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THE ACTIVIST BOARD AND CORPORATE GOVERNANCE*

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I. INTRODUCTION

I am here to present the inside board perspective of this discussion on corporate governance. I have been with Pfizer, Inc. for over thirty years, and I have been involved with our board of directors in one capacity or another throughout most of that time. I have seen the whole concept of corporate governance arise and develop.

Like most companies thirty years ago, we had an inside board. In fact, the accepted norm was to have an inside board, because the theory was that the inside directors knew the company the best and thus, they knew how best to plan the direction of the company.[1] The concept of having outside board members was really not in vogue at the time.[2]

In 1972, our chairman,[3] who had pretty good foresight as to the direction of the corporate

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[1] *See, e.g.*, Diana Bilimoria & Sandy Kristin Piderit, *Qualifications of Corporate Board Committee Members*, GROUP & ORGANIZATION MGMT., Sept. 1, 1994, at 334 (discussing the role and advantages of having inside directors).

[2] *See, e.g.*, Cyrus F. Freidheim, Jr., *New World Order in the Boardroom*, DIRECTORS & BOARDS, June 1, 1996, at 1 (presenting an in-depth discussion of the development of the concept of outside directors from the early 20th century through today); *see also* Murray L. Weidenbaum, *The Evolving Corporate Board*, SOCIETY, Mar. 1, 1995, at 9 (contrasting 1938, when only half of industrial corporations had a majority of outside directors on their boards with 1992, when the average corporate board had nine outside and three insider directors); *see also* JAY LORSCH & ELIZABETH MCIVER, PAWNS OR POTENTATES: THE REALITY OF AMERICA'S CORPORATE BOARDS (noting that the percent of companies with a majority of outside directors grew from 50% in 1938 to 83% in 1979).

[3] *See* Graef Crystal, *Equality of Outcome Management at Pfizer*, PENSIONS & INVESTMENTS, Sept. 19, 1994, at 12 (indicating that Edmund T. Pratt, Jr. was Pfizer's chairman in 1972).

world and corporate boards,[4] brought Felix Rohatyn[5] of Lazard Frères on as our first outside director. We progressed through the 1970s until we achieved a majority of outside and independent directors.[6] Currently, we have twelve directors, eight of whom are truly outside and independent.[7] We have a couple of bankers, including Felix Rohatyn, who have some relationship with the company, and we have only one inside director, our chairman.[8] Thus, we have evolved into a truly independent board.

II. THE ROLE OF THE BOARD

A. Monitor and Counsel Management

With regard to Martin Lipton keynote address, *Corporate Governance: Does it Make A Difference*,[9] it has been my experience that corporate governance has had an effect on the atmosphere in the board room. As we moved to an outside and independent board, and as the developments in corporate

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[4] *See* Freidheim, *supra* note 2; *see also* Arthur M. Louis, *Firms Seek Outsiders as Directors*, S.F. CHRON., June 17, 1994, at E1 (citing a survey which found four outsiders to each insider on the boards of 100 large corporations compared with two outsiders to each insider fivė years earlier).

[5] *See World/Nation Briefs*, NEWSDAY, July 19, 1997, at A15 (noting that Felix Rohatyn was the Managing Director at Lazard Frères, an investment banking firm); *see also Vershbow for NATO?*, FIN. TIMES, Aug. 28, 1997, at 9 (reporting Felix Rohatyn's confirmation as the U.S. Ambassador to France).

[6] *See* Terence J. Gallagher, *A Vice-President for Corporate* Governance?, CORP. BOARD, May 1995, at 16 (citing excerpts from Pfizer's New Corporate Governance Principles including the policy of the company to maintain a majority of outside members on the board).

