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**UNITED STATES BANKRUPTCY COURT  
SOUTHERN DISTRICT OF NEW YORK**

	)	Chapter 11
In re:	)	
	)	Case No. 05-17923 (ASH)
DELTA AIR LINES, INC. et al.,	)	
	)	(Jointly Administered)
Debtors.	)	
	)	

**RESPONSE OF THE PENSION BENEFIT GUARANTY  
CORPORATION TO DEBTORS' MOTION SEEKING A  
DETERMINATION THAT THEY SATISFY THE FINANCIAL REQUIREMENTS FOR  
A DISTRESS TERMINATION OF THE DELTA  
PILOTS RETIREMENT PLAN AND APPROVAL OF SUCH TERMINATION**

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## INTRODUCTION

The Pension Benefit Guaranty Corporation (“PBGC”) responds to the Debtors’ Motion Seeking a Determination that they Satisfy the Financial Requirements for a Distress Termination of the Delta Pilots Retirement Plan and Approval of Such Determination.

Under Title IV of the Employee Retirement Income Security Act of 1974, as amended (“ERISA”), 29 U.S.C. §§ 1301-1461 (2000 and Supp. III 2003), a bankruptcy court’s role in the distress termination process is limited to a factual determination under the reorganization in bankruptcy test set forth in 29 U.S.C. § 1341(c)(2)(B)(ii)(IV). This test requires a bankruptcy court to determine whether a debtor “will be unable to pay all of its debts pursuant to a plan of reorganization and will be unable to continue in business outside the chapter 11 reorganization process,” unless the pension plan is terminated. 29 U.S.C. § 1341(c)(2)(B)(ii)(IV); *see also* 29 C.F.R. § 4041.41(c)(2)(iv). ERISA directs PBGC to determine whether the contributing sponsor and each member of the sponsor’s controlled group satisfy the other criteria for a distress termination of the pension plan. 29 U.S.C. § 1341(c)(2)(B); 29 C.F.R. § 4041.41(a)(3).

PBGC files this response to advise the Court of the agency’s views regarding the interpretation and application of the distress termination provisions of ERISA. PBGC urges the Court to carefully review the evidence offered by the Debtors “so as to enable the Court to make the necessary determinations to meet ERISA’s strict criteria for distress terminations.” *In re Wire Rope Corp. of Am.*, 287 B.R. 771, 773 (Bankr. W.D. Mo. 2002). If the Court concludes the requisite factual showing has been made, PBGC will determine whether the application for distress termination of the Delta Air Lines, Inc. Pilots Retirement Plan (the “Pilots Plan”) meets the other requirements of ERISA.

## PBGC

PBGC is the wholly-owned United States government corporation that administers the defined benefit pension plan termination insurance program established by Title IV of ERISA. When a pension plan covered by Title IV terminates without sufficient assets to pay all of its promised benefits, PBGC typically becomes trustee of the plan and pays plan participants their pension benefits up to the limits established by Title IV. *See* 29 U.S.C. §§ 1321, 1322, and 1361.

## PILOTS PLAN

Delta Airlines, Inc. (“Delta”) sponsors and administers the Pilots Plan pursuant to a collective bargaining agreement with the Air Line Pilots Association, International (“ALPA”). The Pilots Plan provides pension benefits to approximately 13,294 current and former pilots and their beneficiaries. It is a tax-qualified, defined benefit pension plan covered by PBGC’s insurance program under Title IV. (*See* Joint Statement of Stipulated Facts With Respect to the Motion of DP3 to Compel the Continued Payments of Collectively Bargained-For Pension Benefits to the Retired Pilots ¶ 18, *In re Delta Air Lines, Inc.*, No. 05-17923 (Bankr. S.D.N.Y. Oct. 12, 2005) (Docket No. 711) (“Joint Statement of Stipulated Facts”)).

