, California 94577.

If you are receiving multiple copies of these materials and would like to receive a single copy in the future, please contact your broker, bank, or other nominee, or the Company's investor relations department to request a single copy only in the future.

How are votes counted?

All shares of common stock represented by valid proxies will be voted in accordance with their instructions. In the absence of instructions, proxies will be voted "FOR" Proposals 1, 2, 3, and 4.

Brokers, banks, and other nominees may submit a proxy card for shares of common stock that they hold for a beneficial owner, but decline to vote on certain items because they have not received instructions from the beneficial owner. These are called "Broker Non-Votes" and are not included in the tabulation of the voting results for the election of directors or for purposes of determining the number of votes cast with respect to a particular proposal. Consequently, Broker Non-Votes do not have an effect on the vote.

Brokers have the discretion to vote such shares for which they have not received voting instructions from the beneficial owners on routine matters, but not on non-routine matters. The routine matter up for vote this year is the ratification of the independent registered public accounting firm (Proposal No. 2).

A broker is prohibited from voting on a non-routine matter unless the broker receives specific voting instructions from the beneficial owner of the shares. The election of directors (Proposal No. 1), the advisory vote on executive compensation (Proposal No. 3), and the vote on our equity compensation plan (Proposal No. 4) are non-routine matters, and your broker cannot vote your shares on these proposals unless you have timely returned applicable voting instructions to your broker.

Abstentions have no effect on the outcome of voting for Proposal No. 1, election of directors. Abstentions are treated as shares present or represented and voting regarding Proposals No. 2, 3, and 4, so abstentions have the same effect as negative votes on those proposals.

Who counts or tabulates the votes?

The votes of stockholders attending the Annual Meeting and voting in person will be counted or tabulated by an independent inspector of election. For our meeting, a representative of Georgeson Inc. will tabulate votes cast by proxy.

How do I access the proxy material and annual report via the Internet?

Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting of Stockholders to be Held on June 5, 2012.

This proxy statement and the 2011 Annual Report are available electronically at <http://www.edocumentview.com/ERII>

We are mailing physical copies of our proxy statement, proxy, and 2011 Annual Report to our stockholders. However, you may also access these materials at the website noted above.

If you have previously chosen to receive the Proxy Statement and the 2011 Annual Report over the Internet, you will be receiving an e-mail on or about April 26, 2012, with information on how to access stockholder information and instructions for voting over the Internet. Stockholders of record may vote via the Internet until 11:59 p.m. Eastern

Daylight Time, June 4, 2012.

4

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If a stockholder's shares are registered in the name of a brokerage firm and the stockholder has not elected to receive the Proxy Statement and Annual Report over the Internet, the stockholder may still be eligible to vote shares electronically over the Internet. Many brokerage firms participate in programs that provide eligible stockholders who receive a paper copy of the Proxy Statement and Annual Report the opportunity to vote via the Internet. If a stockholder's brokerage firm participates in a program, a form from the broker will provide voting instructions.

Stockholders can elect to view future proxy statements and annual reports over the Internet instead of receiving paper copies. Stockholders of record wishing to receive future stockholder materials electronically can elect this option by following the instructions provided when voting over the Internet at <http://proxy.georgeson.com>.

Upon electing to view future proxy statements and annual reports over the Internet, stockholders will receive an e-mail notification next year with instructions containing the Internet address of those materials. The choice to view future proxy statements and annual reports over the Internet will remain in effect until the stockholder contacts their broker or the Company to rescind the instructions. Internet access does not have to be elected each year.

Stockholders who elected to receive this Proxy Statement electronically over the Internet and who would now like to receive a paper copy of this Proxy Statement so that they may submit a paper proxy in lieu of an electronic proxy should contact either their broker or the Company.

#### PROPOSAL NO. 1

#### ELECTION OF DIRECTORS

As set by the Board of Directors under the Bylaws of the Company, the authorized number of directors of the Company will be eight as of the date of the 2012 Annual Meeting.

