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Whoops! There Goes Another Pension Plan

By [MARY WILLIAMS WALSH](#)

ROBERT S. MILLER is a turnaround artist with a Dickensian twist. He unlocks hidden value in floundering Rust Belt companies by jettisoning their pension plans. His approach, copied by executives at airlines and other troubled companies, can make the people who rely on him very rich. But it may be creating a multibillion-dollar mess for taxpayers later.

As chief executive of [Bethlehem Steel](#) in 2002, Mr. Miller shut down the pension plan, leaving a federal program to meet the company's \$3.7 billion in unfunded obligations to retirees. That turned the moribund company into a prime acquisition target. Wilbur L. Ross, a so-called vulture investor, snapped it up, combined it with four other dying steel makers he bought at about the same time, and sold the resulting company for \$4.5 billion - a return of more than 1,000 percent in just three years on the \$400 million he paid for all five companies.

Two years later, as the chief executive of [Federal-Mogul](#), an auto parts maker in Southfield, Mich., Mr. Miller worked on winding up a pension plan for some 37,000 employees in England. The British authorities balked at the idea, fearing that such a move would swamp the pension insurance fund that Britain was creating; it began operations only last April. But the investor Carl C. Icahn has placed a big bet that Federal-Mogul will pay off after the pension plan is gone; he has bought its bonds at less than 20 cents on the dollar and is offering money to help the insurance fund. He, too, stands to make millions.

Now Mr. Miller is at [Delphi](#), the auto parts maker that was spun off by [General Motors](#) in 1999. If past is prologue, one of the most powerful turnaround tools at his disposal will be his ability to ditch Delphi's pension fund. He did not return numerous telephone calls seeking his views for this article, but in the past he has said that his first priority at Delphi was to "resolve" its "uncompetitive labor cost structure." That includes the roughly \$5.1 billion gap between the pensions it has promised employees and the amount it has put aside to pay for them.

If the obligation to make good on Delphi's pensions eventually lands, in whole or in part, at the door of a governmental guarantor, few should be surprised. [The Pension Benefit Guaranty Corporation](#) has become an increasingly popular option for private-capital funds and other investors who are seeking to spin

investments in near-bankrupt industrial companies into gold. The key is to shift the responsibility for pensions, which weigh as heavily as bank loans on a company's balance sheet, to the pension corporation.

The same financial alchemy has been performed at Polaroid and US Airways, at textile companies like Cone Mills and WestPoint Stevens, and at a host of smaller companies over the last four years. And bankruptcy specialists say that it is almost certain to keep happening, because shedding pensions - and pensioners' health care obligations - is turning into an irresistible way to make a high-risk investment pay off.

"It's become a kind of system to bail out companies," Thomas Conway, vice president of the United Steel Workers of America, said of the pension corporation, which Congress created in 1974 to protect retirees if their employers went bust. "People have been able to use it tactically, as a business strategy, and I don't think that's what Congress meant."

Over the long term, the rate of defaults is clearly rising, said Lynn M. LoPucki, a professor of law at the University of California, Los Angeles, who has tracked the large companies that have shed their pension plans while in bankruptcy since 1980.

Less obvious is precisely how the trend will ultimately affect retirees, who sometimes have their pensions cut in the process. The cuts appear to be hitting more and more workers, but the government has not calculated how many since 1998.

Nor is it certain how the trend will affect taxpayers, who may wind up on the hook if the rising tide of failed pension obligations overwhelms the resources of the pension corporation. A year ago, when the agency last reported its balance sheet, it had \$39 billion in assets and \$62.3 billion in liabilities, leaving a shortfall of \$23 billion. The Congressional Budget Office on Friday estimated that the deficit will widen to \$86.7 billion by 2015 and \$141.9 billion by 2025.

Mr. Ross, the investor who picked up the five dying steel companies, said he also thought that the current practice of sending failed pension plans to the federal guarantor "needs some reforming."

But, he added, the private sector was not to blame. "If we're going to continue defined-benefit pension plans at all," he said, "I really think we need to look at who enforces the rules, what the rules should be, and why there isn't a meaningful, risk-based system."

In a risk-based pension insurance system, companies that run failure-prone pension funds would pay higher premiums than the companies that manage their pension plans more conservatively. But instead of charging more, the government has been waiving the pension rules, he said. "When you start giving people waivers," he said, "you're creating a time bomb."

