
# Director Compensation—What Public Boards are Considering in Light of Substantial Energy Price Declines and/or COVID-19

*This will be the first in a series of updates that Meridian will produce, on potential impacts to executive and director compensation programs and related governance issues, from the economic turndown that has followed the COVID-19 pandemic, and the recent sharp decline in oil prices.*

## *Director Compensation*

Directors at many companies are currently looking at their own compensation in light of:

- The precipitous declines in share prices at many Canadian companies, driven by global COVID-19 issues, exacerbated for energy companies by significant reduction in oil prices; and
- The compensation actions being taken/considered for executives and employees, which range from no actions (and a wait and see approach, particularly for companies that awarded long term incentives and set incentive targets prior to March), to salary increase rollbacks and cuts, to significant layoffs

At companies already facing a cash crunch or whose share price is materially lower—whether due to COVID-19, oil prices, or both—we have already started to see directors take compensation actions that are aligned with actions being taken by executives and for employees. This includes interim/temporary reductions in compensation and, for a few in the hardest hit sectors, temporarily moving to no director compensation at all. Given the value of director compensation relative to company revenue, these reductions demonstrate alignment with investors, executives, and employees, rather than materially improving a company's financial position.

Some of the approaches we are seeing include:

— Directors deferring any increases in compensation that had already been planned for 2020, even where current compensation levels are below market

— Directors temporarily reducing total compensation on an interim/temporary basis, aligned with reductions being taken by executives, employee salary increase rollbacks or employee layoffs

— Where cash is constrained, directors taking compensation in the form of equity—subject to the comments below on director equity

Companies whose share price has been only moderately impacted by recent events, and that are still in relatively strong financial positions, are generally not considering these actions (unless there are reputational issues that drive a different decision).

## *Director Equity Compensation*

Equity is a significant component of many director compensation programs, with deferred share units (DSUs) being the most common form of award in Canada (followed by others including common shares and, for some, stock options). Director equity raises some unique challenges when share price movement is volatile and extreme. In the current circumstances:

— Most companies made their regular executive and employee long term incentive awards before share prices declined

— Companies generally award director equity in connection with the AGM, or quarterly, and almost all companies award a fixed dollar value of equity (for example, for DSUs awarded annually/quarterly, the number of DSUs awarded is calculated using a pre-determined calculation method based on the pre-determined dollar value and share price at the time of the award)

For companies that have seen a sharp decrease in share price since the award of executive equity, we may see:

— A significantly greater number of DSUs/shares/options awarded than prior years, with increased equity leverage,  and potential criticism when share prices recover

— Director equity being awarded at a significantly lower share price than executive equity and the perceived unfairness of an increased “windfall” opportunity for directors compared to employees—note that the situation is worse for companies that award stock options to both executives and directors, given the additional leverage of options and the importance of exercise price to the value of the award

Companies may consider the alternatives below:

- Determining the number of DSUs/shares/options using a price basis other than as of the grant date—this could, for example, be the same price used to determine executive awards, a reasonable “floor” price, or a longer term average price
- Reducing the targeted dollar value of the equity award
- Converting some equity value to cash, with a requirement that directors purchase common shares on the open market with the after-tax cash—note that while tax is payable at the time cash is received, subsequent gains on the shares may be eligible for favourable capital gains tax rates
- Deferring a portion or all of the equity award to a later date, in hopes that the stock price will have recovered/stabilized

Any action should be considered, proportionate, and aligned with executive and employee actions. For companies that award director equity quarterly, rather than annually, the proportion of compensation reflected and its dollar value may already moderate the impact of the share price movement sufficiently, and “no action” may remain the most reasonable course of action.

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