Davis Polk

Glass Lewis Outlook on COVID-19's Impact on the Present and Future of Governance for Boards and Companies

March 30, 2020 | Client Update | 5-minute read

Glass Lewis (GL) shared last Thursday more of its **perspective and outlook** of the effect that the coronavirus (COVID-19) pandemic may have on corporate governance for the 2020 proxy season. GL explains that it is issuing further updates because "it is important to provide the market with certainty and transparency on [GL's] established approach" given that it believes that all governance issues and most proposal types will be impacted by the pandemic. Anticipating that the pandemic will continue for up to 18 months, GL states that the proxy advisor is monitoring the markets; the sentiments of institutional investors and shareholder proponents; disclosures by public companies; and the approaches and actions of public companies. GL has been communicating its public updates, observations and perspectives through its **blog**, including the recent update of its **virtual meetings policy** in the **2020 policy guidelines**, and its regularly updated **note** on the COVID-19's impact on annual shareholder meetings in the markets globally.

GL predicts that companies with stronger boards and governance practices will fare better during and after the pandemic than those without. GL writes that "[u]ltimately, the ability of boards and management to successfully navigate the crisis and outperform their competitors will highlight the stark differences in the effectiveness of boards, directors and their governance structures."

KEY TAKEAWAYS

GL believes that market attention is likely to shift to executive remuneration and balance sheet issues before other concerns and issues (some regions have already addressed concerns regarding virtual meetings) in response to market conditions. GL provides a list of the key governance areas it is focusing on in the upcoming months. The following is a list of the key topics covered by this GL statement:

- Compensation and Balance Sheets. GL expects to see:
  - Amendments to existing compensation plans and substantial adjustments to equity compensation plan proposals;
  - "Crocodile tears" for maintaining, or even increasing, executive pay;
  - Attempts to address shareholder concerns in say-on-pay proposals as a result of poor **pay and performance grades**;
  - Greater shareholder concerns relating to the actions companies may take to mitigate the impact of the COVID-19 pandemic, including concerns about repricing, dilution, burn rates, hurdle adjustments, changes to vesting periods, caps and cuts on incentives, and the quality of disclosure describing the limitations on and exercise of board discretion;
  - A likely decline in worker and executive pay given a very different market for talent;
  - Widespread pausing on buybacks and dividend issuances; and
  - Companies desiring an increase in capital raisings and placements.

GL commends "responsible companies" that have taken action to roll back planned salary increases or above-target bonus outcomes and suggests that companies should expect to have proposals rejected and board members voted out if they attempt to make executives whole at even further expense to shareholders and rank-and-file employees.

- Board Composition and Effectiveness. GL anticipates that:
  - Board diversity (based on age and gender) will receive greater focus given that persons 65 and over are more susceptible to the severe health effects of COVID-19. A director who contracts the virus, serves on multiple boards and becomes sick/dies may affect those boards in a myriad of ways including placing a strain on the other directors who must shoulder the burden generally and specifically in dealing with the increased workload that the crisis presents.
  - The resultant market conditions will inevitably test the adequacy of existing board renewal programs.
- Activism and M&A.
  - GL predicts that the effects of COVID-19 may contribute to market conditions that are more conducive to activist maneuvers similar to those during the global financial crisis. While the current pandemic could disrupt existing activist campaigns, if meeting dates are harder to come by or if activists are seeking a spinoff or similar M&A transaction which is difficult in this environment, other campaigns may benefit from inexpensive debt and high dry powder in private equity which these firms may deploy in support of these campaigns.
  - While larger companies have been more apt, for various reasons, to settle with activists (what we dub "peace treaties"), mid-level and small-size companies "with more variable quality in boards" and less access to passive investors, may have greater susceptibility to activist campaigns that progress to proxy fights.
  - GL expects that, if conditions begin to stabilize in the second quarter, the number of proxy contests and M&A deal volume will increase in the latter half of 2020 and continue into 2021.
- Oil and Gas.
  - GL will be closely monitoring how oil and gas companies react in this climate to protect shareholder value—a climate where GL predicts an increase in restructurings and bankruptcies.
  - GL will be watching the closely related plastics industry as well for shareholder concern and proposals.
- Shareholder Proposals and ESG.
  - Given that most shareholder proposal submission deadlines have passed, the written text of a lot of submitted proposals (not subsequently withdrawn) will not change nor reflect the epidemic; however, the context under which the proposals will be substantively evaluated and assessed has changed. While a long-term perspective is still important, "ensuring that companies are able to operate in the short-to medium-term is also a very important consideration."
  - GL observes that shareholder proposals must make sense given existing market conditions. GL warns against the unreasonableness of shareholder proposals "asking companies to undertake resource-intensive actions or reporting that would undermine their ability to respond to more immediate concerns that are also in shareholders' interests."
- Disclosure and Explanation.
  - GL states that effective disclosure and rationales provided by companies will be critical as the proxy advisor decides in its discretion whether a company's changes or actions as a result of the pandemic are justified and address "material shareholder concerns." GL will assess the reasonableness of a company's proposed changes and outcomes by considering whether they are consistent and in proportion to the impact on the interests of shareholders and employees.
  - Particularly with regard to executive pay, GL expects boards to proactively seek changes that align with employee and shareholder experiences—meaning that "executives might need to take a pay cut."
  - It will afford more discretion to a company with a historically "good track record on governance, performance and the use of board discretion."
- Timing and Certainty.

- “[GL] will exercise discretion when considering governance issues where there is a clear material benefit to shareholders for supporting proposals that bring timing and/or certainty of decisions and outcomes.”
- GL notes that companies’ acting swiftly and decisively, with the cooperation of shareholders, during a time of crisis could be more beneficial for containing damage and identifying opportunities.

If you have any questions regarding the matters covered in this publication, please reach out to any of the lawyers listed below or your usual Davis Polk contact.

Kyoko Takahashi Lin
+1 212 450 4706
kyoko.lin@davispolk.com