On September 14, 2005, Delta and 18 of its subsidiaries (collectively with Delta, the “Debtors”) each filed a voluntary petition for relief under Chapter 11 of the United States Bankruptcy Code. The Debtors continue to operate their businesses and manage their properties as debtors in possession. 11 U.S.C. §§ 1107, 1108. The Debtors and seven non-bankrupt subsidiaries of Delta are members of Delta’s controlled group.<sup>1</sup> Delta and each of its controlled group members are jointly and severally liable for the unfunded benefit liabilities of any

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<sup>1</sup> A group of trades or business under common control, referred to as a “controlled group,” includes, for example, a parent and its 80% owned subsidiaries. *See* 29 U.S.C. § 1301(14)(A), (B); 26 U.S.C. § 414(b), (c); 26 C.F.R. §§ 1.414(b)-1, 1.414(c)-1, 1.414(c)-2.

terminated pension plan sponsored by Delta and covered by Title IV of ERISA,<sup>2</sup> and for any unpaid minimum funding contributions and unpaid premiums. *See* 29 U.S.C. §§ 1301(a)(18), 1307(e), 1362; 26 U.S.C. § 412(c)(11). PBGC has filed, with respect to the Pilots Plan, claims for the unfunded benefit liabilities, unpaid minimum funding contributions and any unpaid premiums. PBGC currently estimates that the Pilots Plan's unfunded benefit liability is approximately \$3 billion.

Generally, a Delta pilot who retires at the age of 60 is entitled to an annual pension benefit equal to 60% of his or her Final Average Earnings ("Pension Benefit"), with such benefit reduced for early retirement and service of less than 25 years. Final Average Earnings is the average of the retiring pilot's last three years of earnings. A pilot's Pension Benefit is paid from the Pilots Plan and two other pension plans that are not tax-qualified and not covered by Title IV of ERISA. (*See* Joint Statement of Stipulated Facts, ¶ 7.) In addition to the Pension Benefits provided by the Pilots Plan and the two related non-qualified plans, the pilots receive pension benefits from other defined contribution retirement plans.<sup>3</sup>

Upon retirement, a pilot may elect to take a one-time lump sum payment equal to 50% of the present value of his or her Pension Benefit. (*See* Joint Statement of Stipulated Facts, ¶ 25.) Even though the lump sum benefit is equal to 50% of each pilot's total Pension Benefit, which include benefits that are earned under the non-tax qualified plans, the lump sum benefit is paid entirely from the Pilots Plan. (*Id.* at ¶ 26.) Delta first promised these lump sum payments

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<sup>2</sup> Delta also sponsors the Delta Air Lines, Inc. Retirement Plan, and the Western Air Lines, Inc. Pilots Defined Benefit Plan.

<sup>3</sup> A defined contribution plan (or individual account plan) is a pension plan that provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant's account, and any income, expenses, gains, and losses. *See* 29 U.S.C. § 1002(34). A defined benefit plan generally is a plan under which the employer promises to pay a specific monthly benefit at retirement.

to its pilots in 1989. (*See* Declaration of Margaret M. McDaniel in Support of Debtors' Motion ("McDaniel Declaration"), ¶ 14.)

Since 2001, as the financial condition of Delta deteriorated, a significant number of pilots retired early and elected to receive a lump sum. During this time frame, the Pilots Plan paid out approximately \$2.5 billion in lump sums to approximately 3,200 pilots. (*See* McDaniel Declaration, ¶ 18.) To avoid any interruption in its operations as Delta trained pilots to replace the large number of recently retired pilots, in 2004, pursuant to Letter of Agreement #45, Delta and ALPA agreed that pilots could retire and receive their lump sum benefits under the Pilots Plan and subsequently be rehired by Delta on a contract basis. (*See* Declaration of Geraldine P. Carolan in Support of Motion to Reject ALPA Collective Bargaining Agreement ¶ 18(e), *In re Delta Air Lines, Inc.*, No. 05-17923 (Bankr. S.D.N.Y. Nov. 1, 2005) (Docket No. 1006.))