The Nominating and Corporate Governance Committee of the Board of Directors has recommended, and the Board of Directors has nominated, the three nominees listed below for election as Class I directors at the Annual Meeting. If elected, each newly elected director will serve until the 2015 annual meeting of stockholders and until each director's successor is duly elected and qualified, or until the director's earlier removal or resignation.

Each of the nominees is currently a director of the Company, and each of the nominees named below has consented, if elected as a director of the Company, to serve until his/her term expires.

In the event that any nominee of the Company is unable or declines to serve as a director at the time of the Annual Meeting, the proxies will be voted for any nominee who shall be designated by the present Board of Directors to fill the vacancy. In the event that additional persons are nominated for election as directors, the proxy holders intend to vote all proxies received by them in such a manner as will assure the election of as many of the nominees listed below as possible. In such event, the specific nominees to be voted for will be determined by the proxy holders. The Board has no reason to believe that any of the persons named below will be unable or unwilling to serve as a director, if elected. Each of the three nominees for director who receives the greatest number of votes will be elected.

Set forth below are the names, ages, and certain biographical information relating to the Class I director nominees as of April 9, 2012.

Name of Nominee	Age	Position with Company	Director Since
Paul Cook (1)	87	Director	2008
Marie-Elisabeth Paté-Cornell (1)	63	Director	2009
Fred Olav Johannessen (1) (2)	58	Director	1995

(1) Member of the Compensation Committee.

(2) Member of the Audit Committee.

Paul M. Cook has served as a member of the Board of Directors since July 2008. Mr. Cook is the founder of Raychem Corporation, a pioneer in material science based on radiation chemistry. Mr. Cook served as its chief executive officer and chairman of the board for 33 years and oversaw Raychem's growth through innovation and market creation into a \$1.6 billion global enterprise. Mr. Cook is the chairman of Global Translation, Inc., a private company that provides automated translation services for television stations and networks, a position he has held since December 2006. Mr. Cook is a member of the National Academy of Engineering and the American Academy of Science. He is a member of the Bay Area Business Hall of Fame and received the National Medal of Technology in 1988. Mr. Cook holds a B.S. in Engineering from Massachusetts Institute of Technology. The Board selected Mr. Cook as a member after its initial public offering because of his successful tenure as founder and chief executive officer of a high-growth technology company, his expertise in material science and markets, and his strategic and organizational business acumen.

Marie-Elisabeth Paté-Cornell has served as a director of the Company since February 2009. Dr. Paté-Cornell is a professor at Stanford University in the Department of Management Science and Engineering. She served as this department's chair from January 2000 until 2011. She was a professor at Stanford's Department of Industrial Engineering and Engineering Management from September 1991 to December 1999 and became chair of that department in September 1997, a position she held until December 1999. She has been a member of the Board of Trustees of Aerospace Corporation since 2004 and of InQtel since 2006. She was elected as a member of the board of Draper Laboratory at Massachusetts Institute of Technology in 2009. Dr. Paté-Cornell is also a member of the National Academy of Engineering. She received a B.S. in Mathematics and Physics from the University of Marseilles in France, a M.S. and Engineering Degree from the Institute Polytechnique in Grenoble, France, a M.S. in Operations Research from Stanford University, and a Ph.D. in Engineering-Economic Systems from Stanford University. The Board selected Dr. Paté-Cornell as a member because of her leadership role at a major U.S. university, her academic background in management science and engineering, her work in public policy, and her specialized knowledge of risk analysis and management.