[7] PFIZER, INC. 1996 ANNUAL REPORT 63 (1997) (The independent directors are: **W. Don Cornwell**, Chairman and Chief Executive Officer of the Granite Broadcasting Corporation; **Michael S. Brown, M.D.**, Distinguished Chair of Biomedical Sciences and Regental Professor at the University of Texas Southwestern Medical Center; **George B. Harvey**, Former Chairman, President, and Chief Executive Office of Pitney Bowes Inc.; **Constance J. Horner**, Guest Scholar at the Brookings Institution and Former Assistant to the President of the United States; **Stanley O. Ikenberry, Ph.D.**, President of the American Council on Education; **Harry P. Kamen**, Chairman, President, and Chief Executive Officer of the Metropolitan Life Insurance Company; **M. Anthony Burns**, Chairman, President, and Chief Executive Officer of Ryder Systems, Inc.; and **Ruth J. Simmons, Ph.D.**, President of Smith College. The affiliated directors are: **Thomas G. Labrecque**, President, Chief Operating Officer of the Chase Manhattan Corporation and the Chase Manhattan Bank; **Felix Rohatyn**, Former Managing Director of Lazard Frères & Co. LLC; **Jean-Paul Vallès, Ph.D.**, Chairman and Chief Executive Officer of Minerals Technologies Inc.; and **William C. Steere, Jr.**, Chairman of the Board and Chief Executive Officer of Pfizer).

[8] *See Who's News*, WALL ST. J., Mar. 29, 1991, at B2 (indicating that Pfizer named William C. Steere, Jr. chief executive officer); *see Who's News*, WALL ST. J., Jan. 27, 1992, at B8 (indicating that William C. Steere, Jr. would become the chairman of the board at Pfizer on March 1, 1992).

[9] *See* Martin Lipton, *Corporate Governance: Does It Make a Difference*, 2 FORDHAM FIN. SEC. TAX L.F. 41 (1997).

governance outlined here by the various speakers came about, the feeling and the atmosphere in the board room did change. The board does in fact recognize its responsibility to the shareholders. Marty quoted from Chancellor Allen's speech[10] during the part of his discussion which dealt with the monitoring or policing role of the board of directors over management. In a company that has financial or personality difficulties, such as those exemplified in the case of W.R. Grace,[11] the monitoring role of the board is in fact the most important role.[12] However, in a company that is doing well and has an expanding business, such as Pfizer,[13] it has been my experience that the board's role as counselor, strategic planning body, and as a check on management's direction for the company, is the more important role.

B. Maintain a Dynamic Balance

I have described the board's dual function in some of my articles as a "dynamic balance," where the board's role is part adviser or planner to, and part monitor of, management.[14] The balance shifts as the fortunes of the corporation shift.[15] The key here, of course, is knowing when, and how quickly, to make that shift.[16] When you move from a company that has been doing well and you begin to see some problems - whether in terms of sales, earnings, personalities, or succession to the CEO position - that is the time when the board has to move to its monitoring role.[17] However, it is very difficult to pin that down and to

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[10] *Id.*

[11] *See* Kenneth N. Gilpin, *Grace's Board Votes Changes Meant to Satisfy Big Investors*, N.Y. TIMES, Apr. 7, 1995, at D1; *see also* Kenneth N. Gilpin, *Big Investor Talked, Grace Listened*, N.Y. TIMES, Apr. 10, 1995, at D1; For another example, *see* Weidenbaum, *supra* note 2 at 19 (discussing how GM's board sought to forestall the development of a crisis situation by replacing the CEO because of poor performance on the part of management's reporting to them).

[12] *See* John W. Byrd, *The Insider Story*, ACROSS THE BOARD, Feb. 1994, at 12 (arguing that independent outside directors are needed to monitor management in situations of potential conflicts of interest, whereas in most business decisions vigilant monitoring is not as necessary).

[13] PFIZER, *supra*, note 7, at 2 (1997) (indicating that from 1995 to 1996, Pfizer's net income increased 23% on net sales growth of 13%. During the same period, Pfizer's market capitalization increased 33% to $53.5 billion).

[14] Terence J. Gallagher, *Corporate Governance: A Dynamic Balance*, METROPOLITAN CORP. COUNSEL, Dec. 1996, at 54 (describing how the board's two roles can be adjusted before disaster strikes and drastic action is required).

[15] *Id.* (noting that if a corporation is doing well and management is doing a competent job, the counseling role should be emphasized, but if the board detects problems in the business or in management, then the monitoring role should be emphasized).