The financial condition of the Plan also dramatically deteriorated after 2001. As of July 1, 2001, by the Plan's calculation, its actuarial value of assets exceeded its current liability by \$628 million. (*See* McDaniel Declaration, ¶ 21.) By July 1, 2004, the Pilots Plan's funded status had declined to 75% of current liability and the Plan had a funding deficit of approximately \$1.02 billion. (*Id.*) By July 1, 2006, the Plan was projected to have assets equal to only 39% of current liability and a funding deficit of \$2.5 billion. (*Id.* at ¶¶ 18, 21.) The deteriorating financial condition of the Pilots Plan was caused in large part by the dramatic increase in early retirements and lump sums, as well as lower than expected investment return on Plan assets and decreasing interest rates. Yet, during this time period, as Delta paid \$2.5 billion out of the Pilots Plan to retiring pilots, Delta made only the minimum amount of contributions required under ERISA and the Internal Revenue Code ("IRC"). For example, Delta represents that they made only \$71 million in contributions to the Plan for the 2002 plan year and \$177

million for 2003. (*Id.* at ¶ 21.) And once Delta filed for bankruptcy, they essentially ceased funding the Pilots Plan altogether.

The IRC requires a plan sponsor such as Delta to pay annual minimum funding contributions to its defined benefit pension plan on a quarterly and annual basis. 26 U.S.C. § 412; 29 U.S.C. § 1082. On August 3, 2006, Congress passed the Pension Protection Act of 2006, which, among other things, provides special pension funding relief for commercial airlines, including Delta. H.R. 4, 109th Cong. § 402. (2006). The new legislation, which was signed into law by President Bush on August 17, 2006, gives an airline that freezes benefit accruals under its defined benefit pension plans up to seventeen years – ten more than the seven years granted to other employers – to fund the pension plan’s unfunded liability.

In addition to the minimum funding requirements, the IRC requires that a certain amount of a pension plan’s assets be liquid. The amount of liquid assets must be three times the total disbursements for the 12-month period ending on the last day of the quarter. Disbursements include payment of pension benefits and administrative expenses. If a pension plan does not have the required amount of liquid assets, the plan sponsor is required to make a supplemental contribution to eliminate the shortfall. If the plan sponsor does not make the supplemental contribution, the pension plan is deemed to be in a “liquidity shortfall.” 26 U.S.C. § 412(m)(5); 29 U.S.C. § 1082(e)(5).

While in liquidity shortfall, a pension plan is prohibited from paying lump sums. 26 U.S.C. § 1056(e)(1). Because of the manner in which the liquidity shortfall is calculated, even if the plan sponsor makes no further contributions, the pension plan will eventually emerge from liquidity shortfall. (*See* Joint Statement of Stipulated Facts, ¶ 41.) Upon emergence from liquidity shortfall, the pension plan may resume making lump sum payments. Lump sum

payments must stop if a notice of intent to terminate a pension plan in a distress termination has been filed with PBGC. 29 U.S.C. § 1341(c)(3)(D)(ii)(II); 29 C.F.R. § 4041.42(b)(2).

As of October 1, 2005, the Pilots Plan was deemed to be in “liquidity shortfall.” Therefore, in addition to the quarterly minimum funding contribution that was due on October 15, 2005, an estimated supplemental contribution of not less than \$129 million was also due. (See Joint Statement of Stipulated Facts, ¶ 39.) Contrary to its statutorily mandated responsibility, since filing bankruptcy, Delta has paid neither the full amount of its minimum funding contributions nor the supplemental contributions to eliminate the liquidity shortfalls. Instead, Delta unilaterally decided to make only relatively *de minimis* contributions to the Pilots Plan that Delta has determined to be attributable to post-petition services. (See Debtors’ Motion, ¶¶ 22-23.)

Delta projected that it would come out of liquidity shortfall on July 1, 2006, at which time lump sum distributions would again become available. (See Debtors’ Motion, ¶ 32.) On June 20, 2006, however, Delta issued a notice of its intent to terminate the Pilots Plan in a distress termination to the Plan participants and beneficiaries, which prohibited Delta from paying any lump sums under the Pilots Plan while its application for the distress termination of the Plan is pending. 29 U.S.C. § 1341(c)(3)(D)(ii)(II); 29 C.F.R. § 4041.42(b)(2).

