The New York Times

April 21, 2006

Pfizer and the Proxy Adviser

By GRETCHEN MORGENSON

Correction Appended

Directors of Pfizer Inc., up for election at the company's annual meeting next Thursday and under fire from shareholders over the pay awarded to executives, got a welcome show of support late last week from one of the nation's three proxy advisory services.

Proxy Governance Inc. of Vienna, Va., urged its investor customers to vote for all 13 of the drug maker's directors. In contrast, the other two advisory firms — Institutional Shareholder Services of Rockville, Md., and Glass Lewis & Company of San Francisco — have recommended that Pfizer shareholders withhold their votes from some board members because of the company's pay practices.

Differences of opinion, of course, make the financial markets go round. And the Proxy Governance report on Pfizer outlines in detail how it arrived at its opinion. It said the company should be given credit for making significant changes to its pay practices.

Nevertheless, a memo written in 2004 by Hank McKinnell, the chief executive of Pfizer, urging corporations to buy and promote Proxy Governance's services just as the firm was opening for business, raises questions about whether the advisory firm's Pfizer recommendation reflects an unbiased point of view or a relationship with the company and its top executive.

Recommendations made by proxy advisory firms carry significant weight and are closely watched each proxy season, when shareholders assemble to vote on matters relating to their company's management. Financial institutions can own stakes in hundreds of companies for their investor clients and rely heavily on these firms for advice on how to vote their shares in director elections and on other matters that come up at the meetings.

Naturally, the opinions issued by the three major proxy advisers are a matter of interest to Pfizer's board, its management and owners. But this is especially so now because the coming election at Pfizer will be subject to guidelines adopted by the company last year that require any director who receives less than 50 percent of the shares cast at the annual meeting to offer to resign from the board.

The 2004 memo supporting Proxy Governance was written by Mr. McKinnell in his capacity as chairman of the Business Roundtable, a Washington-based lobbying group for corporate America. Through a spokesman, he declined to comment on it. The memo was supplied by a recipient who was concerned about its tenor; he was granted anonymity because he feared retribution from Pfizer.

In it, Mr. McKinnell called on Roundtable members to help Proxy Governance "thrive in the marketplace" by using its services. "We have all seen the increasingly hostile recommendations from existing proxy advisory firms," he wrote, "who continue to promote narrow interests at the expense of long-term shareholder value." Identifying a "pressing need for a serious alternative," Mr. McKinnell continued, "we are pleased to report on the creation of Proxy Governance Inc."

Founded in 2004, Proxy Governance describes itself as a new breed of advisory service, providing advice that is "completely free of conflict" and "with the goal of truly building long-term shareholder value." Its founder, Steven M. H. Wallman, was a commissioner at the Securities and Exchange Commission from 1994 to 1997; the firm is a unit of Foliofn, a financial services company.

John J. Castellani, president of the Business Roundtable, said Mr. Wallman approached the organization in the early 1990's about starting a new proxy advisory firm. When he came back to them in 2004, they liked what they saw. "It met our criteria of independent, conflict-free and increasing the competition in investment advisory services," he said.

Mr. Wallman said that Mr. McKinnell's memo asking for support had no bearing on Proxy Governance's current or past opinions on Pfizer. The firm's analysts "do whatever they thought was the right thing and I have given them complete free rein to do that," Mr. Wallman said. "We don't have any conflicts; we don't provide consulting services; we don't provide services to short sellers; we don't do anything other than present our views or opinions."

Proxy Governance covers 3,000 United States companies. "Instead of subscribing to a best-practices principle that should be applied to all companies, we look at individual firms and how they performed in making a voting recommendation," said Shirley Westcott, managing director for policy at the firm.

In its Pfizer report, Proxy Governance concluded that the company's directors merited support from shareholders even though the pay awarded to Mr. McKinnell in recent years, including his pension benefit, exceeded that of the company's peers while its performance lagged theirs. Mr. McKinnell will receive $6.5 million a year after he retires.

"The amount of pay per se is really not that far above that of peer companies," Ms. Westcott said. "The issue, of course, is his pension payments. What we did here is we gave the company credit for the initiatives it has taken."

Those initiatives included removing the stock component of Pfizer executives' pay to calculate the company's pension payouts, and Pfizer's move to ask shareholders to approve future yearly pension payouts that exceed 100 percent of an executive's annual salary and bonus. "They also did a very good job of disclosing their pension benefits," Ms. Westcott said, "something very few companies did to date."

Neither of these actions persuaded either Institutional Shareholder Services or Glass Lewis to recommend shareholder support for Pfizer's entire board. I.S.S. advised owners to withhold votes from two directors: Dana G. Mead, chairman of the Massachusetts Institute of Technology Corporation, the university's board of trustees, and head of Pfizer's compensation committee; and George Lorch, a former chief executive of Armstrong Holdings, a maker of flooring and ceiling materials, who is also on the committee.

Glass Lewis recommended that Pfizer shareholders withhold support for M. Anthony Burns, former chief executive of Ryder System Inc., a transportation company, because he headed Pfizer's compensation committee from 1995 to 2005. During those years, the committee was slow to address and identify the growing pension benefit that was accruing to Mr. McKinnell and other executives, Glass Lewis said.

There are several relationships between Pfizer, the Business Roundtable and Proxy Governance. For example, William C. Steere Jr., Pfizer's chairman emeritus and one of its directors, is a member of Proxy Governance's policy council. The firm said that he did not participate in any matters involving Pfizer.

In addition, the Business Roundtable, headed by Mr. McKinnell, was Proxy Governance's first subscriber, buying about 160 subscriptions to its service for its members. Subscriptions ranged in cost from a few hundred dollars a quarter to $35,000 a quarter, the firm said. Mr. Wallman declined to say how much the Roundtable paid but said the bulk subscriptions stopped last year.

And, according to a public S.E.C. memorandum, James P. Melican, Proxy Governance's chairman until recently, represented the Business Roundtable at a private meeting with Cynthia A. Glassman, an S.E.C. commissioner, in October 2003, as the firm was being created. The Roundtable representatives attended the meeting to argue against an S.E.C. proposal that would have provided greater access to shareholders in the nomination of directors; the proposal subsequently died.

Margaret M. Foran, Pfizer's corporate secretary and its vice president for corporate governance, joined Mr. Melican as a Roundtable representative at the meeting. Mr. Melican could not be reached for comment.

One enthusiastic recipient of Mr. McKinnell's memo about Proxy Governance was Philip J. Purcell, then the chief executive of Morgan Stanley who was ousted from the firm last year. "We should put your heads together to see how we can support and use this service" he wrote in the memo's margin to three of his top lieutenants.

Correction: April 22, 2006