[16] *Id.* (indicating that the board has to recognize when it should move from its counseling to its monitoring role or vice-versa).

[17] *See id.*

judge whether the board is moving quickly enough to change its role in the corporation.

I think that this "dynamic balance" is something boards are striving for, and that is where the influence of the institutional investors has had an effect.[18] The board is certainly much more sensitive, and in the discussions and meetings that I attend, I see the board acting in a way that is responsive to, and aware of, the climate of the institutional investor and expectations of how things are to be done by boards today.

With respect to Marty's point that boards may have overbalanced in favor of protecting shareholders and not taking risks in the business,[19] I am not sure that I would go so far as to say that this has happened at Pfizer. I think we have hit a pretty good balance of what boards should do in terms of being responsive to the institutional shareholders. If there are companies with an overbalance in favor of the shareholders and not taking the business judgment risks that are expected of management or of boards, I have not seen them. Mr. Lipton may have a point that an overbalance is beginning to happen,[20] but I have not seen it in the companies that I am aware of, and certainly not in my own company.

C. Take a Proactive Approach

One of the things that has happened over the years at Pfizer, as we moved to an outside board, is the development of our activities in corporate governance. Pfizer has always been a regulated company, in terms of its pharmaceutical products, and as a regulated company, we have learned to be proactive in trying to affect the environment in which we operate - whether that be legislation, regulation, or what have you. Thus, it became natural for us to be proactive in trying to affect the development and regulation of corporate governance.

We noted early on that there was not much in the way of academic work being done from the corporation's point of view. Most of the writing was in terms of the individual or institutional shareholders. So we have taken on as part of our responsibility to support work being done in the area of corporate governance. For example, Pfizer sponsored a series of lectures by Michael Novak.[21] Each lecture dis-

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[18] *See* Gilpin, *supra* note 11 (discussing the effect that institutional investors have had on W.R. Grace & Co. and the relations between the company and institutional investors).

[19] Lipton, *supra* note 9.

[20] *Id.*

[21] Michael Novak, ON CORPORATE GOVERNANCE: THE CORPORATION AS IT OUGHT TO BE 45 (1997) (Michael Novak is the George Frederick Jewett Chair in Religion, Philosophy and Public Policy as well as the Director of Social and Political Studies at the American Enterprise Institute).

cussed three different subjects: corporations in general,[22] intellectual property,[23] and corporate governance.[24] We have sponsored some other seminars. We have supported writing by Margaret Blair at the Brookings Institution,[25] who has been writing some books in the area of corporate governance.[26] Finally, Marty mentioned the GM Corporate Guidelines or Corporate Principles.[27] Of course, we have our Corporate Governance Principles,[28] which are in fact similar to the GM Principles.[29] There are some differences because we felt a little bit differently about some things.

II. DEVELOPMENTS IN CORPORATE GOVERNANCE

A. Shareholder Activism

We came to be active in corporate governance in response to the developments that the other speakers have outlined through the 1970s and 1980s.[30] We saw this trend developing. We saw the hostility between companies and their institutional shareholders.[31]

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[22] Michael Novak, THE FUTURE OF THE CORPORATION 26 (1996) (challenging corporations to acquire a greater degree of philosophical and public policy self-consciousness by taking a central role as the chief alternative to government).

[23] Michael Novak, THE FIRE OF INVENTION, THE FUEL OF INTEREST: ON INTELLECTUAL PROPERTY 29-30 (1996) (acknowledging that patent protection enhances the common good by stimulating useful inventions and creative works from which the public benefits).

[24] Michael Novak, *supra* note 22, at 31-32 (challenging corporations to contribute to the success of democracy by animating civil society and helping the poor rise up from poverty).

[25] Brookings Institute (visited June 29, 1997) <http://www.brook.edu>. (The Brookings Institution, an independent, nonprofit research organization, provides funding for academics and publishes scholarly works that analyze and make suggestions for improving the performance or effectiveness of American institutions, government programs, and U.S. public policy).