#### **DISTRESS TERMINATION REQUIREMENTS**

Title IV of ERISA provides the exclusive means for terminating a single-employer defined benefit pension plan. 29 U.S.C. § 1341(a); *Hughes Aircraft Co. v. Jacobson*, 525 U.S. 432, 446 (1999); *PBGC v. Mize Co.*, 987 F.2d 1059, 1061 (4th Cir. 1993); *Phillips v. Bebbler*, 914 F.2d 31, 34 (4th Cir. 1990). Under Title IV, the plan sponsor may seek to voluntarily terminate a pension plan in a distress termination under 29 U.S.C. § 1341(c). There are three statutory prerequisites to a distress termination: (1) the plan administrator must provide

PBGC and plan participants a 60-day advance written notice of the distress termination; (2) the plan administrator must provide PBGC with certain actuarial and financial information; and (3) PBGC must determine that the plan sponsor and each member of its controlled group satisfy one of the three statutory distress tests under 29 U.S.C. § 1341(c)(2)(B), which are (i) the liquidation test, (ii) the reorganization in bankruptcy test, and (iii) the business continuation/pension cost test.<sup>4</sup> See 29 U.S.C. § 1341(c)(1)(A)-(C), (2)(B)(i)-(iii).

In its notice of intent to terminate the Pilots Plan, Delta stated that the Debtors expect to meet the “reorganization in bankruptcy” distress test under 29 U.S.C. § 1341(c)(2)(B)(ii)(IV) and that Delta’s non-bankrupt controlled group members expect to satisfy the “termination required to enable payment of debts while staying in business” distress test under 29 U.S.C. § 1341(c)(2)(B)(iii). (See Exhibit A, attached, Notice of Intent to Terminate.) PBGC has the sole authority to determine whether Delta’s non-bankruptcy controlled group members satisfy the distress test. The Bankruptcy Court has jurisdiction only over each Debtor to make the limited factual finding as to whether each Debtor satisfies the reorganization-in-bankruptcy distress test. See *In re Sewell Mfg. Co.*, 195 B.R. 180, 183 (Bankr. N.D. Ga. 1996).

As one court explained:

[T]he Court does not find itself faced with the ultimate question of the [d]ebtor’s entitlement to the termination of its pension plan. Instead, the Court simply must perform one narrow factual determination, the satisfaction of which will compose a single element in the [d]ebtor’s individual case for reorganizational “distress.” The ultimate sufficiency of that distress showing, as well as the adequacy of the [d]ebtor’s required disclosures and the qualification of any “controlled group” parties, then will become a collective matter for the PBGC’s consideration as it makes a final determination of the [d]ebtor’s right to a distressed termination.

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<sup>4</sup> PBGC can also initiate an involuntary termination of a pension plan under 29 U.S.C. §1342(a) if it determines that certain criteria have been met.

*Id.* at 185. Once the Court's factual determination is final and non-appealable, PBGC will be bound by the determination. 29 C.F.R. § 4041.41(d)(1)(iv). Although the bankruptcy court determines whether a pension plan must be terminated in order to enable a debtor to reorganize, PBGC must make the other requisite finding set forth under ERISA. The ultimate determination of whether a pension plan may be terminated in a distress termination rests with PBGC. *See In re Wire Rope*, 287 B.R. at 777.

With respect to the distress test, the Debtors bear the burden of proof. *See, e.g., In re US Airways Group*, 296 B.R. 734, 744 (Bankr. E.D. Va. 2003); *In re Wire Rope*, 287 B.R. at 777. ERISA requires them to prove that unless the Pilots Plan is terminated, they will be unable to pay all debts under a plan of reorganization and will be unable to continue in business outside of bankruptcy. 29 U.S.C. § 1341(c)(2)(B)(ii)(IV). This statutory language requires a showing that *but for* the termination of the Pilots Plan, the Debtors will liquidate. *See In re Resol Mfg. Co.*, 110 B.R. 858, 862 (Bankr. N.D. Ill. 1990); *see also In re US Airways Group, Inc.*, 296 B.R. at 743; *In re Phillip Servs. Corp.*, 310 B.R. 802, 807 (Bankr. S.D. Tex. 2004); *In re Wire Rope*, 287 B.R. at 777; *In re Sewell Mfg. Co.*, 195 B.R. at 185.

