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**HEADLINE:** Plan Mergers Spark Employee Unrest

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**HIGHLIGHT:**
When firms merge, it is important to determine the potential legal problems that may arise if retirement plans are merged, as seen with the problems First Union and SBC Communications

**BODY:**

When new employers force changes, class-action lawsuits can follow.

By Laure Edwards

Before you do the merger, calculate the consequences of merging the retirement plans.

That's the lesson that First Union Corp. continues to learn as it defends itself against a pair of suits flied on behalf of some 100,000 current and former participants in its 40 l(k) plan. The plaintiffs, who worked for Signet Bank Corp. before it was purchased by First Union, allege that they are owed $300 million because First Union liquidated some of their old 401(k) holdings and invested the cash in its proprietary mutual funds. Those funds have generally performed poorly in comparison with other mutual funds.

The plaintiffs also have argued that First Union's asset management arm charged them higher fees and expenses to service their accounts than it did outside clients.

A federal district court last February 17 threw out several of the participants' claims regarding plan adoption, termination and vesting procedures. However, the case is far from over. The court let stand the critical question for employers of whether First Union acted in its own interests and against those of employees in making its liquidation and investment decisions.

Plaintiffs' lawyers are now seeking what they claim are "smoking gun" documents that First Union once showed them and then withdrew. Whatever the merits of their arguments~and several lawyers and retirement plan specialists say it is too early to assess them~the case is being closely watched.

SBC Takes Center Stage

Now it's SBC Communications' turn in the retirement plan hot seat.

In a complaint filed in late April, 18 former employees allege that the San Antonio, Tex.-based Baby Bell violated its fiduciary duties to them after it purchased Pacific Telesis Group, their former employer. The crux of their complaint? SBC converted some of their retirement plan holdings to its own stock

following the 1997 merger. The plaintiffs say the transfer cost them about $1.15 billion and violated provisions of the federal Employee Retirement Income Security Act (ERISA).

SBC does not deny that it liquidated about $650 million worth of shares in AirTouch Communications, a competing wireless telecommunications company. Few companies allow their employees to hold individual stocks of outside companies in their retirement portfolios (excluding stock shares held in mutual funds). PacTel made an exception because it had spun off AirTouch into an independent company in 1994, and shares were distributed at the time to the employees.

photo omitted

Unfortunately for SBC, not to mention the former PacTel employees, the trade was disastrous.

Shortly after SBC liquidated the positions, AirTouch became the target of a bidding war between Vodafone, the British telecom giant, and Bell Atlantic. The former PacTel employees, who are seeking class-action status in federal district court in Los Angeles, could only sit and watch as AirTouch shares climbed 300% throughout most of 1998 en route to the creation of Vodafone AirTouch in June 1999.

Meanwhile, the stakes are growing higher for SBC. About 40,000 people could be consolidated into the suit if class-action status is granted, says Janet Brown, a partner at Sigman, Lewis & Feinberg, an Oakland, Calif, law firm that is representing some of the plaintiffs.

Although the specifics of the case are interesting, the broader issues surrounding sponsors' fiduciary activities are what interest the broad corporate community. The suit highlights how critical it is for potential acquirers to conduct careful due diligence of 401(k) plans in advance of a deal, experts say. And it again focuses attention on the rigorous fiduciary responsibilities set for companies under terms of ERISA.

ERISA Arguments

Indeed, the employee suit alleges that when SBC sold the AirTouch shares, it violated ERISA in two key areas.

First, it claims that the Texas company administered the plan for its own gains, violating the law's mandate that employers manage retirement plans for the sole benefit of the employees.

Second, plaintiffs' lawyers initially focused some of their argument on the manner in which the transaction occurred, arguing that SBC had not properly communicated its plan to employees in violation of ERISA. They said that the regional phone company failed to give the new employees clear and timely notice of the plan and the alternatives available to them.