Fred Olav Johannessen has served as a member of the Board of Directors since August 1995. Mr. Johannessen is the founder and owner of Nordiska Literary Agency, a Danish company that licenses theater productions and musicals in Scandinavia. Mr. Johannessen has served on the Board of Directors of Thalia Teater AS, a private theater production company in Norway, since June 1985. He has also been a member of the Board of Directors of Folin, a private European company that invests in literary agencies, since March 1999. He joined the Board of Directors of SynchroNet Logistics Inc., a maritime technology service provider, in 2010. Prior to his work in theater, Mr. Johannessen worked as a securities analyst and owned and managed several radio stations in Scandinavia. Mr. Johannessen earned his M.S. in Finance from Colorado State University. The Board selected Mr. Johannessen as a member because of his early investment in the Company, his prior experience as a securities analyst, his financial know-how, and his entrepreneurship.





THE BOARD RECOMMENDS A VOTE FOR  
THE ELECTION OF THE NOMINEES NAMED ABOVE

PROPOSAL NO. 2

RATIFICATION OF APPOINTMENT OF INDEPENDENT REGISTERED  
PUBLIC ACCOUNTING FIRM

BDO USA, LLP has been appointed by the Audit Committee to continue as the Company's independent registered public accounting firm for the year ending December 31, 2012. Although the Company is not required to seek stockholder approval of its selection of independent registered public accounting firm, the Board believes that the practice constitutes sound corporate governance. If the appointment is not ratified, the Audit Committee will investigate the reasons for stockholder rejection and will reconsider its selection of its independent registered public accounting firm.

A representative of BDO USA, LLP is expected to be present at the Annual Meeting. The representative will have an opportunity to make a statement and to respond to appropriate questions.

Principal Accountant Fees and Services

The following table summarizes total fees that BDO USA, LLP, our independent registered public accounting firm, billed to us for its work in connection with fiscal years ended December 31, 2011 and 2010.

	2011	2010
Audit Fees (1)	\$431,305	\$454,847
Audit-Related Fees	—	—
Tax Fees (2)	7,500	3,360
All Other Fees	—	—
Total	\$438,805	\$458,207

(1) Audit fees represent fees for professional services related to the performance of the audit of our annual financial statements, review of our quarterly financial statements, and consents on SEC filings.

(2) Tax fees include professional services related to the preparation of tax returns and for related compliance and consulting services.

Audit Committee Pre-Approval of Audit and Permissible Non-Audit Services of Independent Registered Public Accounting Firm

The Audit Committee pre-approves audit, audit-related, tax, and non-audit services provided by our independent registered public accounting firm, BDO USA, LLP and will not approve services that are impermissible under applicable laws and regulations. The pre-approval of services may be delegated to one or more of the Audit Committee's members, but the decision of that member to pre-approve specific services must be reported to the full Audit Committee at its next scheduled meeting.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR RATIFICATION  
OF THE APPOINTMENT OF BDO USA, LLP AS THE COMPANY'S  
INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM FOR  
THE YEAR ENDING DECEMBER 31, 2012.

PROPOSAL NO. 3

ADVISORY VOTE ON EXECUTIVE COMPENSATION

The Compensation Discussion and Analysis beginning on page 26 of this proxy statement describes the Company's executive compensation program and the decisions made by the Compensation Committee for our fiscal year ended December 31, 2011 with respect to the executive officers named in the Summary Compensation Table on page 39. The Board of Directors is asking our stockholders to cast a non-binding advisory vote on the following resolution:

“RESOLVED, that the stockholders of Energy Recovery, Inc. approve the compensation of the executive officers named in the Summary Compensation Table for 2011, as disclosed in the Company's proxy statement for the 2012 Annual Meeting of stockholders pursuant to the compensation disclosure rules of the Securities and Exchange Commission (which disclosure includes the Compensation Discussion and Analysis, the executive compensation tables, and the related footnotes and narrative accompanying the tables).”

We believe that the compensation of our executive officers and directors in 2011 facilitated the necessary transition of our senior management team and provided appropriate incentive for key employees to drive product innovation, market diversification, cost reduction, and sales activity to position the Company for the future. For 2011, financial results were reflective of a severe downturn in the desalination market, with revenue and profitability negatively affected by macroeconomic and geopolitical events around the world.