Also, “the reference to ‘a’ plan of reorganization does not permit a distress termination simply because a particular plan requires it; rather the test is whether the debtor can obtain confirmation of *any* plan of reorganization without termination of the retirement plan.” *In re US Airways*, 296 B.R. at 743-744; *In re Phillips Servs. Corp.*, 310 B.R. at 807. Importantly, ERISA requires that the distress test must be met by *each* debtor that is a plan sponsor or controlled group member and with respect to *each* pension plan sought to be terminated. *See, e.g., In re Sewell Mfg. Co.*, 195 B.R. at 184.

The legislative history of ERISA indicates that the Debtors' burden of proof is an

extremely high one. Congress significantly changed the termination requirements for pension plans in 1986 and 1987. Before these amendments, a plan sponsor could terminate a pension plan for any reason. Congress first enacted the distress termination provisions as part of the Single-Employer Pension Plan Amendment Act of 1986 (“SEPPAA”), Pub L. No. 99-272, 100 Stat. 237 (1986). In doing so, Congress sought to limit employers’ ability to voluntarily terminate an underfunded pension plan to cases of severe hardship. The legislative history shows that the “policy of the legislation is to limit the ability of plan sponsors to shift liability for guaranteed benefits onto other PBGC premium payers and to avoid responsibility for the payment of certain nonguaranteed benefits, to cases of severe hardship.” H.R. Rep. No. 300 (1985), *reprinted in* 1986 U.S.C.C.A.N. 930. The House Report further explained a primary purpose for the distress termination provisions was “to provide for the transfer of unfunded pension liabilities onto the single-employer pension plan termination insurance program only in cases of severe hardship so as to keep the premium costs of such system at a reasonable level.” H.R. Rep. No. 300 (1985), *reprinted in* 1986 U.S.C.C.A.N. 929. Congress then further clarified the distress criteria in the Pension Protection Act of 1987, Pub. L. No. 100-203, 101 Stat. 1330 (1987), when it added the current stringent reorganization test.<sup>5</sup>

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<sup>5</sup> As explained by Rep. Schulze, one of the conferees:

The conference agreement narrowed the ability of a pension plan sponsor to transfer his pension plan obligations to the PBGC by the mere filing of a bankruptcy petition under chapter 11. Under the conference agreement a bankruptcy court judge will not allow a distress termination of a pension plan *unless he determines that the company is unable to pay its debts* pursuant to a plan of reorganization and continue in business outside of [C]hapter 11.

Furthermore, a pension plan termination would be allowed *only if it otherwise would force the sponsor into liquidation*; and where, for example, the court had found that the sponsor had made meaningful sacrifices, such as in its pay package agreements.

In making a determination under the reorganization in bankruptcy test, a bankruptcy court should therefore inquire whether the debtors have pursued and exhausted all realistic measures that would enable them to pay their debts under a plan of reorganization and continue in business outside Chapter 11. These measures can and should include evidence of the costs of maintaining the pension plan, evidence on the costs of maintaining the plan if funding waivers are obtained, evidence on the costs of maintaining the plan if a freeze on future accrual of benefits were put in place, evidence on the projected costs of the pension plan(s) using different actuarial assumptions or cost methods, and evidence on whether there are other cost savings or discretionary spending in the debtors' business plan that can be used to fund the pension plan.<sup>6</sup> See, e.g., *In re US Airways Group*, 296 B.R. at 744-46; *In re Phillip Servs. Corp.*, 310 B.R. at 808; *In re Wire Rope*, 287 B.R. at 777-80. Only after a fully developed record is made on these issues can a court decide whether "but for" the termination of the pension plan, the Debtors would be forced to liquidate, and thereby make the necessary findings required by ERISA.

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133 Cong. Rec. H11970 (Dec. 21, 1987) (emphasis added).

<sup>6</sup> A defined benefit plan must be funded in accordance with the minimum funding standard prescribed by the IRC and ERISA. 26 U.S.C. § 412; 29 U.S.C. § 1082. The sponsor of a defined benefit pension plan may request from the Internal Revenue Service a waiver of the minimum funding contributions owed for a plan year if the employer is unable to satisfy the minimum funding standards for the plan year without temporary substantial business hardship. 26 U.S.C. § 412(d); Revenue Procedure 2004-15, 2004-7 I.R.B. 490. The statute also requires the IRS to provide PBGC with the opportunity to comment on whether it believes the waiver should be granted. 26 U.S.C. § 412(f)(3)(B). An employer may be required to provide security for any funding waiver, 26 U.S.C. § 412(f)(3), and only three waivers can be obtained in any given 15 year period. 26 U.S.C. § 412(d)(1).

