

# Airline carriers lack the assets to cover \$7B in pension obligations

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Another potential roadblock has entered the atmosphere surrounding a possible merger between Northwest Airlines and Delta Air Lines, even as pilot union leaders for both airlines have apparently resumed talks.

In a letter dated Feb. 28, the Washington D.C.-based Pension Benefit Guaranty Corp. (PBGC), insurer of last resort for the nation's private-employer pension plans, urged both airlines to bring the PBGC into the merger discussions.

The two airlines combined would cover more than {sic} 160,000 workers and retirees, said the letter from PBGC director Charles E. F. Millard, which was addressed to Douglas M. Steenland, Northwest's CEO, and Richard H. Anderson, CEO of Atlanta-based Delta.

Millard wrote that his agency's role in any merger discussions was necessary to ensure "that all appropriate considerations with respect to the continued health of the airlines' defined benefit pension plans are addressed."

Together, the letter said, the two pension plans "do not have enough assets to pay all promised benefits: if the plans were to terminate, they would be underfunded by over \$7 billion."

In a separate statement to Finance & Commerce, Millard said that the "PBGC has a vital stake in making sure that pension plans are not weakened in the course of corporate transactions.

"The Northwest and Delta pension plans cover more than 160,000 workers and retirees [and] their interests must be represented at the table as the companies continue their merger talks."

Delta spokesman Anthony Black said in an e-mail to Finance and Commerce on Thursday that preserving pensions is important to Delta.

"Delta is proud of the work we have done alongside our employees and retirees to preserve our non-pilot pension plans and to continue steadily funding these plans since our emergence from Chapter 11 last year," Black wrote.

"Delta has been very clear that any consideration of potential consolidation must protect the interests of our employees and retirees, including ensuring that their pension plans are maintained."

On February 26, Delta executives issued an internal memo to employees that said that any merger would have to meet a number of "principles," including maintaining the pensions and remaining headquartered in Atlanta.

Black declined to comment on continuing speculation about a Northwest-Delta merger.

Northwest Airlines did not return several calls seeking comment.

While it isn't clear what impact a Delta-NWA merger would have on the companies' defined benefit pension plans, the PBGC's interest reflects the greater diligence federal regulators are giving to protecting employee benefits in the post-Enron era, according to Sunil Ramlall, an assistant professor in management at the University of St. Thomas and a specialist in human resource practices in the airline industry.

"All the government agencies are trying to be more protective of employees," following the disastrous failures at companies like Enron and WorldCom, which ended up emptying pension coffers, Ramlall said. "Employees essentially lost all their retirement savings."

Pension programs at airlines have faced their own special hazards in recent years, bringing that industry under

special scrutiny at PBGC. Many carriers went bankrupt during the last decade as fuel prices, health care costs and post-9-11 travel slumps erased earnings, and most of those failed airlines left unfunded pension obligations for the PBGC to pay.

In fact, failures in the airline and steel industries combined accounted for almost 75 percent of all the pension liabilities that the PBGC has assumed, and contributed to an agency deficit that peaked at \$22.8 billion in 2005. It dropped to \$13 billion by the end of 2007, following pension reforms passed by Congress in 2006.

The pension plans at Delta and Northwest appeared to be ready to join their industry peers in insolvency in summer 2005, when both companies began reorganizing under Chapter 11 bankruptcy protection.

According to the PBGC website, Delta's unfunded pension obligations at that time totaled \$10.6 billion, and Northwest's had reached \$5.7 billion.

As part of Delta's bankruptcy reorganization, its judge allowed the carrier to terminate its pilots' pension and turn those obligations — along with a \$2.2 billion payout — over to the PBGC.

But the rest of the Delta and Northwest pensions were retained, thanks in part to those 2006 reforms that extended from seven years to 17 years the period during which they can make their plans solvent. That extension made the annual pension payments affordable for the two airlines.

However, those pension obligations are still probably much on the minds of the merger negotiators and the airline employees, Ramlall believes.

"If Delta ends up picking up both companies' pension obligations, that's a bigger burden for a single company to look at. What happens if fuel prices continue to rise? Those things hit the income statement right away," and those factors will be crucial to executives and shareholders at both carriers during merger talks, Ramlall said.

Employees at both airlines will also want to see promises that a merger won't put their pensions in jeopardy again.

Airline industry wages and salaries haven't been at the top of the scale, but benefits packages have traditionally been strong, Ramlall said. "The benefits and pensions at both airlines have been very popular with their employees. It would be a big takeaway if pensions were lost, and that would be a real blow to the trust and commitment of their workforce."