Importantly, we have entered 2012 with significant new sales orders related to mega-project activity around the world, a new management team, a reduced cost structure, a fully integrated manufacturing capability, an enhanced portfolio of quiet products and intellectual property, and a strategic plan to diversify into new markets.

Significant compensation decisions in 2011 included the following:

- We evaluated and revised director compensation as of July 1 to establish an appropriate composition of fees and equity-based compensation;
- The base salary of our new president and chief executive officer, Thomas S. Rooney, Jr., was established through negotiations and with consideration of a number of factors including Mr. Rooney's past experience as a chief executive officer of a U.S. publicly-traded company;
- The base salary of our new chief financial officer, Alexander J. Buehler, was established through negotiations and taking into consideration Mr. Buehler's existing compensation package and his expatriate status in a foreign country;
- With the new chief executive officer on board, we transitioned our former Executive Chairman, Hans Peter Michelet, to a director and chairman role;

- Excluding new hires, base salaries for our other named executive officers generally remained the same as compared to 2010, which reflected our current market reality and level of profitability;
- Excluding new hire grants meant to attract key members of the management team along with the aforementioned director grants, no equity awards were granted to existing employees in 2011; and
- With input from the new chief executive officer, the Compensation Committee and the Board of Directors made a decision to partially fund the bonus pool for new and existing executives because certain objectives were met in 2011 that supported the Company's strategic plan, discussed in more detail under "Compensation, Discussion and Analysis" below in this proxy statement.

We believe that the compensation decisions enumerated above allowed the Company to attract and retain key employees, create and initiate execution of a strategic plan, and reward executive officers for their respective contributions. For these reasons, the Board of Directors is asking our stockholders to vote "FOR" this proposal. Although your vote on this proposal is advisory and non-binding, the Compensation Committee values the views of our stockholders and will take into account the outcome of the vote when considering future compensation decisions for our named executive officers.

THE BOARD OF DIRECTORS RECOMMENDS A VOTE FOR  
PROPOSAL NO. 3.

PROPOSAL NO. 4

APPROVAL OF THE AMENDED AND RESTATED 2008 EQUITY INCENTIVE PLAN AND  
RE-APPROVAL OF MATERIAL TERMS RELATED TO PERFORMANCE-BASED  
COMPENSATION

The Board of Directors is requesting that our stockholders vote in favor of approving the Energy Recovery, Inc. Amended and Restated 2008 Equity Incentive Plan (the "Plan") to allow the Company to retain the ability to grant "performance-based" awards under the Plan that would be fully deductible for federal income tax purposes. In addition, if approved by our stockholders, the Plan, which was approved by our Board of Directors on April 23, 2012, will amend and restate the Energy Recovery, Inc. 2008 Equity Incentive Plan (the "Initial Plan") in its entirety, effective as of the date of stockholder approval, generally to implement technical amendments to comply with current law and to improve the Company's corporate governance practices.

Status of the Plan

The Initial Plan was originally adopted by our Board of Directors in March 2008 and was approved by our stockholders immediately prior to the effectiveness of the initial public offering of our common stock. The Plan currently authorizes the Company to issue up 10,000,000 shares of common stock to its employees, outside directors, and consultants, of which 3,989,484 shares remain available as of March 31, 2012 for the grant of new awards. The stockholders are not being requested to approve any increase to the number of shares of common stock currently reserved for issuance under the Plan.

### Code Section 162(m) Stockholder Approval

To preserve our ability to deduct in full for federal income tax purposes compensation that certain of our executive officers may recognize in connection with performance-based awards that may be granted in the future under the Plan, the stockholders are being asked to approve certain material terms of the Plan related to such awards. Section 162(m) of the Internal Revenue Code of 1986, as amended (the “Code”), generally denies a corporate tax deduction for annual compensation exceeding \$1 million paid to the chief executive officer or to any of the three other most highly compensated officers of a publicly-held company other than the chief financial officer. Code Section 162(m), which applies to public companies, provides an exemption from this limit for “qualified performance-based compensation” payable under a plan satisfying certain requirements that has been approved by the public company’s stockholders.

