IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

US AIRLINE PILOTS ASSOCIATION, Plaintiff, v. PENSION BENEFIT GUARANTY CORPORATION, Defendant.	)	Civil Action No. 1:09-cv-01675 (FJS)

POST-TRIAL BRIEF OF DEFENDANT
PENSION BENEFIT GUARANTY CORPORATION

PBGC respectfully submits this brief on the issues the Court identified at the end of trial.[1] The Court asked the parties to address:

(1) the scope of USAPA's requested relief (who would be the replacement trustee, who would pay for it, what would its duties be); and

(2) how USAPA could gain anything in this suit, and specifically the relevance of the $500 million threshold.

A. THERE ARE NO MEANINGFUL DUTIES LEFT FOR A REPLACMENT TRUSTEE TO PERFORM.

USAPA has never identified who its proposed replacement or supplemental trustee would be, nor who would be qualified to serve as a new trustee under the facts and circumstances of this case. What USAPA *has* asserted, without any support of law, is that the money to pay for the trustee and any associated fees should come from PBGC. During the second preliminary injunction hearing, Judge Kennedy asked, "[W]ith respect to the question of who would pay for the trustee, I would assume that would be the government or the PBGC?" USAPA counsel

[1] Tr. at 63:9 to 64:9 (Feb. 28, 2013).

responded: "Yes, sir."[2] It is not clear that PBGC is authorized to pay the fees and expenses of such a trustee. But even if it were, to order such relief here would be a waste of scarce agency resources.

USAPA conducted discovery for 18 months, including 17 depositions and receipt of more than 200,000 pages of documents. Despite that, USAPA has been unable to identify a single meritorious claim against the Plan's former officials.[3] Nonetheless, USAPA insists that a new trustee is needed to conduct further inquiry into alleged "red flags" identified by its expert Steven Stanton. But on cross-examination, Mr. Stanton conceded that he had never conducted a forensic accounting investigation of an ERISA plan that resulted in a successful claim for damages against a fiduciary. *Id.* at 79:14-22. And at trial, one by one, Mr. Stanton's list of "red flags" was whittled down until nothing remained.

The decrease in the Plan's share of master trust assets from 66% to 44% between December 31, 1999, and December 31, 2000, was explained by the merger of the Certain Employees plan into the master trust on August 1, 2000. *Id.* at 67:1 to 72:20. The change in trustee from Wachovia Bank to State Street Bank in 1999 was caused by State Street's purchase of Wachovia's institutional trust business. *Id.* at 73:3 to 76:2. Mr. Stanton chose a Milliman report to compare the Plan's investment performance to that of other plans, but acknowledged that the Milliman report included data from nonqualified and foreign plans, and that his analysis did not take into account differences arising from calendar-year versus fiscal-year reporting. *Id.* at 88:6-18; 95:10 to 99:24. Mr. Stanton pointed to what he thought was an increase in hard-to-value assets in the Plan, but admitted he misinterpreted one of USAPA's own exhibits, which

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2 Tr. at 34:17-20 (Jan. 26, 2011).

3 Stanton Test., Tr. at 80:25 to 81:8 (Feb. 27, 2013, a.m.)

showed that the data pertained not to the Plan but the master trust.[4] Mr. Stanton also conceded that he did not compare the percentage of hard-to-value assets in the Plan to the percentage in comparable plans at the time, and had no idea how well the hard-to-value assets performed relative to other assets. *Id.* at 36:16 to 37:13.

