KINGSDALE MEMO:

Governance Considerations: Leading by Example in the Face of COVID-19

March 31, 2020

In a short period of time, the COVID-19 pandemic has shaken the global financial system to its core and has led to unprecedented changes across society. Industries across the board have been impacted with companies in capital intensive industries with long time horizons, such as airlines, mining and rail transport experiencing debilitating blows to their cash flow and balance sheets.

While governments and central banks throughout the world are demonstrating strong leadership by developing bold policies to alleviate these negative supply and demand shocks, directors and senior executives in Canada are struggling to develop their own measures to preserve capital and avoid mass layoffs.

Canadian Companies Leading by Example

Times of crisis are when your company's culture can shine. With the "S" in ESG as a key measure of responsible investing, companies that step-up to the plate at this time will be recognized. The COVID-19 pandemic is providing boards and management an opportunity to demonstrate their leadership. To date, we've seen a number of examples of public company boards and executive teams electing to implement significant changes to *their* own compensation plans, in the midst of staff lay-offs, furloughs, and pay cuts.

Cineplex Inc. (TSX:CGX; Mkt cap: $749.23M), which is facing a June 30th deadline to meet all the conditions in its $2.8B deal to be acquired by Cineworld PLC, has been forced to shutter all 165 of its theatres along with its entertainment venues, lay off its hourly workers, and reduce the pay of other workers. Its executives, however, have taken steps to share the pain. Specifically, Cineplex has imposed a two week pay freeze for executives along with a 40 – 60% cut in salary, depending upon seniority. They've also committed to covering health and benefit costs for all employees who choose to stay on and accept the pay reduction.

Canadian Natural Resources Ltd. (TSX:CNQ; Mkt cap: $22.13B) is one of the Canadian companies experiencing a double whammy affected by both the COVID-19 pandemic and the Russia/Saudi oil price war, leading to a share price drop of about 60% in the past several weeks. The company has been forced to cut approximately $1B in spending, implemented a hiring freeze, reduced its payroll, and asked suppliers to cut fees. But, like Cineplex, the executive is also absorbing some of the negative impacts: Canadian Natural Resource's president will take a 20% pay cut, while other members of the management team will take 15% and vice-presidents will take 12%. Further reductions for salaried employees will range from 0 to 10%, dependent upon seniority and pay quantum.

Recipe Unlimited Corporation (TSX:RECP; Mkt cap: $489.51M) was forced to close all its dining facilities, in response to social distancing protocols implemented across the country. In response, Recipe Unlimited suspended board and CEO compensation while, at the same time, implementing measures aimed at easing the strain on employees such as providing corporate hourly employees with two weeks pay in advance of Employment Insurance benefits and paying a premium to employees that continue to work in corporate restaurants for take-out and delivery.

Ensign Energy Services Inc. (TSX:ESI; Mkt cap: $89.72M), another company affected by both COVID-19 and tanking oil prices implemented sweeping salary cuts for their Chair by 40%, president and chief operating officer by 20%, and named executive officers by 12.5%. In addition, the company's board of directors have had their cash retainers cut by 20% and equity compensation reduced by 40%.

Air Canada (TSX:AC; Mkt cap: $4.20B) which has seen its stock price tank in the face of international travel restrictions, has laid-off half of its workforce. Senior executives and directors at Canada's largest airline have stepped-up: The company's CEO and CFO have agreed to forgo 100% salary while other executives will take a 25% to 50% pay-cut. The board of directors has agreed to cut their salaries by 25%.

Also, this week, we saw **Caisse de dépôt et placement du Québec (CDPQ),** a global institutional investor with over $340B in net assets, announce various operational and philanthropic initiatives, in response to the crisis. CDPQ's measures include a $4B envelope to support Québec companies temporarily impacted by the pandemic, salary freezes for all senior executives and postponement of variable compensation incentives, and $300,000 in donations to community organizations addressing the needs of vulnerable populations.

What Can Canadian Boards Do

Beyond salary cuts, there are further measures that boards and executives may want to implement given the difficulties faced by employees and the larger market as a whole:

- Reduce or waive board approved 2020 total pay increases, especially for cash compensation such as salary and target bonus opportunities. We recommend that the board clearly communicate that these are contingency measures given the extraordinary circumstances, especially if pay increases were made to narrow or close a gap against your market peers.
- Suspend or defer salary by varying degree, relative to severity of impact on business operation.
- Cap payout of 2020 bonus based on absolute performance (e.g. max of 50% of bonus if 2020 TSR is negative or EBIDTA fell below a certain threshold) and/or elect to defer payout into shares.
- Encourage executives to leverage the current reduced share price to acquire shares toward meeting any required share ownership guidelines. This may be viewed positively by the market as a display of confidence in the company's future share price, which may be further bolstered by implementing a post-exercise holding requirement.
- If annual performance objectives have already been set and approved by the board, consider re-evaluating the appropriateness of those objectives through the lens of the new economic environment and revise if needed to ensure they provide clear line of sight to the leadership team. In addition, it is essential that incentives are not tied to metrics linked to specific COVID-19 measures such as headcount reduction, cost savings, etc.
- Evaluate the retention risk for certain key roles and high-potential employees, and consider the use of equity awards tied to certain key long-term strategic priorities over cash if such retention awards are warranted given the risk.

Reactionary measures by leadership need not be limited to a company's executive team; boards may also elect to pursue solidarity with their executive counterparts and company employees:

- Many issuers utilize the option to elect to receive retainer fees in the form of DSUs rather than cash. Proactively pursuing 100% DSU payments will serve to provide the same confidence boost associated with open market purchases by executives.
- Shift to a flat-fee structure or waive fees for additional meetings associated with efforts and workload required to respond to COVID-19.
- In accordance with executives, encourage directors to leverage the current reduced share price to acquire shares toward meeting any required share ownership guidelines.

- Continue to exercise effective governance oversight and ensure all decisions made during this time follow a rigorous process.

Every issuer has its unique situation and challenges and the board and management need to act accordingly.

Clearly, we are only at the tip of the iceberg when it comes to the consequences of the global COVID-19 pandemic and despite the uncertainty of the coming months, issuers can take bold actions to maintain shareholder and employee confidence, and to buttress the long-term sustainability of their businesses.

The time is now for public company boards and executives to display leadership and goodwill to all stakeholders and market participants. As the saying goes: “We judge ourselves by our intentions, and judge others by their actions.”

UPDATE: GOVERNMENT OF ONTARIO ISSUES EMERGENCY ORDER ON MEETING FLEXIBILITY

On Monday, the Government of Ontario issued an Emergency Order that will allow corporations in Ontario, under the Corporations Act and Business Corporations Act, to i). hold meetings of directors, shareholders, and members virtually, and ii). Extend the timeframe by which corporations must hold Annual General Meetings (AGMs) in certain circumstances related to the COVID-19 pandemic. Under the Order, companies that are required to hold meetings in 2020, will be allowed an extension to “no later than the 90th day after the day the emergency is terminated.”

The Emergency Order is in effect province-wide and is retroactive to March 17, 2020.

More details are available here.

Kingsdale remains committed to providing you with the highest level of service and advice when, where, and how you need it during the COVID-19 crisis. If you have any questions, we are here to help 24/7. Contact us today.