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CUTTING BENEFITS? OFFER STOCK

There has been an awful lot of handwringing lately, and rightly so, as old-line companies cut retiree health benefits.

Sorry, the companies say. We just can't afford to subsidize health coverage as much as we did on the day when you took that gold watch and called it a career. If we don't cut back a little bit everywhere, we'll go under and everyone will lose.

Dirty pool, the retirees retort. You made a bargain back when we were building up the franchise. It's immoral to break that vow now, when there's nothing we can do in response.

We have a logjam. It will get worse as long as we have the lethal combination of rising health care costs and executives who will do anything to add pennies to per-share income.

Retirees -- once corporate America's most loyal constituency -- are angrily pushing for a federal law to lock in the benefits forever. That idea has big problems.

There is a better solution for the large, publicly traded companies doing most of the cutting. It's a simple compromise that neither side particularly likes.

But it works.

Companies taking away health care subsidies can, and should, issue shares of stock to compensate retirees for the lost value of the benefits. Here's how it would work, and why:

When a company cuts retiree benefits, it saves money on yearly costs. The savings boosts income from operations, which is the main thing Wall Street wants to see. The CEO keeps his job, his bonus and his options package. More on that in a minute.

The company also reports a one-time accounting gain, equal to the amount it would have to keep in reserve to pay the benefit far into the future. The gain

makes sense; now the company will not pay the benefit, so it can, and does, wipe out a long-term liability. Thus the one-time gain.

An example illustrates how the stock award would work. Aetna Inc. said last winter it would eliminate its dental coverage subsidy for about 11,600 retirees who now have that benefit. The company will save $3 million a year, at a cost of ill-will by many of those former employees.

Last Sunday, I looked at the problem through the eyes of John Dwyer, chairman of the newly formed Aetna Retirees Association and a former top executive there. He's rightly upset at what he says is a promise broken.

Sticking with Aetna as an example -- and there are many companies in this group -- the corporation booked a $32 million gain in the first quarter of this year, when it shed the retiree dental subsidy burden.

Aetna could now issue stock worth that amount, $32 million, to the retirees on Jan. 1, 2005 -- the day the benefit vanishes.

Yes, Aetna would have to book the stock issue as an expense. But the result would be a dead-even wash on the balance sheet. By eliminating a long-term obligation and issuing stock, Aetna would simply swap a $32 million liability for equity.

Retirees will lose a benefit worth, typically, $300 to $400 a year. They each would gain stock worth $2,759, on average -- $32 million divided by 11,600 retirees. Yes, the stock would be taxable, and it would cost them money to sell.

A document saying you own a piece of Aetna is of little immediate value if you're an 82-year-old retired secretary in need of some bridge work, and your total income from Social Security, pension and individual savings plans amounts to $22,000 a year. Still, in exchange for losing dental-benefit subsidies it's better than the goose egg you're going to get as it stands now.

Aetna would still maintain its $3 million annual savings in operations. The value of the company's shares would be watered down, of course, but by less than one-fifth of 1 percent of Aetna's $15.3 billion total market value.

That is only fair; after all, taking away benefits from retirees amounts to a transfer of wealth from them to company shareholders.

Numerous retiree advocates, corporate auditors, accountants and benefits experts said the idea has never been put into practice at a large American company, but may have merit.

"I'd run it up the flagpole and see if anyone salutes," said Dallas Salisbury, founder and president of the Employee Benefits Research Institute, a Washington, D.C.-based group that promotes commentary on the topic but doesn't take sides.

"From a technician's standpoint, it works," said University of Connecticut accounting professor Larry Gramling, a former president of the Connecticut Society of Certified Public Accountants.

Trading debt for equity, he points out, is not uncommon for companies, especially when cash flow is tight, whether they are start-ups or established firms in distress, or just looking to rebalance their balance sheets.

Aetna did not have a comment on the likelihood of its adopting a stock swap, other than to point out that distributed shares must be booked as an expense. Likewise, a spokeswoman at the American Benefits Council, which represents Fortune 500 companies, said only that they've never seen the idea.

On first impression, A.J. Norby, president of the National Retirees Legislative Network, was not thrilled with the idea.

"I would take that deal as opposed to nothing," said Norby, 76, who was marketing director at Northwestern Bell, and is now a Qwest retiree.

One problem, he and others said, is that probable sharp increases in the cost of medical coverage make a one-time payment in stock a dicey proposition. Add to that the unpredictability of stock in any one company, and it's a risk people in the golden years would rather not have to take.

Lucent, for example, the troubled maker of telecom equipment, has cut hundreds of millions of dollars in retiree benefits. Its shares, unlike those at high-flying Aetna, remain depressed -- which leaves many retirees in no mood to take them as a fair trade for thousands of dollars in annual costs.

I'd suggest the tradeoff as a last resort, a fair solution only after a company backs away from implied promises it made to workers when they retired. What would happen if companies adopted it wholesale, and issued vast caches of shares as they exited annual health subsidies? Mayhem, in some places.

C. William Jones, executive director and president of the Association of BellTel Retirees Inc., represents 100,000 people covered by Verizon, which he said has "nibbled away" at benefits. His group is behind a proposal in Congress to amend the Employee Retirement Income Security Act, ERISA, to cover health benefits.

Jones said he would not add a stock-swap provision to the bill. But he said, "It's something that might be interesting to bounce around."

Some experts suggested a stock swap for benefits would spawn all sorts of administrative headaches. Companies, of course, don't like to dilute their stock, but, sticking with Aetna as a typical example, it's worth noting that the dental plan would require 320,000 shares -- almost exactly the number CEO Jack Rowe has averaged in options over the last three years.

Among the Aetna retirees, Bob Quinn, vice president of the group, said, "On the dental, it may have some merit, certainly worth consideration. I wouldn't necessarily want to put it in play as a precedent for other types of benefits."

Dwyer, the Aetna retirees chairman, would not comment on the stock swap idea, saying instead, "They've made a promise, and they're not keeping it. ... There hasn't been any overture, or any effort to engage in a dialogue."

That's the point. We're at the leading edge of a crisis, part of a broader, national calamity in health care. This stock swap plan should be one of many ideas that spark action.

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