Mr. Stanton questioned the Plan actuary's rate-of-return assumptions, but did not dispute that they were comparable to those used by many other large plans. *Id.* at 20:4 to 30:13. Mr. Stanton questioned the Plan actuary's retirement-age assumption, but conceded that he could not quantify the effect a change in that assumption would have on required contributions, if any. *Id.* at 40:14 to 41:5. Mr. Stanton expressed suspicion that the Plan used actuarial "smoothing" techniques, but acknowledged that they were perfectly legal, and did not dispute that they were used by almost half of the largest plans. *Id.* at 43:18 to 44:11. Mr. Stanton acknowledged that he did not identify a single Plan investment that was inconsistent with the Plan's investment policy.[5] Mr. Stanton chose an aggregate benchmark for investments that differed from the benchmarks for separate asset classes contained in the Plan's investment policy. *Id.* at 88:6 to 91:10. And Mr. Stanton conceded that the 2004 Department of Labor investigation — which found no significant difference between the performance of the Plan's investments and the experience of comparable market investments during that period — used separate benchmarks for each asset class, and reached an opposite conclusion from his.[6]

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[4] Stanton Test., Tr. at 38:8-14 (Feb. 27, 2013, p.m.)

[5] Stanton Test., Tr. at 86:2-4 (Feb. 27, 2013, a.m.).

[6] Stanton Test., Tr. at 8:24 to 12:5 (Feb. 27, 2013, p.m.).

USAPA asserted: "In 2000, US Airways claimed the Pilots Plan was 104% funded . . . . Three years later, the Plan was suddenly and (and inexplicably) underfunded by $2.2 billion."[7] But PBGC's expert Neela Ranade, the only actuary to testify, demonstrated that the reasons for the underfunding, with the exception of investment loss, were outside the control of the Plan's fiduciaries. Ms. Ranade explained that it is improper to compare funding figures measured on an ongoing basis to those expressed on a PBGC termination basis.[8] Based on an apples-to-apples comparison on a PBGC termination basis, Ms. Ranade concluded that the change in the Plan's unfunded benefit liabilities could be readily explained by ordinary factors. *See generally id.* at 61:16 to 71:14. She testified that the Plan's investment loss during that period was $325 million. *Id.* at 66:15 to 67:12; 71:11-14. Other factors included $628 million due to change in interest rates, $346 million due to change in discounting periods, and $575 million due to accrual of benefits. *Id.* at 63:1 to 66:14. Moreover, the $325 million investment loss was in line with market performance, as shown by the Plan's cumulative return on assets of negative 19.1%, which was within 0.4% of the cumulative return for the benchmark large plans of negative 18.7%. *Id.* at 68:17 to 69:1. Ms. Ranade explained that it was unsurprising the sponsor made no contributions in years before termination when none were required. *Id.* at 85:2-8. And Ms. Ranade testified that in her experience it was common to see a substantial increase in plan underfunding before termination. *Id.* at 76:4 to 77:9.

Finally, PBGC's ERISA expert, Carol Connor Cohen, rebutted USAPA's central premise that PBGC was subject to the standard of care governing Title I fiduciaries.[9] Ms. Cohen

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[7] Dkt. #111, Pl.'s Trial Brief at 16.

[8] Ranade Test., Tr. at 60:9 to 61:15 (Feb. 27, 2013, p.m.).

[9] Cohen Test., Tr. at 11:6 to 14:4 (Feb. 28, 2013).

corroborated that it is not unusual, and indeed normal, for a plan that terminates in an underfunded state to have a significant increase in underfunding before termination. *Id.* at 17:21 to 18:9. Ms. Cohen testified that ERISA's prudence test for investments is one of procedural prudence (i.e., how the investment is made), not how the investment performs. *Id.* at 19:7-16. Ms. Cohen explained that the establishment of actuarial assumptions is not a fiduciary function at all, but one performed by actuaries. *Id.* at 19:23 to 20:7. And she testified that allegations that a plan sponsor avoided making contributions also do not implicate fiduciary duty, because plan funding obligations are a settlor function, not a fiduciary function. *Id.* at 20:8-14.

In sum, both the Plan's funded status and investment losses were explained at trial, and require no further investigation. The alleged "red flags" that USAPA raised beginning in 2009 have already been investigated by PBGC or shown to be nonexistent. Accordingly, no meaningful duties remain for a new trustee to perform.

