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Investors vs. Pfizer: Guess Who Has the Guns?

By GRETCHEN MORGENSON

IF outsized executive pay has indeed become a source of outrage to American shareholders, then the contest this week between [Pfizer Inc.'s](#) investors and its board could prove the most compelling of the year.

The battle lines have been drawn between Pfizer's owners and managers, who will assemble on Thursday at the annual shareholder meeting in Lincoln, Neb., at the Cornhusker Marriott hotel.

On one side stands Hank McKinnell, Pfizer's chief executive and chairman, recipient of \$65 million in pay since he took the top job at the company in January 2001 and beneficiary of an \$83 million pension when he retires. On the other are Pfizer shareholders, angry over the 46 percent decline in market value since Mr. McKinnell took the reins.

Some shareholders are threatening to withhold votes for several Pfizer directors over Mr. McKinnell's pay. Pfizer, meanwhile, is fighting back in the proxy contest, working overtime to convince shareholders that its directors deserve support.

Adding drama to this battle is the effect that withheld votes may have on Pfizer directors. Such acts of shareholder defiance are strictly symbolic; at most companies directors can win a seat if they receive one "yes" vote in an election. Last year, though, Pfizer changed its guidelines so that any director who received more "withhold" votes than "for" votes will have to resign. If the board rejects the resignation offer, it will publicly state why.

Like many other companies, Pfizer has a mighty arsenal, backed by shrewd alliances and relationships with institutional shareholders. The Pfizer battle, governance experts say, illustrates an imbalance of power between company owners and managers that is prevalent today.

"The management has these unlimited resources to fight back, and the shareholders are pretty much powerless," said John C. Bogle, founder of the Vanguard Group. "The thing has gotten so out of hand that words almost fail me. The shareholders should not tolerate it."

Institutional shareholders, who vote the stock on behalf of their individual investors, are supposed to act in the best interests of those who own the stock, and the institutions questioned said they were careful to avoid conflicts in proxy votes. But shaking up the status quo may not always be in their own interest.

Pfizer is known for its assiduous courting of institutional shareholders. One way is through Margaret M. Foran, Pfizer's corporate secretary and vice president for corporate governance, who is co-chairwoman of the board at the Council of Institutional Investors, an influential organization of pension funds. She is also on the board of the International Corporate Governance Network, an institutional investor organization in London. Ms. Foran, who said she is a student of governance issues, added that her involvement in these organizations helped her stay current on best practices at corporations.

MANY of Pfizer's biggest institutional stockholders also earn considerable fees for providing money management services to the company. These institutions could fear damaging such relationships by voting against the company. Some members of Pfizer's board serve on boards of firms that are among its larger shareholders, raising questions about their allegiances.

Management says Mr. McKinnell is being paid for 35 years of service in an industry that has very long business cycles for attaining measures of success established by the board. It says Pfizer's board continues to strengthen the connection between pay and performance.

"We have a duty to the shareholders to articulate and communicate the position of the board and I think that is what the company is intending to do," said Stanley O. Ikenberry, president emeritus at the University of Illinois and a member of Pfizer's board and compensation committee. "Hank McKinnell's compensation is down sharply for the current year, but looked at both in the context of one year and multiple years and in terms of pension, the board has reviewed those issues, discussed them extensively and supports the decisions that have been made."

By contrast, a grass-roots group of businesspeople — Investors for Director Accountability — sees a pervasive problem in his pay. "Mushrooming management compensation, unconnected to performance, is an obvious area where directors have failed the people they legally represent," the organization said last month. "Shareholders should withhold their votes for the four nominees of the Pfizer board of directors who are members of the board's compensation committee. This would be a first step on a long road to restore director accountability to owners."

Glass Lewis & Company of San Francisco, and Institutional Shareholder Services of Rockville, Md. — two of the nation's three proxy advisory firms — recommend withholding support from at least one Pfizer director because of questionable pay practices. Mr. Ikenberry is not one of them.

The third firm, Proxy Governance Inc. of Vienna, Va., recommends that owners vote in support of the entire board. Proxy Governance has received major support from the Business Roundtable, a lobbying organization for big corporations whose chairman is Mr. McKinnell. The firm says its opinions are free of conflict.

But recommendations from proxy advisers, who are paid by institutions for advice on how to vote, are not always heeded — a vivid example of a power shift outlined by Mr. Bogle, in his book, "The Battle for the Soul of Capitalism." Ownership of American companies, he argued, has moved from a diffuse group of individual shareholders into a handful of powerful financial

institutions such as mutual funds and banks. These organizations are "reluctant dragons" when it comes to exercising corporate citizenship, Mr. Bogle wrote.

One reason, he said, "is the clear conflict of interest they face in managing the retirement plan assets of the very corporations whose shares they own and collectively control."

