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Companies quietly use mergers, spinoffs to cut worker benefits

Companies still scrounge for ways to reduce pension benefits

By **Ellen E. Schultz**
THE WALL STREET JOURNAL

Dec. 27 — General Electric Co. got more out of the sale of its aerospace unit seven years ago than the publicized purchase price of \$3 billion. The company also extricated itself from certain pension benefits it owed to transferred workers such as Vernon Wagner, a veteran missile-plant employee in Utica, N.Y. Today, GE is thriving and has a hugely overfunded pension plan.

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Mr. Wagner and his wife, Pauline, lost \$23,000 in severance money and thousands more in pension payments. Now, they skip seeing the dentist and are just scraping by.

GE is just one of many major companies that have cut employee benefits in connection with mergers and other deals. Mergers often lead to more visible forms of pain for employees, such as layoffs and plant closings. But when it comes to benefit cuts,

workers and retirees often don't even realize they are happening because the language of pension and medical plans can be arcane and some companies tend to shroud benefit reductions in euphemism.

Among the other large corporations that in recent years have trimmed benefits in connection with mergers, sales of units or other deals are: Monsanto Co., Merck & Co., SmithKline Beecham PLC and Chiquita Brands International Inc.

Companies use a range of methods for shrinking benefits. Some try to make units more attractive for sale by cutting employee medical-coverage liability. Others convert a pension plan to one that's less generous. Yet other corporations retain the pension plan for a unit being sold — which allows them to continue to invest the pension assets — but at the same time freeze the pension rights of the transferred employees.

Some corporate deals include the transfer of a sizable pension-plan surplus, an amount over and above what is needed to fulfill obligations to retirees. You might assume that where there are surpluses, current and retired workers could expect their benefits to remain secure.

But in an ironic twist, companies involved in such pension-surplus transactions sometimes still scrounge for ways to reduce pension benefits. The reason for this is that under the tutelage of outside lawyers and consultants, companies have come to view pension surpluses as assets that, in effect, can be bought and sold at the time of a merger, sale or acquisition. Companies' ability to cash in their surpluses — a maneuver that Congress sought to deter in the past — provides a powerful incentive to pump up surplus levels by slashing benefits.


CLASHES OVER AN AEROSPACE DEAL

Consider the benefit disputes related to General Electric's 1993 sale of its aerospace unit — clashes that still linger in federal courts in New York and Washington, D.C.


GE sold the unit to fellow defense contractor Martin Marietta Corp. As part of the deal, GE transferred \$1.2 billion in pension assets to Martin Marietta to cover the liabilities for 30,000 employees who were transferred. The companies didn't specify what portion of the pension assets constituted a surplus. But in subsequent litigation against GE concerning the pension plan, the federal government estimated the overfunded portion at \$531 million.


The existence of such a large surplus didn't mean,

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however, that transplanted workers such as Mr. Wagner saw their pension rights bolstered. To the contrary, when GE transferred the pension plan, it sharply curtailed workers' eligibility for an early-retirement subsidy that can be worth as much as hundreds of dollars a month to employees who retire in their 50s. Actuaries estimate that truncating this kind of benefit typically saves an employer 20% of its overall pension expenditures for a given pool of workers — perhaps tens of millions of dollars, in GE's case.

Normally, early-retirement subsidies are protected by federal pension law. But the law allows companies to strip away such benefits from workers transferred in connection with a sale. Rather than remaining eligible for the benefit, the former GE workers retained eligibility for only about a year after the unit sale, and then the subsidy was ended.

The GE transaction cost Mr. Wagner and other transplanted workers in another way: They lost their rights to severance pay built up over the years of their GE service.

Before being transferred to Martin Marietta, Mr. Wagner, who is 58 years old, worked for GE for 22 years, most recently as a quality inspector at a radar and missile plant in Utica. Two years after that move, in 1995, Martin Marietta merged with Lockheed Corp. The new Lockheed Martin Corp. then shut Mr. Wagner's plant, costing him his \$18 hourly paycheck. His now-lost GE severance, based on his long service, would have paid him a lump sum of \$32,000. Lockheed Martin, by contrast, gave him only \$8,900.

In addition, because he was no longer in the GE pension plan, he lost his ability to draw his pension immediately. Lockheed Martin's less-generous rules required him to wait 21 months, until he turned 55. At that time, he began collecting \$1,090 a month.

