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PBGC: Effect of New Airline Bankruptcies

September 14, 2005 may prove to be one of the worst days in the history of the Pension Benefit Guaranty Corporation (PBGC). Delta and Northwest Airlines both announced that they had filed for protection under Chapter 11 of the Bankruptcy Code. Neither has indicated that they will terminate their pension plans and Northwest particularly seemed to make a point that it desired not to do so. However, it seems unlikely that either airline will be able to avoid the eventual termination of their pension plans. If they do, PBGC estimates that it would receive a claim of \$8.4 billion in regards to Delta's plans, on present information, with another \$2.2 billion absorbed by employees and retirees. The figures for Northwest would be a \$2.8 billion claim on PBGC and a \$2.9 billion hit to employees and retirees.

There are three major reasons to be skeptical that either airline will be able to avoid a distress termination of its pension plans. First, history is strongly against it. United, US Airways, TWA, Eastern, Pan Am, and Braniff all terminated their pension plans in bankruptcy. The author does not know of any major airline that entered bankruptcy without eventually terminating their plans. Nor does there appear to be any steel company that entered bankruptcy without doing so.

Second, the underfunding represents a considerable chunk of the money owed by these airlines. Delta reportedly has \$28 billion of obligations. Thus, on PBGC figures, the pension underfunding would represent at least 27% of the total liabilities, or higher if the \$28 billion already includes underfunding.

Third, pension liabilities are the only major debt faced by these airlines where a third party, in this case PBGC, can be handed most of the cost. Plans of reorganization are heavily negotiated with the different creditor groups and the fighting is intense because every dollar given to one group normally comes out of the pockets of another. However, PBGC estimates that it would pick up 79% of the pension underfunding at Delta, meaning that employees and retirees would be very considerably cushioned against the plan terminations. (This is less true at Northwest, where it is about 50/50, which may partially explain their stronger assertions about trying to avoid plan terminations.) We have seen with United how difficult the process of distress termination can be, but it is as nothing compared to pulling an equivalent amount of money from other creditor groups and dedicating it to the pension underfunding.

Distress terminations at the two airlines could add almost 50% to the \$23 billion PBGC deficit reported at the end of last fiscal year. The exact figure would be affected by two additional factors. First, it has been nearly a year since the end of the last fiscal year and the \$23 billion number will have been pushed up or down by interest rate changes, new bankruptcies, changes in the credit standing of firms that were near bankruptcy, investment performance at PBGC and at the relevant pension plans, etc. Second, there is a chance that a piece of the Delta underfunding was already included in the \$23 billion figure.

PBGC is required by GAAP accounting to include in its financial position claims that have not yet come in, but which it expects to be filed, even if that may be years off. The underfunding at United and US Airways was clearly already included in the \$23 billion, even though the actual terminations came months later. PBGC does not announce which companies are included, since it does not wish to appear to prejudge the survival chances of companies that have not yet filed for bankruptcy. Still, we can make educated guesses from the total amount of "probable losses" and the underfunding levels at firms like United that were clearly included. It appears very unlikely that Northwest's plans would have been included, even in part, given the information available at the time about its financial condition. Delta was on shakier ground and it is possible that one or two of its plans might have been included, however the author is 90% certain that the bulk of the \$8.4 billion for Delta would not have been in the \$23 billion number.

We are not yet changing our most recent estimate that there would need to be a taxpayer rescue of \$92 billion, in today's dollars, if current law is not changed and if our base case projections are accurate. Our figures anticipated terminations at Delta and some possibility that Northwest would follow.