Like defaulting on a loan, terminating a pension plan significantly lightens a company's balance sheet:

the business instantly becomes more valuable because it does not have to use its cash flow to pay for past mistakes.

But defaulting on a loan affects the lender, who presumably vetted the borrower and charged interest commensurate with the risk. Defaulting on a pension, on the other hand, affects the pension corporation, which is required by law to accept a low premium unrelated to the risks it takes.

James A. Wooten, a pension-law historian who is a professor at the University at Buffalo Law School, said that Congress knew it was creating an imperfect system when it established the pension corporation in 1974, and that it expected to make improvements later. The bill was highly contentious, and Congressional leaders struggled mightily to achieve compromise in the last chaotic months of the Nixon presidency, with the Watergate scandal roaring around them.

In the beginning, they set pension insurance premiums at a token \$1 per employee. Today, the basic premium is up to \$19 a head, but Congress has found it hard to raise the rates even remotely enough to cover growing claims. Some companies have warned that if they have to pay more for their pension insurance, they will stop offering pensions.

"They took cautious steps, and those cautious steps weren't enough to prevent the abuse of the insurance program," Mr. Wooten said. "Once there's insurance, you have an incentive to run up liabilities to get more out of the insurance."

MR. MILLER'S arrival at Delphi in July, and the intense labor negotiations that have followed, are signals that the auto parts industry may be in for a long cycle of bankruptcies and restructurings, like those that reshaped steelmakers and are beginning to transform airlines.

"Something has to happen to all of these liabilities and cost structures," said Mr. Ross, who has said that he may invest in Delphi, the world's largest auto parts supplier, after those changes are made. "Delphi needs to sort out these complicated relationships before anybody will buy it. Something has to change."

Delphi isn't the only troubled automotive company to catch Mr. Ross's eye. He has also expressed an interest in Collins & Aikman, a manufacturer of automotive interiors that is already in bankruptcy, and he recently invested \$30 million in a French auto parts maker, Oxford Automotive. But because of Delphi's size and its relationship with G.M., its former parent, any big cuts in its so-called legacy costs - mainly pensions and retiree health care - would send reverberations through the auto industry.

No one says it will be easy for Mr. Miller to cast off Delphi's pension plan - it never is - but he was dealt a good hand when he came to the company. Not only would the federal pension guarantor end up with at least part of Delphi's plan if the company went bankrupt, but the company could also rely on an unusual promise that G.M. made to the United Automobile Workers seven years ago - in far better times - that it would take over any part of the Delphi pension plan that the pension agency refused. Generally, the agency caps pension payouts at about \$45,000 a year, to workers who are 65 when the plan fails. For

younger workers, the limits are a good deal lower.

G.M.'s involvement means that Delphi workers - unlike many unlucky employees of Bethlehem, United Airlines and Polaroid - might not lose any benefits if their plan were taken over by the government.

(G.M. also promised to assume all medical costs for retirees if Delphi faltered, an obligation estimated at \$9.6 billion. Securities analysts have been parsing the language of the promise, trying to determine if G.M. must really shoulder this entire amount, and the extent to which Delphi would have to pay G.M. if it rebounded later. G.M. has its own heavy obligations to retirees and can ill afford to take on more.)

Savvy investors know that the existence of these two guarantees gives Mr. Miller great power - the right, if he needs it, to make someone else pay Delphi's large and growing debt to its work force. If he plays his hand skillfully, Delphi could end up shedding billions of dollars of debt without depriving unionized employees of any promised benefits.

To unload the pension fund, however, Delphi would have to declare bankruptcy; a company cannot send an unwanted pension plan to the government without first persuading a bankruptcy judge that it cannot otherwise survive. And if Delphi is to file bankruptcy, it may have to decide quickly. New, stricter bankruptcy laws take effect on Oct. 17, and companies that declare bankruptcy after that date will face a range of restrictions on how much they can pay in executive bonuses and on how long they can take to work on their reorganization plans.

Mr. Ross said that he was not privy to the negotiations at Delphi but that he thought it likely that Mr. Miller would declare bankruptcy before the law tightened. "Delphi's a big company," Mr. Ross said. "I think he'd be very concerned about his ability to retain a whole management team there" if he could not pay bonuses. And controlling the schedule for reorganization is an important tool for debtors negotiating with creditors. "I would be shocked if he would give up the leverage that that tool gives him," Mr. Ross said.