For companies that become publicly traded in connection with an initial public offering, such as our company, stockholder approval is required to be obtained upon the expiration of a limited transition period following a company’s initial public offering in order to preserve the ability to fully deduct certain performance-based awards. The Company is seeking stockholder approval of the Plan because the transition period under Code Section 162(m) for our company will expire on the date of this year’s annual stockholder meeting. The Company’s stockholders are being requested to approve, among other provisions:

- the eligibility requirements for participation in the Plan;
- the performance criteria upon which performance awards may be based; and
- the maximum numbers of shares for which stock options, stock appreciation rights (SARs), and stock units based on attainment of performance goals may be granted to an employee in any fiscal year.

### Material Changes to the Initial Plan

The Plan was also amended to implement changes intended to improve our corporate governance practices, among other amendments. The following items highlight the material changes to the Initial Plan.

- The Plan eliminates the “evergreen” share replenishment provision of the share reserve under the Initial Plan, which provided for an automatic annual increase to the number of shares available for issuance under the Plan by the lowest of (a) 5% of the total number of shares then outstanding, (b) 2,500,000 shares, or (c) a number of shares determined by the Board of Directors. The stockholders are not being requested to approve an increase to the number of shares reserved for issuance under the Plan.
- The Plan prohibits, without stockholder approval, re-pricing of options and SARs and exchanging of any underwater option or SAR for the grant of a new option or stock appreciation right with a lower exercise price, a cash payment, or another award under the Plan.
- The Plan prohibits the return to the share reserve under the Plan for future issuance under the Plan (i) shares covered by an award that are surrendered in payment of the award exercise price or tax withholding obligations incident to the exercise of the award, (ii) shares that are not issued or delivered as a result of net settlement of an outstanding option or SAR, and (iii) shares that are repurchased on the open market with the proceeds of the exercise of an option.
- The Plan limits the term of stock options and SARs to ten years.



The Plan's term is indefinite, subject to termination by the Board of Directors.

#### Material Terms of the Plan

The Plan is intended to promote our long-term success and the creation of stockholder value by encouraging employees, directors, and consultants to focus on critical long-range objectives; encouraging the attraction and retention of employees, directors, and consultants with exceptional qualifications; and linking employees, directors, and consultants directly to stockholder interests through increased stock ownership.

The Board of Directors believes that the Plan is in the best interest of the stockholders and of the Company. The following summary of certain major features of the Plan is qualified in its entirety by reference to the actual text of the Plan, which is attached to this proxy statement as Appendix A.

#### Key Terms of the Plan at a Glance

**Plan Term:** The Plan will become effective on the date that the stockholders approve the Plan and continue in effect until the date that the Board of Directors terminates the Plan.

**Eligible Participants:** Employees and consultants of the Company, our subsidiaries, and affiliates and non-employee directors generally are eligible to receive each type of award offered under the Plan, except as set forth below with respect to incentive stock options ("ISOs") within the meaning of Section 422 of the Code.

Only common-law employees of the Company, a parent, or a subsidiary are eligible to receive ISOs under the Plan.

**Shares Available for Awards:** 10,000,000 shares over the term of the plan, subject to adjustment in the event of certain capitalization events of the Company.

3,989,484 shares remain available as of March 31, 2012 for grant of new awards.

**Award Types**

- (1) Stock options
- (2) SARs
- (3) Restricted shares
- (4) Stock units

**Award Terms:** Options and SARs will have a term of no longer than ten years.

**ISO Limits:** No more than the maximum number of shares reserved for issuance may be granted as ISOs under the Plan.

162(m) Share Limits: Code Section 162(m) requires, among other things, that the maximum number of shares awarded to an individual must be approved by the stockholders in order for the awards granted under the Plan to be eligible for treatment as performance-based compensation that will not be subject to the \$1 million limitation on tax deductibility for compensation paid to certain specified executive officers.

