Investment News

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HEADLINE: First Union's latest deal haunted by mergers past; Suits question bank's roll-up of some funds

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BODY:

First Union Corp. can't seem to shake off the ghosts of acquisitions past.

A lawsuit against the Charlotte, N.C., bank is moving forward, arising from its purchases of Signet Banking Corp. of Richmond, Va., in 1997 and CoreStates Financial Corp. of Philadelphia in 1998.

The suit, which was granted class-action status by a Pennsylvania court May 8, alleges that investors in six former CoreStates and three former Signet common-trust funds suffered unnecessary capital gains because of the way the funds were rolled into First Union's Evergreen Funds.

It was not the conversion of the common-trust funds that led to the high taxable gains, the suit claims, but rather the sale of stock in anticipation of the funds' conversion.

A lawyer representing First Union had no comment, but one fund lawyer suggests that the investors' suit will be difficult to win.

Pamela Wilson of Hale & Dorr in Boston says, "It's implicit in a managed account that portfolio managers will buy or sell stocks." The investors will have to overcome that built-in expectation, she adds.

The lawsuit comes at a bad time for First Union, which wants to buy Wachovia Corp. in Winston-Salem, N.C. First Union is fighting a hostile bid for Wachovia from SunTrust Banks Inc. in Atlanta.

Mutual fund investors have a stake in the sale because if Wachovia goes to First Union, Wachovia's $9 billion fund family will likely be merged into the $83 billion Evergreen Funds.

Industry experts, however, say they would be surprised if First Union were to repeat the mistakes they are accused of having made in the cases that led to the latest lawsuit and other similar suits that already have been settled.

Earlier this year, two class actions accusing First Union of mismanaging employee's retirement funds were settled for $26 million in the U.S. District Court for the Eastern District of Virginia. The suit alleged that First Union forced its employees into the Evergreen Funds.

Eli Gottesdiener, one of the lawyers who represented the employees, says those cases and the lawsuit First Union faces now involve many of the same issues.

"It's very similar in tenor and tone because it's essentially accusing First Union of violating their fiduciary duties by putting people into its own mutual funds for it to earn additional income when that was not in the best interests of these folks," Mr. Gottesdiener says.

Tax Fiasco

The latest class action was originally brought by Robert Parsky and Ann Roantree, investors in the CoreStates Growth and Equity Trust, which was merged into Evergreen on July 9, 1999.

Mr. Parsky and Ms. Roantree claim that the merger of funds caused them to incur $107,734.48 in gains, including $65,000 in short-term capital gains. Considering that 8,000 or so investors are now eligible to participate in the action, the damages facing First Union loom large.

Allen Black, a lawyer for Mr. Parsky and Ms. Roantree, says that First Union could have avoided gains altogether if it had approached the merger of the common-trust funds with the Evergreen Funds differently.

Evergreen portfolio managers, however, guaranteed large taxable gains when they liquidated much of the stock in the common-trust funds, either to make them mesh better with whatever Evergreen fund they were being merged with or because they just didn't like the stock, Mr. Black says.

Such moves were particularly troublesome, he says, given the letters that First Union sent investors in the common-trust funds in 1999 saying that there would be no tax impact as a result of the conversion.

broken promise?

"First Union carried out these conversions in such a way that resulted in very substantial taxable gains even though they promised the investors there would be no tax consequences," Mr. Black says.

Adding insult to injury, First Union failed to notify investors about the gains until it was too late for them to do anything about it, Mr. Black says.

"First Union didn't tell anybody that capital gains of this magnitude were coming until they sent out their year-end statements in February 2000, so it was too late to do anything," he says.

Mr. Black says he is leery of drawing parallels between the pending suit and the two cases that were settled earlier this year.