Flying On Empty?

Airlines, Pensions, and Disappointments

By Professor Nancy S. Abramowitz

Since its deregulation in 1978, the airline industry has provided our bankruptcy courts with a fair amount of business. United Airlines (UAL) has continued operating in bankruptcy since initially filing for chapter 11 protection in December 2002. US Airways is a repeat player having reentered bankruptcy this year - shortly following its emergence from an earlier bankruptcy two years ago. At the time of this article, having just announced a recent agreement with its pilots union for labor cost savings, Delta seems uncertain about whether or not it has narrowly escaped a threatened filing. Other "legacy" carriers, as opposed to the newer, barebones, low-cost carriers, have dissolved in bankruptcy, been absorbed by others in bankruptcy, or merely flirted off and on with bankruptcy as the industry struggles with its new highly price-competitive identity.[1]

The old guard domestic airline industry, like the domestic steel industry, has often struggled under the weight of labor costs – especially enormous pension obligations. The bankruptcy forum has become the vehicle with which employers may shed these obligations and move forward in reorganized, leaner form. The weighty pension obligations arise from bargaining table promises (often made as "IOUs" in lieu of cash wages) to provide retirement plans that offer workers defined benefit pension annuities at retirement. Until the passage of the Employee Retirement Income Security Act of 1974 (ERISA), such plans with their promises of future benefits were under lightly regulated and certainly were not subject to requirements that employers set aside funds to cover the benefits promised to employees.

ERISA first imposed certain minimum funding standards on employer promises of this type, although the legal obligation did not involve playing a quick "catch-up" for outstanding obligations nor the immediate funding of new promises for prior years' work. ERISA also created a federal insurance program through the Pension Benefit Guaranty Corporation (PBGC) to insure some portion of promised benefits in the event of a plan termination where the plan assets are unable to satisfy the promised benefits. The PBGC's assets used for the payment of guaranteed benefits are derived from several sources: first, the PBGC collects insurance premiums from sponsors of insured plans; second, the PBGC succeeds to both the assets *and* liabilities of terminated plans insufficient to cover promised benefits; and, third, in the case of bankrupt employers with terminated plans, the PBGC stands as creditor generally with a host of claims in its own right and as a successor to the plan entity.

The history of PBGC's financial health might be described as a roller coaster. After some major corporate defaults in the PBGC's formative years, it was in critical negative territory. After some legislative tinkering with the insurance program and changes in the economic climate, PBGC moved unmistakably to an estimated $9 billion profit several years ago. But fortunes and circumstances changed. With reduced interest rates, a softer stock market, and a new swell of corporate bankruptcies giving rise to large plan terminations, the PBGC is back in the negative column. Because the PBGC's deficit or surplus is measured on a present valuation of assets and liabilities, the present deficit does not suggest the PBGC is unable to meet its pay as you go liabilities for insured benefits on a current or near-future basis. But, given the cur-

rent deficit and the specter of possible terminations of covered plans maintained by UAL, US Air, and Delta, the Executive Director of the PBGC has recently advised Congress:

> Considerable attention has been - and must be - paid to the PBGC's financial position. The Corporation's single-employer insurance fund had a record deficit at the end of the 2003 fiscal year of $11.2 billion, and we will be reporting a significantly increased deficit for the 2004 fiscal year. As you know, United Airlines has said publicly that it will not make any further contributions to its pension plans during bankruptcy and that it "likely" will have to terminate them. Those plans are now underfunded by an estimated $8.3 billion on a termination basis, $6.4 billion of which is guaranteed by the PBGC.
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> Likewise, US Airways, which recently re-entered bankruptcy, announced that it is suspending contributions to pension plans that are already underfunded by an estimated $2.3 billion on a termination basis, almost all of which - $2.1 billion - would be guaranteed by the PBGC. In addition, Delta has publicly indicated that the company may have to file under Chapter 11 in the near future. We estimate that the total exposure of plan participants and the pension insurance program to the airline industry was $31 billion on a termination basis as of the end of 2003.[2]

The PBGC's prior experience with the airline industry included terminations of plans maintained by Pan Am, Eastern, and TWA, whose plans were funded merely 31 percent, 65 percent, and 39 percent respectively, at termination. Based upon past experience and the prospect of imminent plan terminations, the PBGC has made – and continues to make – its case before Congress about shoring up the system. Specifically, the PBGC has requested stronger funding standards, a more rational and risk-based premium system, better information on participating employers' financial health, and more and better options for the PBGC when a corporate plan sponsor is in bankruptcy.[3]

Especially irksome to the PBGC is the deliberate and announced policy of bankrupt debtors defaulting on funding obligations without terminating plans. UAL recently announced that it would not meet its required annual funding obligations of some $500 million this year for its defined benefit plans. US Air, for the defined benefit plans it still maintains, followed suit announcing it would not be making $100 million in contributions this year because such payments would not benefit the bankrupt estate. In so doing, the airlines are extending a warm invitation to the PBGC to exercise its statutory authority to terminate the plans, and step in and take over - without the employers having to face unions and employees by taking the termination step on their own.