Accordingly, the Plan limits awards granted to an individual employee in any calendar year to awards that in the aggregate cover no more than 500,000 shares of common stock, except that a newly hired employee is eligible to be granted one or more awards which in the aggregate cover up to 800,000 shares.

Vesting: Determined by the Compensation Committee within limits set forth in the Plan.

Not Permitted: (1) Granting stock options or SARs at a price below fair market value of our common stock on the date of grant.  
(2) Re-pricing or reducing the exercise price of an underwater stock option or  
(3) SAR without stockholder approval.

Exchanging underwater stock options or SARs for (i) the grant of new options  
(4) or SARs with a lower exercise price, (ii) a cash payment, or (iii) any other award without stockholder approval.

Adding shares back to the number of shares available for issuance when a SAR or stock option is net settled, when shares are retained or delivered to us to pay the exercise price and/or tax obligations associated with an award, or when we repurchase shares on the open market using the proceeds from payment of the exercise price in connection with the exercise of an outstanding stock option.

#### Summary of the Plan

**Term of the Plan.** The Plan will become effective upon approval by the stockholders and continue in effect until our Board of Directors decides to terminate the Plan.

**Share Reserve.** The maximum number of shares that we have authorized for issuance under the Plan is 10,000,000 shares.

Any award intended to comply with Code Section 162(m) is limited to an aggregate of 500,000 shares per individual in a single calendar year, except that a newly hired employee may receive one or more awards intended to comply with Code Section 162(m) of up to 800,000 shares in the first calendar year of employment. All shares available under the Plan may be issued upon the exercise of incentive stock options.

In general, if options or other awards granted under the Plan are forfeited or terminate for any other reason before being exercised or settled, then the shares subject to such options or awards will again become available for awards under the Plan.



The following shares will be counted against the maximum number of shares reserved for issuance and will not be returned to the Plan: (i) shares covered by an award that are surrendered in payment of the exercise price or to satisfy tax withholding obligations arising from the exercise, (ii) shares that are not issued upon the net settlement of a SAR or stock option, or (iii) shares that are repurchased in the open market with the proceeds of the exercise of a stock option.

Administration of the Plan. The Plan is administered by the Compensation Committee of our Board of Directors, which will have complete discretion to make all decisions relating to the interpretation and operation of the Plan. The Committee will have the discretion to determine who will receive an award, the type of award, the number of shares that will be covered by the award, the vesting requirements of the award, if any, and all other features and conditions of the award. The Committee may implement rules and procedures that differ from those described below in order to adapt the Plan to the requirements of countries other than the United States. Any action taken or determination made by the Committee will be final, binding, and conclusive on all affected persons. Within the limits set forth by the Plan, the Committee may also re-price outstanding options and modify outstanding awards in other ways.

Eligibility. Any employee, consultant, or non-employee director may be selected by the Committee to participate in the Plan. Except as set forth below with respect to ISOs, all awards may be granted by the Committee to any employee, consultant, or non-employee director who performs services for us or our parent, subsidiary, or affiliate and who is determined by the Committee to be eligible for an award. As of March 31, 2012, we had 98 employees, including five executive officers and seven non-employee directors who were eligible to participate in the Plan. As of March 31, 2012, we maintained relationships with two consultants who were eligible to participate in the Plan.

Awards. Awards granted under the Plan may include any of the following:

- non-qualified options are options to purchase shares of our common stock at an exercise price of not less than 100% of the fair market value per share on the date of grant. On March 30, 2012, the closing price of the common stock on NASDAQ was \$2.30 per share;
- ISOs are options designed to meet certain tax code provisions that provide favorable tax treatment to optionees if certain conditions are met. ISOs are issued at an exercise price not less than 100% of the fair market value per share (or 110% of the fair market value per share if issued to 10% stockholders) on the