## CONSIDERATION OF THE DEBTORS' DISTRESS MOTION

Debtors argue that absent termination of the Pilots Plan, Delta will face an “imminent operational and financial crisis that will threaten Delta’s near term survival.” (See Debtors’ Motion, p. 21.) Debtors claim that if the Pilots Plan does not terminate, lump sums will again become available which will cause an estimated 800 to 1,000 pilots to retire immediately, Delta will need approximately 14 to 16 months to train and replace the recently retired pilots, and Delta’s mainline capacity will decline by 29 to 41 percent as Delta attempts to replace the recently retired pilots. (See *id.* at ¶¶ 45, 48, 49.)

Before this Court may approve the termination of the Pilots Plan, the Court must decide whether the Debtors have satisfied their burden to prove that “*but for* the termination of the pension plan, the debtor will not be able to pay its debts when due and will not be able to continue in business.” *In re Resol Mfg. Co.*, 110 B.R. at 862 (emphasis added). Accordingly, Debtors must prove to this Court that if the lump sum window opens, 800 to 1,000 Delta pilots will in fact immediately retire and elect to receive a lump sum. And, Debtors must prove that, if such a large number of Delta pilots did in fact immediately retire, no other options exist to prevent the crisis Debtors argue will occur. In doing so, Debtors must show that they have exhausted all realistic measures to retain the Pilots Plan. For example, Debtors must prove that Delta cannot eliminate or sufficiently modify the lump sum provision of the Pilots Plan to mitigate the crisis it predicts, and that nothing in the new pension legislation mitigates the predicted crisis, either. Debtors should also be required to prove that Delta cannot rehire retired pilots on an interim basis, as it has done before, or even if it could, such measure would not avoid an operational and financial crisis. Debtors cannot simply claim that such crisis would occur and no other alternative exists but to terminate the Pilots Plan.

Debtors also argue that even if they could overcome the purported operational and

financial crisis that would occur if the lump sum window reopened, Debtors could not secure the exit financing necessary to emerge from bankruptcy. (See Debtors' Motion, ¶ 56.) Often, a key question a bankruptcy court must resolve in making its factual determination under the reorganization in bankruptcy test is whether a debtor can obtain the necessary financing to emerge from bankruptcy if the pension plan is not terminated. See, e.g., *In re US Airways*, 296 B.R. at 745; *In re Phillip Servs. Corp.*, 310 B.R. at 807; *In re Wire Rope*, 287 B.R. at 777; *In re Sewell Mfg. Co.*, 195 B.R. at 185. This question must be answered based upon a careful analysis of the available financial information taken as a whole. See *In re U.S. Airways, Inc.*, 296 B.R. at 745-46.

As one court has observed:

[I]n determining whether a pension plan must be terminated as a distress termination, the bankruptcy judge should consider the provisions of a proposed chapter 11 plan (if one has been proposed at the time of the decision) but that the bankruptcy judge must also look to existential financial reality and try to judge whether the plan provisions are necessary or whether they are merely desired by the entities that would benefit from the termination.

*In re Philip Servs. Corp.*, 310 B.R. at 808.

Here, this Court must not only analyze the specific business plan proposed by Delta, but should also look at all available financial information to assess whether any business plan could be implemented that would allow Delta to retain the Pilots Plan and emerge from bankruptcy.

After reviewing all available financial and operational information, only if this Court is satisfied that the Debtors have shown *but for* the termination of the Pilots Plan, each Debtor will not be able to pay its debts when due and will not be able to continue in business, should this Court make the factual determination required by ERISA and grant the Debtors' Motion.

## CONCLUSION

The Debtors must make the factual and legal showings required by ERISA before this Court may determine that the strict criteria for a distress termination of the Pilots Plan is met.

Dated: August 18, 2006  
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