"SBC didn't tell the employees abut their options, and in some instances gave them the runaround when they inquired about possibilities," asserts Eli Gottesdiener, a partner at Sprenger & Lang in Washington, D.C., which is representing some of the plaintiffs. (His firm also worked with many of the First Union litigants.)

The actual sale of the AirTouch shares does not in itself appear to be a violation because the sale "wouldn't directly benefit SBC," says Martin Ween, a partner at the law firm Wilson, Elser, Moskowitz, Edelman & Dicker in New York.

Self-interest Debate

SBC is expected to address the self-interest charge by showing that its exchange of shares followed procedures spelled out in its written 401(k) guidelines. One of its biggest defense challenges, however, may be countering the self-interest charge, given that AirTouch was an acknowledged competitor to SBC in the wireless telecommunications markets.

Gottesdiener says that he expects to enter as evidence a document in which a key SBC 401(k) official admitted that SBC made the trade for competitive reasons. Not only did the company want the benefit of having its new employees feeling "really invested in the company so they'll work hard, but SBC wanted to see its stock price increase," alleges Gottesdiener.

An SBC spokesman said company officials would not comment on the complaints.

Get the Distribution

Experts disagree as to whether employees of a company that is being acquired can take a 401(k) distribution without penalty and roll them over into an IRA.

David L. Wray, the president of Profit Sharing/401(k) Council of America, says that the cases where a distribution can be taken are circumscribed by the particularity of each situation. But he adds that employees who know they are going to be laid off in a merger should almost certainly try to arrange such a transfer.

About 7,000 PacTel employees were laid off, but did not get their AirTouch stock, says Eli Gottesdiener, a partner at Sprenger & Lang in Washington, D.C., which is representing some of the plaintiffs in the retirement plan suit.

Other than termination, however, EPJSA law and the IRS 401(K)(2)(b)(i) section "have very specific events as to when you can get a distribution from a plan," notes Paul Lang, a partner at Dow Lohnes & Albertson in Washington. DC.

In the SBC case, the only circumstance that could have triggered a distribution would have been if the deal included "a termination of the plan [without a] successor plan," Lang says. Even then the plan for the distribution would have had to be in place before the merger occurred. Moreover, distributions would occur only for fully vested participants.

If distributions are allowed, they could have major impact for the merging companies. The new company is likely to object if employees withdraw retirement assets since it gives them less reason to show loyalty. Some M&A deals have been known to founder over this and similar issues, experts say.

Stock Options and Mergers

Retirement plan investments aren't the only employee benefits that can be affected by mergers and spinoffs. There's also unexercised stock options.

More than 1,000 former employees of Qualcomm Inc. joined a class-action suit filed in May 1999 after the infrastructure division where they worked was sold to Swedishbased Ericsson last year. (The deal was part of an agreement to end a patent dispute between the two telecommunications companies.) Qualcomm's stock had risen 2,600% after the Ericsson deal.

The plaintiffs alleged that the switch to Ericsson deprived them of millions of dollars of vested stock options. Qualcomm had promised to restore some of the unvested options to workers who signed waivers, but many rejected the offer and sued.

Earlier this year, the litigants tentatively accepted an $8.9 million settlement from Qualcomm. (The settlement also called for the plaintiffs' lawyers to share about $2.7 million.) However, disputes among the workers over allocations of the award scuttled the settlement offer, according to wire-service reports. The deal was rejected at the end of April because too few employees opted to take Qualcomm's offer. Sixteen workers wrote to a Span Diego County Judge to protest the deal, and Qualcomm said many other also had opted out.

The settlement would have granted 35 workers about $5 million, or more than $100,000 each. Other would have received about $1,000 on average. Some workers who signed the waiver have claimed that Qualcomm chairman and chief executive lrwin Mark Jacobs promised them at least as much money as those who challenged the company in court.

"The nonsigners thought the signers were getting too much," said Superior Court Judge John S. Meyer, according to the Associated Press. "The signers thought the nonsigners were getting too much, and everyone thought the lawyers were getting too much."

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