[26] *See, e.g.*, Margaret M. Blair, OWNERSHIP AND CONTROL: RETHINKING CORPORATE GOVERNANCE FOR THE TWENTY-FIRST CENTURY (1995) (arguing that corporations should not focus on maximizing value solely for the shareholders, but rather maximize the total wealth they create for all of the parties with a stake in the firm); *see also* THE DEAL DECADE: WHAT TAKEOVERS AND LEVERAGED BUYOUTS MEAN FOR CORPORATE GOVERNANCE (Margaret M. Blair ed., Brookings Press 1993) (illustrating how the corporate restructurings from the past decade shed light on the corporate governance controversies and boardroom shakeups of today).

[27] Lipton, *supra* note 9; *see also* James E. Heard, *Instituional Investors: Agents of Change*, 2 FORDHAM FIN. SEC. TAX L.F. 19, 20-21 (1997).

[28] *See* Gallagher, *supra* note 6 (to request a copy of Pfizer's Corporate Governance Principles, write to: Pfizer, Inc., 235 East 42nd Street, New York, NY 10017-5755, attn.: Terence Gallagher).

[29] *Id.* (to request a copy of GM's Corporate Governance Guidelines, call: (313) 556-2044).

[30] Lipton, *supra* note 9.

[31] *See* Gilpin, *supra* note 11 (discussing the hostility between W.R. Grace & Co. and its institutional shareholders).

Since sixty-four percent of Pfizer is owned by institutions, we are in that category of companies where the institutions can combine and get something passed if they want to.[32] They can approach management and have them listen very carefully to their concerns.[33] So as institutional shareholders became more active in corporate governance throughout the 1980s,[34] we wanted to be responsive to this development. And since we wanted to be involved with our institutional investors, we acknowledged that they were in fact our owners and opened up a dialogue with them.

For example, one of the things Mr. Lipton had talked about was the poison pill,[35] and we, like most companies,[36] have a poison pill. Pfizer's poison pill is coming up for renewal later this year, and we have been considering whether it should be renewed. When one of our institutional shareholders brought a shareholder proposal to have us redeem our poison pill, we told them that we would look into and work on what should be done about it. We even invited them to come and meet with our Corporate Governance Committee,[37] which is considering the issue.

If we do decide to renew our poison pill, we want to be responsive to the institutions and we want our decision to reflect the independence of our board of directors. Our Corporate Governance Committee, which is entirely made up of outside and independent directors, is going to have the authority to look at the

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[32] *See generally* Dennis J. Block and Jonathan M. Hoff, *Mergers and Acquisitions: Corporate Governance and Institutional Activism*, N.Y.L.J., Jan. 18, 1996, at 5 (noting that because institutional investors hold 50% of the stock in large U.S. public companies, they have a significant influence on the board of directors).

[33] *Id.* (discussing the push by big institutional shareholders for changes among the board of directors at W.R. Grace & Co.).

[34] *See, e.g.*, James E. Heard, *Institutional Investors Are Flexing Their Muscles*, LEGAL TIMES, Oct. 24, 1983, at 11 (discussing how institutional investors exercised their strength during the 1983 proxy season).

[35] BLACK'S LAW DICTIONARY 1156 (6th Ed. 1990). A *poison pill* is "a defense tactic used by a company that is a target of an unwanted takeover to make its shares or financial condition less attractive to acquire. For instance, a firm may issue a new series of preferred shares that give shareholders the right to compel their redemption at a premium price after a takeover." *Id.* *See Poison Pills. To Die For*, THE ECONOMIST, Feb. 24, 1996, U.S. Ed., at 79 (providing a general discussion of poison pills); *see also* Randy Myers, *Pretty Poison: Anti-takeover Defenses Regain their Dangerous Allure*, CFO: MAGAZINE FOR SENIOR FIN. EXECUTIVES, Mar. 1996, at 43-46 (discussing "chewable" poison pills, which have proven to be more palatable to institutional investors by overriding certain provisions when acceptable bids surface); *see also*, Lyn Perlmuth, *Easy-to-Swallow Poison Pills*, INST. INVESTOR, June 1996, at 35 (commenting that poison pills' bad reputation may be mainly a public relations problem, which a company can solve by explaining its thinking to institutional investors).

