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COVID-19 – Considerations for Public Company Director Compensation

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As businesses continue to navigate the health and economic challenges posed by the COVID-19 pandemic, annual shareholder meeting dates are approaching for most public companies. Accordingly, where annual director equity grants are made on the date of the annual shareholder meeting, boards of directors should carefully consider, with guidance from their legal advisors and compensation consultants, whether any adjustments to director compensation programs are necessary in response to recent market turbulence.

We have listed key considerations we believe boards of directors should examine in connection with this review, particularly in light of the current environment of investor and activist scrutiny and the risk of Delaware breach of fiduciary duty claims related to director compensation.

- **Reassess the existing methodology for annual director equity grants.** If the compensation program contemplates an annual equity grant based on a fixed dollar amount converted into a number of shares based on the company's stock price, it is imperative to consider how recent market volatility may impact the size of the grants. Furthermore, each company should confirm that its equity plan has a sufficient number of shares to cover the annual equity grants and that the annual equity grants will not exceed any fixed share limits on director compensation.
- **Consider using stock price averages to determine the number of shares subject to annual director equity grants.** The impact of recent market volatility can be reduced by using a trailing average stock price when determining the number of shares subject to an annual equity grant awarded based on a fixed dollar amount. If a trailing average stock price is already used, it may be appropriate to consider a longer period (e.g., 90-200 trading days) in order to avoid either the appearance of unfairness when the size of annual director equity grants are compared to equity grants made earlier in the year to executives and other employees, or the appearance of a windfall if the stock price recovers quickly.
- **Reconsider director compensation increases.** If an increase to director compensation in 2020 is currently being considered, or was previously approved, consideration should be given to whether such increase remains reasonable, how such increase will be disclosed and the potential market perception of such increased amounts. Such reconsideration is especially important when prior guidance the board of directors received regarding the reasonableness of the increase may not have taken into account the impact of the COVID-19 pandemic on the company's business and recent market practice related to director compensation.
- **Determine whether a reduction of director compensation is warranted.** Many companies have already announced salary reductions for executives and retainer reductions for directors. In some instances, directors have forfeited their cash retainers entirely. It may be appropriate for certain cash-constrained companies to reduce director compensation or change the form of compensation (e.g., the mix of cash and equity grants and/or the types of equity grants awarded). Any reductions to cash paid to directors should be carefully implemented to avoid deferring compensation to a later taxable year, unless such deferrals are structured to comply with Section 409A of the Internal Revenue Code.
- **Review stock ownership guidelines.** Many public companies have minimum stock ownership guidelines applicable to directors that are commonly expressed either as a dollar value that is a multiple of a director's annual retainer or as a fixed number of shares. It is often the case that compliance with stock ownership guidelines is measured at the end of the company's year using either a trailing average stock price or a spot price for the company's stock. Stock ownership policies and director stockholdings should be examined well in advance of the year-end assessment to determine whether any of the directors will potentially fail to comply with the company's stock ownership guidelines as a result of recent market volatility.

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