"Even when a governance or proxy issue involves a corporation that is not a client," he added, "the reluctance to speak out persists, giving credence to this perhaps apocryphal comment by a pension fund manager: 'There are only two types of clients we don't want to offend: actual or potential.' "

Conflicts of interest are not always evident, of course, but the potential for them arises at five investment firms among the top 10 holders of Pfizer shares. These are companies that earn money from Pfizer by managing some part of its pension plan, retirement savings plans or employee 401(k) accounts. And Pfizer directors serve on the boards of three investment firms that hold enough Pfizer stock for their customers to be among the company's top 20 shareholders.

PFIZER'S top shareholder is Barclays Global Investors, holding 4.54 percent of the stock outstanding. It also manages three funds offered to Pfizer employees in various 401(k) plans and provides investment management services to Pfizer's pension, from which it generated \$2.65 million in 2004, the most recent year for which documents are available.

Fidelity Management and Research, which holds 1.62 percent of Pfizer's shares for its customers, also manages several funds offered in Pfizer employee 401(k) and savings plans. Dodge & Cox, holder of almost 1.3 percent of Pfizer's shares, manages a stock fund offered to Pfizer employees in various 401(k) plans and provides investment management services to Pfizer's pension, for which it earned \$1.06 million in 2004.

[Northern Trust](#), holder of 1.35 percent of Pfizer's shares, made approximately \$2 million as trustee of the company's pension and savings plan. It also manages an index fund for Pfizer employees in Puerto Rico. [J. P. Morgan](#) Chase, holder of 1.26 percent of Pfizer shares, generated \$750,000 in fees from the drug company's pension plan.

Jeffrey Diermeier, chairman of the CFA Institute, the nonprofit association that sets performance-reporting standards for the investment industry, said these types of relationships were troubling. "It is fundamental that multiproduct financial organizations aggressively and proactively deal with these conflicts by actively requiring their asset managers to vote proxies in the interests of their asset management clients and not in their own short-term business interests," he said. "This takes leadership, but it can be done."

An analysis of last year's votes shows that most of these large holders supported Pfizer's board in both the election of its directors and in shareholder proposals.

Officials at Fidelity, Dodge & Cox and Northern Trust, for example, supported Pfizer's board completely in 2005, voting for its directors and against all shareholder proposals on its ballot.

Barclays' funds also voted for all Pfizer directors, but a handful of the funds voted against management on some matters and supported shareholder proposals such as one recommending that Pfizer separate the roles of chairman and chief executive.

Tom Taggart, a spokesman for Barclays Global Investors, said the firm would not discuss how it planned to vote but said "the investment side of the business is totally separate from the proxy voting side." He added that Barclays used an outside adviser to determine how it voted.

A spokesman for Dodge & Cox funds referred to its proxy voting guidelines, which state that the firm is committed to resolving all potential conflicts in its clients' best interests and uses an outside consultant to determine how it will vote. Northern Trust's spokesman said this was also the case at his firm. J. P. Morgan Chase and Fidelity said they vote their clients' shares without regard for any of their firms' other relationships.

TIAA-CREF, the money management firm that counts Mr. Ikenberry as president of its board of overseers, also voted alongside Pfizer's board last year. Mr. Ikenberry said that he had had absolutely no discussion with the firm on the issue of voting Pfizer shares. A spokesman for TIAA-CREF said that members of the board of overseers have no role in voting of proxy matters at the firm.

OTHER Pfizer directors also serve on boards of financial services firms, such as [Goldman Sachs](#), a holder of 0.82 percent of the company's shares; J. P. Morgan Chase; and trust units of [Deutsche Bank](#), which holds 1.36 percent.

Representatives of those firms said their directors have no influence whatsoever over voting decisions made by their asset management units.

Frederick E. Rowe Jr., chairman of Greenbrier Partners, a money management firm in Dallas, and head of the Texas Pension Review Board, is the point man for the grass-roots organization aiming at Pfizer.

"It's not 80/20 or 90/10," Mr. Rowe said. "One hundred percent of the people we've talked to on the phone and on the Web are outraged at what has happened in executive compensation in general and at Pfizer in particular. I know Pfizer has long-term relationships with institutional holders and they have lots of business to pass around, but I am hopeful that the institutions will vote the way 100 percent of the true owners of Pfizer would want them to vote."

Shareholder inertia may be a big factor in keeping the status quo at Pfizer. Along with the stock they own directly, institutions hold stock for individual investors in their vaults for safekeeping. Those shares will be voted as Pfizer's board directs unless investors give other instructions to their brokers. Last year, 1.4 billion Pfizer shares, or 20 percent of the stock outstanding, received no instructions from their true owners and were voted with the company's board.

Likewise, if the holders of Pfizer stock in the company's 401(k)'s and pension plans do not instruct the trustees how to vote, those shares will be voted in the same ratio that those providing instruction voted. If, for example, 80 percent of Pfizer's shares voted in favor of its directors, 80

percent of the pension plan shares receiving no instruction would also be voted for those directors.

Gary Lutin, an investment banker at Lutin & Company in New York and an adviser in corporate control contests, said: "The Pfizer case shows that even prominent, good corporate citizens need to be monitored. All the best governance theories won't make any difference if investors don't bother to watch the people who are supposed to be guarding their property."

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