But other analysts speculated that Mr. Miller might well delay a bankruptcy filing past Oct. 17 because he could win wage concessions from the union if he kept the pension plan going. "The carrot that he has to offer is, 'If you keep working for an extra year, you get more benefits, and those benefits are more valuable to you because those benefits are guaranteed not by us, but by G.M. and the P.B.G.C.,' " said Jeremy I. Bulow, a economics professor at Stanford. "That's something Delphi can use as a negotiating tool."

While that may be good news for Delphi, its workers and its shareholders, it could be very bad news for G.M., the pension agency - and perhaps, ultimately, taxpayers. "The policy problem is that we let companies get this deeply in hock to the federal government," Professor Bulow said. "It's kind of a rolling the dice, a heads-I-win-tails-you-lose kind of thing."

COMPARED with Delphi, Bethlehem Steel looked grim when Mr. Miller arrived in September 2001.

Like other big integrated steel makers in the United States, Bethlehem had been fighting a losing 20-year battle with foreign competition and low-cost domestic mini-mills. "I came here to find a way not to file for Chapter 11," Mr. Miller said upon his arrival. But by mid-October, Bethlehem was in bankruptcy.

The company was being killed by its legacy costs - the accumulated promises to retirees it had been making for decades. Bethlehem had whittled down its work force over the years in an effort to cut costs, but by doing so it simply created more retirees to whom it owed pensions and health benefits.

By the time Mr. Miller took over, the company had some 95,000 retirees and just 12,000 active workers to generate enough revenue to pay their benefits - a hopeless proposition. Retiree health care alone was costing Bethlehem about \$125 million a year. In the 1990's, the stock market boom made its pension fund look healthy, but when the boom ended and the pension funds' assets fell, the company had to make up the difference. By November 2002, Bethlehem faced liquidation.

That is when Mr. Ross stepped in. A big concern then - as it is now at Delphi, the airlines and elsewhere - was the pension plan. When the time came to turn it over to the pension agency, officials there realized that Mr. Ross was poised to set off as much as \$550 million in extra "shutdown" benefits - available only to workers idled by a plant closing - by briefly shutting some operations before taking over. The government would have to pay the workers' basic pensions in any case; federal officials thought that if the workers were to get any additional money, it should come from Mr. Ross. (Shutdown benefits are an option that is also available to Delphi.)

Steelworkers applauded these arrangements, but the pension corporation seized Bethlehem's pension plan before Mr. Miller had the chance to shut down operations and activate the extra benefits. The union, Mr. Miller and Mr. Ross all complained, but Mr. Ross nonetheless found enough additional money to offer retiring employees \$50,000 buyouts and to set up a trust fund to pay for LTV and Bethlehem retirees' health insurance. "We felt a moral obligation to those workers, even though we had no legal obligation," Mr. Ross said.

In the end, what bothered Mr. Conway, the union leader, was not so much Mr. Ross's inability to wring more money out of the pension system or his remarkable profit on the deal. What troubled him, he said, was that the country seemed unable to take any lessons away from the demise of the steel companies and how it affected so many working people. "It just staggers us that America's not caught on to what's happening to it," he said.

"Here's [Ford](#) and General Motors, now competing against a lot of U.S.-based transplant companies that have no obligations to any work force," Mr. Conway added, referring to the nonunion factories that [Toyota](#), BMW and other foreign-owned car companies have built in the United States. "That's a tremendous advantage. How does a mature American industry that has obligations to its work force compete with that?"

Because global competition is driving the trend, Mr. Ross said the country should look for a new way -

maybe a value-added tax on imports - to bolster the pension-insurance program or to provide health care to retirees. He said he had suggested this approach to some members of Congress, but in vain. "So far, they've really seemed more interested in lashing out at China," he said.

For now, people approaching retirement are left to hang on and hope.

"What happens is, typically, you've got a boat that holds 40 and you need seats for 50 and people are all trying to hold on till the end of their career and get their promise," Mr. Conway said. "We frankly don't know how to do it, if there's no other assistance out there to help you do it. The P.B.G.C. isn't the solution."

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