[36] *See, e.g.*, Randy Myers, *supra* note 35 (illustrating how Colgate Palmolive, Gillette, International Paper and McDonald's, among others, have renewed their poison pills).

[37] PFIZER, *supra*, note 7, at 63 (1997) (indicating that the following are members of the corporate governance committee: **Constance J. Horner, Chair; Michael S. Brown, M.D., and Harry P. Kamen**).

pill every three years or so. They will decide whether or not things have changed, whether or not the climate is different, whether or not we should continue to have the pill, or whether we should redeem it at that point.

B. Board Activism

This approach reflects what we feel should be the direction that the institutions should be going with respect to companies that have been responsive to them. We want to see institutions place similar levels of trust and faith in their independent board members when there is some confidence that they are indeed an independent board of directors.

If the future is going to be one where we are cooperative with our shareholders, which would get rid of some of the rancor that took place in the 1980's during the takeover period,[38] we need to have the trust of our shareholders. We are going to have them recognize that there is a place for the board. Not only does the board have to be responsive to them, but it also has to be the counselor and advisor to management.[39] And once the shareholders elect a board, they should place their trust in the independence of the board.

Now, if that goes awry, if a company does not have an independent board or if a company has not gone in that direction, then surely the institutional investors have the clout and the power to react as well as do something about it.[40] But if that is not the case, we would like to see them distinguish companies that are trying to do the right thing and are trying to act in the best interests of the shareholders generally from those companies which do not have a responsive board or an effective corporate governance structure. This distinction is important because we would like the institutional shareholders to refrain from invoking the same stringent measures on companies with responsive boards that they might invoke on boards who are not responsive.

We have had an activist board in the sense that it has taken on the things that the institutional investors felt were important to them, such as the Corporate Governance Principles which were adopted

[38] *See* Gilpin, *supra* note 11 (discussing the hostility between W.R. Grace & Co. and its institutional shareholders).

[39] *See* Jonathan L. Johnson, Catherine M. Daily, and Alan E. Ellstrand, *Boards of Directors: A Review and Research*, J. MGMT., Sept. 1, 1996, at 409 (discussing the academic debate over B cards and reviewing the role of the Board of Directors and offering suggestions on how they can improve their performance).

[40] *See* Gilpin, *supra* note 11 (noting the influence institutional investors can have on a company).

early on. We knew of the GM Principles because our Chairman at that time was a director of GM,[41] and, in fact, had participated in a benchmarking program at GM before they wrote their Principles.

Beyond that, and in addition to our Corporate Governance Committee, we have restructured our compensation for our senior managers to reflect the performance of the company.[42] I must say, and Mr. Lipton had made this point too,[43] that with the restructuring of our compensation program, our senior managers now make much more than before because our company has done well. A good percentage of the compensation of senior managers is related to the company's performance, and we have done pretty well.

We did away with our pension plan for our directors, which the institutions told us they did not like. Mainly in that case, I think, the international unions were the leaders in that area.

IV. CONCLUSION

We set up, as I said, a proactive approach to corporate governance in establishing a Corporate Governance Department, which I head up. The Corporate Governance Department tries to be active with the institutional investors, the SEC, and the academic community, and tries to position Pfizer as a company that is responsive to the corporate governance needs of its shareholders.

As we look to the next century, I think that with the kind of approach to corporate governance that I have outlined in my speech, we should be able to work very closely and very much in harmony with our institutional shareholders.

Thank you very much.

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[41] *See* Crystal, *supra* note 3 (noting that Pfizer Chairman was on the Board of Directors of General Motors Corp.).

[42] *See* Gallagher, *supra* note 6 (indicating how Pfizer's executive compensation committee has revised the executive pay package to consist of a salary, an annual incentive award based on meeting performance criteria, and a long-term element consisting of stock options and performance-contingent share awards).

[43] Lipton, *supra* note 9.