For months after the 1996 plant closure, Mr. Wagner says, he looked for new work in the depressed Utica area, sending out 130 resumes. He got no offers. Mr. Wagner supports his disabled wife, Pauline, who has diabetes and can't hold a job. When his severance pay and government unemployment compensation ran out six months later, he began dipping into his only other significant asset: \$53,000 from his GE 401(k) plan, which he had rolled into an Individual Retirement Account. Because he hadn't yet turned 59 1/2, he had to pay 10% federal tax penalties on the IRA withdrawals. By August 1997, when he finally found a new job, the account had shrunk to \$11,000.

He went to work for a local bank, serving home-

foreclosure notices, a task that became even more grim when he was told to repossess his own son's home. Mr. Wagner says he passed that assignment to a colleague. Last year, he quit the bank and took a nursing-home maintenance job that now pays \$7.87 an hour, with no benefits.

The Wagners are struggling to make ends meet. They have health coverage from Martin Marietta that pays for some of Mrs. Wagner's diabetes medication, but they don't have any dental benefits. Besides not seeing a dentist for years, Mrs. Wagner has cut back on her hobby of crocheting to save money on yarn. To help them reduce their grocery shopping, their 33-year-old son, Paul, supplements their larder by hunting deer and turkey.

Thanks in part to its nimble shedding of employee-benefit liabilities and retention of pension-surplus assets, GE, based in Fairfield, Conn., last year reported no net expenses for pension, medical and life insurance for its 193,000 retirees and beneficiaries. Even before its recently announced plan to acquire Honeywell International Inc., which had its own overfunded pension plan, GE had a \$25 billion surplus in its plan in 1999. That surplus helped the pension plan contribute \$1.3 billion to operating income, which accounted for 9% of that income. (Employers by law have to keep surpluses in pension plans. But the ability to enjoy these kinds of balance-sheet boosts is one reason companies try to pump up surpluses and trim benefits.)

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Mr. Wagner says he understands that companies aim to make profits, but he perceives "a loophole in the system, where they can merge

together and benefit, but ruin people's lives."

He wasn't the only ex-GE employee frustrated by the Martin Marietta deal. A group of former GE workers, claiming to represent thousands of others like them, filed a class-action suit against the company in federal court in New Haven, Conn., in 1993. The suit alleged that as part of the Martin Marietta deal, GE had improperly sold a portion of its pension-plan surplus, killed the early-retirement benefit, and failed to make required disclosures about changes in benefits before the sale.

In a series of rulings issued from 1996 through this March, U.S. District Judge Janet Bond Arterton dismissed the entire suit. She concluded that GE's

only legal obligation was to transfer adequate pension assets to cover the former workers. Since it had, the employees lacked any legal claim related to the surplus or the early-retirement benefit, the judge said. The employees have appealed, and the case is pending before the federal appeals court in New York.

A GE spokesman says in an interview that the company preserved all benefits to which employees were entitled. "We do work on transition arrangements [for employees] to provide continuity for a period of time," the spokesman adds, but he declines to comment further.

GE's surplus transfer provoked a separate legal attack by the U.S. government. In an administrative complaint last year, the Defense Department and various other federal agencies argued that since they had funded GE's pension plan in connection with government contracts, any surplus should go to the government. The U.S. valued the surplus at \$531 million and demanded \$419 million in interest, as well.

GE rebuffed the government and sued it in the U.S. Court of Federal Claims in Washington. GE alleged that the government owed the company hundreds of millions of dollars for retirement benefits for aerospace workers that weren't transferred to Martin Marietta. The dispute is pending.

A LEGAL GRAY ZONE

Until the late 1980s, companies that wanted to grab surplus pension assets usually terminated their pension plans to siphon them off. To stop such terminations, Congress approved an excise tax on surplus assets that became effective in 1990 and made these maneuvers much less lucrative. Since then, however, corporate attorneys and benefits consultants have invented ways for companies to get around the tax and "unlock" pension-surplus value, usually by means of restructurings.

