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Pension Math Proves Elastic in Court Case Over Pilots

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US Airways said its pilots' pension plan was terminally ill earlier this year, but now the airline is changing the prognosis, in hopes of saving money.

In February, the airline argued in bankruptcy court that the plan was bleeding it dry and that the only way for the company to survive was to abandon it. The judge agreed, the government took over the plan, and some pilots had their benefits cut.

Now the airline is out of bankruptcy but back in court, arguing that the plan was not so very sick after all. If the airline wins this time, the government will receive a smaller equity stake in the airline. That, in turn, will reduce the amount available for the pilots' pensions, and some pilots will lose out again.

The government says that the pension fund was \$2.2 billion short of the amount needed to make good on its promises to the pilots when US Airways shed the plan on March 31. The airline now says that the shortfall then was less than half that amount, perhaps only \$890 million or less. The difference in the two figures is primarily because of different interest rate assumptions.

The method that US Airways used to derive the new amount "is not in the mainstream for calculating the value of pension obligations," stated Jeremy Bulow, an economics professor at Stanford University's school of business, in court papers supporting the government's position.

The dispute shows the way pension funds can be made to look sick, healthy or anything in between, depending on how their value is being calculated and for what purpose.

As pension funds have deteriorated recently, this variability has caused confusion and concern among investors, employees and policy makers about whether companies are reporting their obligations accurately or gaming the numbers to shrink their required contributions.

The US Airways dispute, which will be heard in court next week, may give guidance to Congress, which is debating how best to measure pensions and whether to give companies more latitude.

If US Airways is permitted to use the lower estimate for the plan, some experts say, the precedent could encourage other companies to abandon their pension plans. The outcome could then affect the health of the Pension Benefit [Guaranty Corporation](#), the struggling agency that insures pension plans in America.

A decision in favor of US Airways essentially will reward the airline "for underfunding the plan, and will encourage others in similar circumstances to do the same," said Victor Modugno, an actuary, in testimony for the government.

The airline points out that some other companies have been able to reduce their pension obligations in bankruptcy court.

"Previous court decisions support the company's position on the liability calculation," said David Castelveter, a spokesman for the airline. "Ultimately, the P.B.G.C. could have avoided this claim altogether, had they allowed for the restoration funding plan the company had proposed last fall." That proposal would have allowed the airline to stretch out contributions to its plan over many years.

The central issue in the case is how to measure, in today's dollars, the value of all the pensions that a company must pay its workers in the future. Neither US Airways nor the government is questioning the amount of money the airline had set aside in the pension fund, \$1.2 billion.

Measuring the pensions themselves, though, is like walking on shifting sand. Because the pensions will be paid in the future, calculating their value today means making many assumptions about what will happen: what ages the workers will retire, how much their pay will increase and how long they will live, among others. Documents filed in court show that the airline and the government use different assumptions about retirement ages.

More important, assumptions must also be made about interest rate movements. These rates — called discount rates — are factored into pension calculations to express the speed at which the pension fund must compound if workers are to receive all their money in the future. For certain calculations, the discount rate is set by law.

When the rate is low, a company's obligations to its workers look very large. Now that rates are very low, companies have been urging Congress to permit them to use higher rates, at least temporarily. If Congress agrees, their pension obligations will look smaller, and companies will not have to set aside as much money today.

The US Airways case shows the power of these assumptions.

Last winter, when it became apparent that the airline could not emerge from bankruptcy without defaulting on the pilots' pensions, the government made calculations using the rate required by law when plans are terminated. That interest is based on a rate used by life insurance companies for obligations

similar to pensions known as group annuities. Last March, the rate was 5.1 percent.

The pension agency concluded that the total value of the pensions owed the pilots was \$3.4 billion.

Because the pension fund held assets of \$1.2 billion, that left a \$2.2 billion shortfall, the agency said. It made a claim for that amount on US Airways' stock after reorganization. (The pension agency routinely asserts such claims as an unsecured creditor in bankruptcies.) The airline intends to set aside 10 percent of its new stock to settle the claims of unsecured creditors.

But US Airways is asking the court for permission to calculate the pensions without using a standard discount rate. Instead, it wants to adopt a rate linked to market performance, something it calls the "prudent investor rate." In its court documents, the airline defines this as "the rate of return achievable by a reasonable, prudent, long-term pension fund portfolio investor."

The airline does not specify a number, but points to the 12 percent returns achieved by the pension agency's own investment portfolio from 1985 through 2002, a period that encompassed a tremendous bull market in stocks and bonds. The airline argues that the prudent investor rate should be closer to 12 percent than to the 5.1 percent used by the agency.

The Securities and Exchange Commission has warned companies that if they use a rate higher than 9 percent to estimate returns on pension assets, they will have to demonstrate that it is justified. Earlier this year, the commission challenged [General Mills'](#) assumption of 9.6 percent.

US Airways' actuarial firm, Towers Perrin, submitted several calculations showing what the obligations to the pilots would be in a range of rates. At 8 percent, for example, the total value of the pilots' pensions is just \$2.1 billion — significantly less than the \$3.4 billion calculated by the government. With \$1.2 billion in assets set aside, that would leave the pilots' pension plan with a shortfall of only about \$900 million.

The airline argues that the government is trying to exaggerate the pension deficit to receive "a windfall."

The agency responds that it does not keep the money from companies that default on pension plans; most is used to increase payments to retirees. The agency's insurance has limits that are well below what the pilots were promised before the airline ran into trouble. The agency says it will use about 75 percent of what it recovers from the airline — whether \$2.2 billion or \$900 million or something else — to bring some pilots closer to the pensions they were originally promised.

The agency uses complicated rules to settle which beneficiaries receive how much additional coverage. Each person's age is a factor, and in the US Airways case, pilots who were at least 53 years old when the plan failed may have their payments raised above the government's limits. Exactly how many pilots qualify for an increase is not clear, but hundreds are likely to be affected.

The amount of the increase depends on how much the agency is able to collect from the airline. The agency's claim of \$2.2 billion is about half of the total claimed by all unsecured creditors. So, if the unsecured creditors ultimately get stock worth \$60 million, the agency will receive about half, or \$30 million.

The agency would then dedicate 75 percent of that amount, or \$22.5 million, to restoring some of the older pilots' lost benefits.

Under the airline's figures, the \$900 million owed the government would represent a little less than one-fourth of the total unsecured claims. So if the creditors get \$60 million, the agency would get less than a quarter of it, or \$15 million. It would then use 75 percent of the money, or about \$11 million, to raise benefits for qualifying pilots.