US Air took the issue head on and minced no words when it announced in its bankruptcy filing that it would be "irrational" to make its required pension contributions as the payments furnish no added value to the debtor's estate.[4] PBGC Executive Director Bradley Belt called the US Air

statement "remarkable," adding "[t]he company is saying it's irrational to keep your pension promises and to comply with federal pension law. Bankruptcy should not be the path of least resistance to deal with your pension obligations."[5]

Given the interplay of plan funding status, the differential between promised and guaranteed benefits, and the operation of current bankruptcy law, the airlines' position is not so remarkable. Bold headlines about the default suggest that employees stand to lose. The reality may be that the participating employees have already lost. To the extent funded benefits are not only below the promised level but also below the PBGC guaranteed level, the additional contributions to a plan that will assuredly be terminated may provide no added benefit to participant-employees. From the debtor's perspec-

tive, there is no incentive to make payments to the plan. Broadly speaking, the PBGC benefit guarantees are determined without regard to the plan's funding status. Accordingly, United and US Air are simply observing that additional funding contributions will only provide PBGC additional assets with which it must pay fixed benefits in any event. The additional plan contributions are unlikely to improve benefit payments over these guaranteed levels.

While pension law requires periodic contributions despite the pendency of bankruptcy proceedings, the bankrupt company, operating as a debtor-in-possession on behalf of the bankrupt estate, might conclude the additional pension funds deplete the estate without adding value to the estate. Because the debtor stands as a fiduciary on behalf of the bankrupt estate, the debtor's disregard of funding rules is neither remarkable nor irrational.

For employees and their union representatives, the failure to fund may not translate into any enhanced benefits on a termination basis, but it may have significance as a trigger or a reason to terminate a plan sooner rather than later. PBGC can initiate an involuntary termination in appropriate circumstances to reduce any increase in its own exposure to long-term loss.[6] Each day by which a termination is postponed tends to result in more individual employees and participants qualifying for more benefits on a termination basis. So, while the employees and participants may not reap a direct monetary benefit from a missed contribution in the face of an inevitable termination, the potential that the failure to contribute may accelerate or make more real the fact of termination is problematic.

The PBGC is the real beneficiary of funding under these circumstances. However, the failure of Congress to make the bankrupt company's choice to fund such benefits prior to termination more "rational" ultimately threatens to endanger the pension insurance program and the future of defined benefit plans generally. Congress might choose to respond now or to put matters off until such time as options are limited to a taxpayer rescue. BLB

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[1] *See* Micheline Maynard, *Survival of the Fittest and Leanest Becomes Strategy for the Airlines*, N.Y. TIMES, Oct. 30, 2004, at A1.

[2] *See The Effect of Federal Bankruptcy and Pension Policy on the Financial Situation of the Airlines: Hearing Before the Committee on Commerce, Science, and Transportation*, 108th Cong. (2004) (testimony of Bradley D. Belt, Executive Director, Pension Benefit Guaranty Corporation).

[3] *See id.*

[4] Editor's Note: In mid-December of 2004, the PBGC urged the bankruptcy court to mandate United's pension contributions; as of December 31, 2004, the PBGC assumed trusteeship of the United pilots' plan (following an agreement between the union and the employer), thereby assuming some $1.4 billion in unfunded. On Feb. 2, 2005, the PBGC assumed responsibility for the pensions of 51,000 US Air employees at an approximate cost of $2.3 billion. At the time of this publication, the PBGC estimated the total claim for US Air's pension to be $3 billion, the second largest claim in the company's history, after Bethlehem Steel at $3.7 billion. See Elizabeth Souder, PBGC Takes Over Some US Airways Pension Plans, Dow Jones Newswires, Feb. 2, 2005.

[5] *See* Albert B. Crenshaw, *Pension Agency Seeks More Power: Federal Insurer Wants to Put Liens on Companies in Bankruptcy*, WASH. POST, Sept. 15, 2004, at E03.

[6] *See* Employee Retirement Income Security Act of 1974, tit. IV, 29 U.S.C. §1001 (1974) (amended 1997).