Most companies keep this kind of arrangement out of the limelight because it falls into a legal gray area. Max Schwartz, a partner with the New York corporate law firm Sullivan & Cromwell, advised an audience of corporate actuaries in Colorado Springs, Colo., in 1996, "The one thing to stay away from, if you're dealing with a surplus-asset transfer" is "build [ing] into the purchase documents a mechanical formula under which the purchase price is mathematically adjusted, based on the amount of the pension surplus transferred."

In other words, if



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you're selling a surplus, don't put the price in writing. The attorney told his audience that buyers typically pay 50 cents to 80 cents on the dollar for surplus assets. In an interview, Mr.

Schwartz, whose law firm has a large mergers-and-acquisitions practice, says his earlier remarks were aimed at explaining that if a surplus were explicitly valued as part of a corporate deal, the Internal Revenue Service might regard the transaction as triggering the excise tax.

In a promotional letter last year, Financial Frontiers Corp., a merchant bank in Los Angeles, exhorted potential corporate clients to "turn pension surplus into cash." The firm said in the letter that it can structure transactions enabling clients to capture as much as 70% of the value of their surplus. Thomas Lawson, a principal of Financial Frontiers, says his company merely acts as a "matchmaker," proposing transfers of overfunded plans to companies with underfunded plans.

CHIQUITA KILLS MEDICAL BENEFITS

Companies also cut benefits in conjunction with transactions where pension surpluses aren't in play. When selling a unit, for example, corporations have an incentive to reduce that unit's liabilities for medical benefits.

In late 1992, Chiquita announced its intention to sell its Morrell Co. meat-packing unit. Earlier that year, as a prelude to the sale, Chiquita filed a legal action in federal court in Sioux Falls, S.D., seeking a judicial order that it had a legal right to cut the medical benefits of Morrell's 3,300 retirees. This sort of "declaratory-judgment" suit, meant to insulate a corporate act from future legal attack, is a common tactic.

In 1994, the court ruled that Chiquita could reduce the retiree benefits. In February 1995, the company eliminated the benefits altogether. Eight months later, Smithfield Foods Inc. bought the meat-packing unit — now free of retiree-medical liability — for \$58 million.

Chiquita said in court filings that the retiree liability had amounted to about \$12 million a year but was diminishing because beneficiaries were dying off

at a rate of 200 a year. Two people familiar with the Chiquita-Smithfield deal say that Chiquita's willingness to strip the meat-packing unit of this liability made the sale far more attractive to Smithfield. A Chiquita spokesman declines to comment about how the benefit cut affected retirees.

A group of the retired meat-packers, along with wives and widows, meet for lunch each month in a Sioux Falls, S.D., restaurant. Now mostly in their 70s and 80s, the retirees eat meatloaf, fried chicken and pickled-bean salad as they trade stories about getting by without their benefits.



Lorraine Jastram

Lorraine Jastram, 74, says she pays \$600 a month for medications for asthma, high blood pressure, arthritis and a bowel disorder. Unable to afford her rent on her widow's pension of \$159 a month, she says she had to move this year into government-subsidized senior housing. "It took me weeks to work up the nerve to go into the assistance program," she says. "I don't think of myself that way."

Formerly a paying patron of the local community playhouse, she now volunteers so she can get in free. Otherwise, she says, "I just plain don't go to things."



George Iwerks

George Iwerks, 85, started with Morrell in 1936 and retired in 1979 with a monthly pension of \$505. The retirees have never received cost-of-living increases in their pensions. Every cent in recent years went to pay for Alzheimer's medications and supplies for his 82-year-old wife, Esther, Mr. Iwerks says. She died Dec. 8.

If his company medical coverage had remained in place, he could have afforded a home attendant to help in the evenings, Mr. Iwerks says. Medicare paid for a helper in the mornings. "I told my minister, 'I'm not sad. Esther and I will be together soon,'" he adds.

KEEP THE PLAN, FREEZE THE BENEFITS

Sometimes, when a company sells a division, it retains the pension assets, but that's not necessarily good news for workers.

In 1995, Merck sold its Kelco kelp-products unit

to Monsanto for \$1.07 billion. Merck, based in Whitehouse Station, N.J., kept the pension plan for the roughly 1,000 transferred workers. But the company froze those employees' already-earned pension benefits — a significant loss to longtime employees, such as Jerry Lucas.



