




November 3, 2005

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Big Stakes in Ailing Airlines Raise Questions for U.S. Pension Agency

By **MICHAEL SCHROEDER** Staff Reporter of THE WALL STREET JOURNAL *November 3, 2005; Page A1*

WASHINGTON -- The U.S. government is on its way to becoming a big shareholder in the nation's airline industry and possibly in the auto industry.

The Pension Benefit Guarantee Corp., the federal agency that partially guarantees traditional pensions, recently was awarded 7% of **US Airways Group Inc.** by a federal bankruptcy court handling the company's Chapter 11 reorganization, according to the PBGC's recent filing with the Securities and Exchange Commission. The agency got the shares as compensation for the underfunded pension plans it assumed when the company filed for bankruptcy.

The agency is likely to get an even larger stake -- between 15% and 35% of new shares -- of UAL Corp.'s United Airlines when it emerges from Chapter 11 in February, after 38 months in court protection, according to a PBGC official. And it's likely to get sizable chunks of **Northwest Airlines, Delta Air Lines** and Delphi Corp. -- if, as expected, the companies ask the bankruptcy courts to dump their pension plans on the insurer.

Taxpayers stand to benefit if the PBGC's stockholdings increase in value. Stock sales would bolster the agency's assets that are used to pay retirement benefits, and possibly forestall the need for a taxpayer bailout of the deficit-ridden federal insurer.

Bankruptcy courts have awarded company stock to the PBGC in the past, but the practice has been relatively rare, given that most companies that terminated their plans then went on to liquidate their assets. Now, companies are using bankruptcy in part as a strategy to shed billions of dollars in unfunded pension liabilities to clean up their balance sheets. That means that the size and number of PBGC's holdings are likely to reach an unprecedented scale, creating a delicate situation for the federal agency: Should it be an activist shareholder and seek the maximum return for its stake, or should it be a passive investor and

maintain an arm's-length distance between the government and private enterprise.



"This trend [of the PBGC acquiring stakes in corporations] has been getting more pronounced in recent years" as more companies underfund their pensions, says agency director Bradley Belt, former managing director of the Commonwealth Group, a merchant-banking and consulting firm in Washington, and a former attorney at the SEC. When those companies dump their pensions on the agency, "that translates into a bigger equity stake in the reorganized company" for the PBGC, he says.

Federal pension laws offer little guidance on fiduciary issues related to the PBGC's equity ownership of public companies. "To the extent that the agency pushes an active agenda, people will say that it's not appropriate for a government entity," says

John Olson, a securities lawyer at Gibson, Dunn & Crutcher LLP in Washington. "On the other hand, it could be argued that they have an obligation to taxpayers and the plans they represent that the value of the stock is maximized." The situation, he said, was "a bit of a minefield" for the agency.

PBGC's assumption of corporate pensions is resulting in a sharply widening deficit. At the end of 2004, the PBGC had \$62.3 billion in obligations and \$39 billion in assets -- a gap of \$23.3 billion. The deficit could swell if the Chapter 11 filings of Delta, Northwest and Delphi lead them to offload unfunded pension liabilities on the agency. The Congressional Budget Office estimates that the shortfall will widen to \$86.7 billion by 2015.

When companies seek to shift pension plans to the PBGC in bankruptcy, the agency typically becomes a member of the unsecured-creditors committee that tries to recover assets to cover unfunded liabilities. As a member of the committee, the agency can object to parts of a proposed reorganization plan, including mergers or acquisitions. Its primary role as a committee member is to get as big a share of the assets recovered as possible.

The PBGC's recoveries are often small because of the relatively low standing of unsecured creditors. The agency has gotten some equity stakes in the past and an occasional board seat. It currently has three board seats, including one with Fansteel Inc., which turned over to the agency a pension plan underfunded by \$21 million early last year; the PBGC has a 26% stake in the company. The agency couldn't immediately provide the names of the other companies for which it holds board seats. The PBGC owned 8% of a new Polaroid Corp. holding company that was created in a 2002 bankruptcy proceeding, and sold the stake a year ago for \$31 million.

The PBGC takes the position that the government should not take an active role in corporate management or governance. That's why it assigns one of its 11 money managers -- which primarily invest its pension assets -- to manage individual equity holdings. J.P. Morgan Chase & Co., one of its money managers, has taken on the role of managing equity stakes because of its experience. As a fiduciary, the money manager's role is to monitor whether company management is getting the maximum for its investment.

As an unsecured creditor in bankruptcy proceedings, the PBGC recovers only about seven cents on each \$1 of unfunded pension obligations it inherits in the form of equity stakes. Common shareholders in the

predecessor companies rarely recover anything.

US Airways went through two Chapter 11 filings in the past three years, and in September emerged from the second and merged with America West Holdings Corp. The shares in the reorganized company that were awarded by the court to the PBGC amount to compensation for the \$2.3 billion in unfunded pension liabilities it took over.

The even larger stake the agency expects to get in United -- between 15% and 35% -- after it emerges from Chapter 11 in February would follow the carrier's 38 months in court protection. Whether the agency gets a board seat along with such a hefty stake isn't known.

The agency could also become a significant stockholder in the other restructured carriers, Delta and Northwest, which both filed for Chapter 11 on Sept. 14. Both have said that they haven't decided whether to ask the court to terminate their pension plans. If Northwest and Delta shed their pension plans, it could saddle the PBGC with an estimated \$11.2 billion in new unfunded liabilities.

Moreover, the PBGC estimates that Delphi, the largest U.S. auto-parts supplier in terms of sales, has an unfunded pension liability of \$10.8 billion -- and that the agency itself would be on the hook for \$4.1 billion. Delphi said it would decide within six months if it will seek to terminate its pension plans.

The PBGC doesn't have the authority to involve itself in management decisions of bankrupt companies. But it does on occasion negotiate deals to make sure pension plans don't suffer from labor agreements, mergers or other corporate decisions. A decade ago, the PBGC negotiated an agreement with **General Motors Corp.** to fund its pension plans with some of the proceeds of its sale of Electronic Data Systems Corp. The PBGC could take actions to protect GM's pension plan if the auto maker spins off its cash-producing GMAC unit.

Other government entities have benefited financially from being given company securities. The Air Transportation Stabilization Board, which was created at the request of the airlines after the terrorist attacks of Sept. 11, 2001, is expected to pocket \$116 million from the sale of stock options it received for guaranteeing an emergency \$429 million loan package to the former America West Airlines after the attacks. The Treasury has made \$35 million on warrants it received for guaranteeing most of a \$70 million loan to Frontier Airlines Inc. of Denver.

The airline-loan program could turn out to be as profitable as another high-profile government bailout, that of Chrysler Corp. In 1980, the government guaranteed \$1.2 billion in loans for the struggling auto maker in exchange for warrants to buy 14.4 million Chrysler shares. A turnaround allowed Chrysler to pay back its loans in 1983, years ahead of schedule. After the government refused to cancel the warrants or sell them to Chrysler for a small premium, Chrysler bought them back through an auction, giving the government a \$311 million profit.

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