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Fund Manager, It's Time to Pick a Side

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IT has been beyond exasperating to watch money managers, who are fiduciaries, vote their clients' shares in support of compliant or incompetent boards in recent years. With the exception of some public pension funds, institutional shareholders have uttered nary a peep about directors on the scene during significant accounting blowups or those who dispensed overly generous pay packages and perquisites to underperforming executives.

The sad fact, of course, is that investment advisers don't want to irk the companies they are doing business with elsewhere in their firms, or trying to. The same mutual fund company that manages your retirement money, for example, also wants corporations to sign up for administrative and advisory services. Because the companies whose shares they own for you may also be clients they do not want to upset, investment companies are in the position of trying to serve two masters.

Hoping to change this dysfunctional setup, a group of concerned entrepreneurs and businesspeople has formed a foundation, the Investors for Director Accountability, that will press directors to act in the interests of the stockholders they are supposed to represent. The foundation hopes to achieve this noble goal by persuading institutional shareholders to withhold their votes for directors — the only method owners have for registering displeasure with board inaction.

The foundation is led by Frederick E. Rowe Jr., chairman of Greenbrier Partners, an investment fund in Dallas. Mr. Rowe is also chairman of the Texas Pension Review Board, and in that role, he said, he has seen the sacrifices that firefighters, police officials and other municipal workers have had to make as their pensions' returns have fallen.

One reason those returns have disappointed, Mr. Rowe said, is executive pay. "In the last decade, management and its entourage have absorbed an ever-expanding share of the value that corporate America generates," he said. "Managers and their friends have done well while future retirees, endowments, universities, museums, widows and orphans have broken even, if they are lucky. This is not a coincidence."

The foundation's first target is Pfizer, the New York-based drug maker whose annual meeting is set for April 27 in Lincoln, Neb. Shareholders should withhold their votes for the four members of the board's compensation committee, Mr. Rowe said, because Henry A. McKinnell, the chief executive, has received munificent pay for presiding over a destruction of shareholder value.

Even though the stock has lost 43 percent of its value since he became Pfizer's chief in January 2001, Dr. McKinnell has received \$65 million in salary, bonus, restricted stock and incentive pay.

MORE troubling to Mr. Rowe is what Dr. McKinnell stands to receive when he retires from Pfizer in 2008: a pension benefit now worth \$83 million. That is, \$6.5 million a year for as long as he lives and the biggest pension benefit for a chief executive at any of the 500 companies in the Standard & Poor's stock index.

Dr. McKinnell's pension swelled partly because, from 1993 to 2001, the value of Pfizer shares he received under long-term incentive arrangements were included in calculating the benefit. The compensation committee decided in 2001 to end the deal, at Dr. McKinnell's urging, Pfizer said.

Pfizer shareholders could pay even more than \$83 million, however, if Dr. McKinnell chooses to take his pension in an annuity, decides to marry and then his wife survives him. A company spokesman said Dr. McKinnell is unmarried but has a companion whose age he declined to provide.

Lucian A. Bebchuk, a professor at Harvard Law School, and Robert J. Jackson Jr., a fellow at Harvard's program on corporate governance, calculate that shareholders would have to pay an additional \$16.7 million if, under the annuity option, Dr. McKinnell married a 50-year-old.

"It seems to us this is tone-deaf to the times and is very offensive to the people who own the company," Mr. Rowe said. "People who want to retire someday who own Pfizer and find out that they have to accept reduced benefits because stocks like Pfizer haven't performed, they are apoplectic that someone could receive that sort of benefit when they have borne the risk of ownership and have nothing to show for it except a loss."

Paul G. Fitzhenry, a Pfizer spokesman, said that Dr. McKinnell earned his pension over more than three decades, including "several years in which the company produced outstanding shareholder returns," and that shareholders approved the pension.

He also said the compensation committee had improved its pay-for-performance measures by establishing a higher-performing peer group for comparisons. He said it had lowered target pay levels to the median of its peer groups, instead of the 75th percentile, and linked long-term performance pay to total shareholder return instead of per-share earnings. Pfizer listens to its shareholders' views on all issues, he added.

Mr. Rowe's group is not the only one urging shareholders to withhold votes from Pfizer directors. Glass, Lewis & Company, the investment advisory firm, recommends that stockholders withhold votes from Dana G. Mead, chairman of the Massachusetts Institute of Technology Corporation, who leads Pfizer's compensation committee.

"There are only two explanations for the compensation committee's largess, in my view," said Greg Taxin, president of Glass Lewis. "Either McKinnell is extremely persuasive and the compensation committee too passive, or it has become very hard in 21st-century America to attract and retain a leader capable of overseeing a 40 percent decline in stock price."

Other members of Pfizer's compensation committee are Robert N. Burt, former chief executive of the FMC Corporation; Stanley O. Ikenberry, president emeritus of the University of Illinois; and George A. Lorch, chairman emeritus of Armstrong Holdings Inc. Franklin D. Raines, who was the embattled chief executive of Fannie Mae, was on Pfizer's compensation committee until he resigned last year.

Dr. Mead said in a statement that his committee members had "carefully reviewed the performance of the company's chief executive officer and have made compensation decisions in light of that performance, as detailed in our proxy statement." Dr. McKinnell's pension benefits, he said, "represent a legal and moral commitment" of the company.

If any director receives more "withhold" votes than "for" votes at the April meeting, he must resign under Pfizer's new guidelines. After a resignation, the board's corporate governance committee will "consider" the offer and possible responses and make a recommendation to the board, which will act on it within three months. If it rejects the resignation offer, it will disclose why.

SO, the Pfizer situation makes an interesting test, not only of Pfizer's commitment to listen to shareholders but also of whether money managers will side with Pfizer or their investor customers who have lost money in the company's shares.

It will be interesting to see, for example, how Northern Trust votes. Northern Trust, a financial services company in Chicago, owns 99 million Pfizer shares on behalf of its clients, but the company also holds the lucrative job of trustee for some of Pfizer's retirement plans. In 2004, the most recent year for which filings are available, Northern Trust received \$490,000 in fees for its work as trustee of one Pfizer savings plan.

Last year, according to public filings, Northern Trust's mutual funds voted with Pfizer management on all matters, including director elections. A spokesman for Northern Trust declined to comment.

Mr. Rowe said: "We know that Pfizer will contact large investors and we know that investors will feel pressure from other accounts, real or imagined, to go along with Pfizer. But we want to establish a record of whose side the people who vote these shares are on — the investors to whom they have a duty or the people who control the company and its purse strings."

We'll keep you posted on the outcome of this exercise in accountability. Or check out investorsfordirectoraccountability.org, the foundation's new Web site, for updates.

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