The 50-year-old chemical engineer kept working at the same desk in San Diego after the division sale. But the \$1,785 a month that, as of 1995, he was qualified to receive when he turns 65, stopped growing. At Monsanto, which had a less-generous pension plan, he didn't build any additional benefits for his first two years. "There was absolutely nothing I could do about it but quit," he says. He didn't, for fear that at his age, he wouldn't find a decent replacement job.

In 1999, Mr. Lucas's division was sold again, this time to ISP International Inc., for an undisclosed amount. Mr. Lucas and other transferred workers lost their rights to pension or severance benefits from the Monsanto plan, lowering that company's liability. ISP doesn't offer a pension but does contribute a percentage of salary to a 401(k) retirement plan.

The bottom line for Mr. Lucas: If Merck had maintained him as an active plan participant, he estimates that by now he would have earned rights to a monthly pension of about \$2,100 — and he could begin drawing that amount in five years, at age 55. Under the Merck plan, he would have received substantially more if he waited until age 65.

But as things stand, he has to wait 15 years, until he turns 65, to draw the frozen amount of \$1,785 a month. If he begins receiving the pension before 65, he would get even less than \$1,785. As a result, he says, he is spending more of his free time researching savings and investing options.

Merck, for its part, has been able to continue investing the pension assets of Mr. Lucas and other transferred worker, while the pension freeze has reduced the company's future expenses. Spokespeople for Merck, Monsanto and ISP decline to comment.

SPINNING OFF LIABILITIES

In other instances, companies find ways to profit from spinning off benefit liabilities along with a part of their business.

In 1997, Monsanto, based in St. Louis, spun off its Solutia Inc. chemicals unit, along with most of the unit's retirees. By shifting medical liability for the 16,000 former workers to the new company, Monsanto reduced its own accumulated health

liability to \$383 million in 1998, from \$1.2 billion in 1997.

Solutia initially assumed the liability but didn't keep it for long. In 1998, the new company sent letters to the Monsanto retirees, announcing that henceforth, they would be responsible for a greater share of medical costs. The cut reduced Solutia's accumulated retiree-medical liability by \$161 million.

In 1998, Solutia filed a declaratory-judgment action in federal court in Pensacola, Fla., seeking judicial approval for the benefit decrease. That suit is pending. Spokespeople for Solutia and Monsanto confirm this information but decline further comment.

A SUBTLE CONVERSION



Randy Kiene

Rather than kill benefits outright, companies sometimes subtly alter them to reduce liabilities prior to selling a business unit. Randy Kiene, 47, has endured a variation on this theme.

Mr. Kiene was a national sales manager for SmithKline Beecham, Philadelphia, until August 1999, when his Clinical Laboratories unit, with 10,600 employees, was sold to Quest Diagnostics Inc. for \$1.3 billion. Just four months before the sale, SmithKline had converted its pension to a "cash balance" plan, which had the effect of reducing Mr. Kiene's pension.

The cash-balance approach generally shrinks payouts owed to more-senior workers like Mr. Kiene, a 15-year veteran at SmithKline. Years of service disappear as an important factor, and the employer calculates pensions based on a modest percentage of a worker's salary.

Because of his seniority at SmithKline, Mr. Kiene qualified for a special subsidy to be paid over seven years and designed to restore some of his loss under the new cash-balance plan. If the company hadn't sold his unit, it would have been required by law to pay the full amount of the subsidy to departing workers. But, as was the case with GE, federal pension law allowed companies in SmithKline's position to drop such subsidies in connection with the sale of a unit. SmithKline kept the subsidy for Mr. Kiene and other transplanted employees for only 16 months and then ended it — a loss of thousands of dollars each for workers like Mr. Kiene.

SmithKline confirms this information, but a spokesman declines further comment.

Mr. Kiene's cash-balance "account," which remains in SmithKline's overfunded pension plan, is currently worth about \$110,000 as a lump sum and will grow at about 6% a year. But he can't touch this money until he turns 65. Quest, his new employer, doesn't have a pension plan but does offer a 401(k).

Mr. Kiene has other work-related worries these days. He was laid off a week before Thanksgiving this year — 15 months into his Quest employment. Quest is continuing his salary of \$108,000 a year for 40 weeks as a severance benefit. Mr. Kiene, who is married and has twin 3 1/2-year-old sons, hasn't found a new job yet.

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