B. USAPA CAN GAIN NOTHING FROM THIS SUIT, WHETHER OR NOT A NEW TRUSTEE IS APPOINTED.

PBGC determines the total amount of a terminated plan's assets based on their fair market value as of the plan's termination date.[10] Once PBGC values a plan's assets as of the termination date, that valuation is not changed by subsequent events, with rare exceptions. This is because ERISA requires that "[a]ny increase or decrease in the value of the assets of a single-employer plan occurring after the date on which the plan is terminated shall be credited to, or suffered by, the corporation" (*i.e.*, PBGC).[11] For example, a change in the price of a plan's holdings of stock occurring after the termination date would not affect participants' benefits.

[10] 29 C.F.R. § 4044.41(b); *see* 29 U.S.C. § 1344(c).

[11] *Id.*; *see* 29 C.F.R. § 4044.3. In rare cases, PBGC may change the valuation of a plan's assets "only if there has been a material mistake of fact or if there has been an extraordinary change of

Judge Kennedy noted in 2011 that "the first $510 million of any litigation recovery would accrue to PBGC rather than the Plan . . . ."[12] He went on to state that "there is little support for the proposition that PBGC's conduct, even if improper, has resulted in any significant loss to the Plan rather than to PBGC itself." *Id.*

This conclusion referred to the six-tier asset allocation scheme under 29 U.S.C. § 1344(a). A terminated plan's assets are allocated to benefits provided by the plan according to the six "priority categories" in section 1344, starting with priority category 1 ("PC1"), and then moving to priority category 2 ("PC2"), and so on, until all assets are exhausted.[13]

Based on the 2006 plan asset evaluation, a PBGC declarant explained:

> After satisfying the benefits in PC3, the Pilots Plan thus had remaining assets of about $40 million to allocate to all remaining benefits. PBGC determined that the Pilots Plan had guaranteed benefits of about $550 million in PC4 that were not included in PC3. Thus, the Pilots Plan would have needed an additional $510 million of assets before any assets could have been allocated to the nonguaranteed benefits in PC5 or PC6.[14]

After Crowe Horwath completed the new plan asset evaluation in 2012, PBGC reported its results to the Court.[15] The revised asset value is about $28 million greater than the amount

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circumstances such as a substantial unexpected recovery in a legal action involving the plan." Dkt. #38-2, Decl. of Rob Jones ¶ 11 (Sept. 11, 2009).

[12] Dkt. #47, Mem. Op. at 12.

[13] This statutory scheme is discussed in more detail at Dkt. #58, PBGC's Mot. for J. on the Pleadings, or in the Alternative, for Summ. J. at 4-6. The Supreme Court explained: "[T]he allocation scheme 'protect[s] against evasion of the . . . limits on the [PBGC's] insurance benefits by use of pension fund assets to first pay uninsured benefits.'" *Mead Corp. v. Tilley*, 490 U.S. 714, 718 n.2 (1989), quoting S. Rep. No. 93-383 at 76 (1973), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4968.

[14] Dkt. #38-2, Decl. of Rob Jones ¶ 15 (Sept. 11, 2009). *See also* Dkt. #108, Joint Pretrial Stipulations at 4, Undisputed Facts ¶ 24.

[15] Dkt. #92, PBGC's Notice of Filing Report of Plan Asset Evaluation.

PBGC had originally calculated, a difference of about 2% on a total asset value of roughly $1.2 billion. *Id.* at 1. There was no effect on the benefits of Pilots Plan participants. *Id.* at 2. The change in asset value, all allocated to PC4, simply brought plan assets to within about $482 million of reaching the nonguaranteed benefits in PC5 or PC6 — still a vast distance.

USAPA counsel argued that "the benefits calculation PBGC does is supposed to be based upon a proper valuation of all assets, including potential claims."[16] "And that's the key, Your Honor: The benefit calculation is based upon valuation, not collection." *Id*. at 18:7-8. But even assuming that a potential claim exists, USAPA confuses the *amount* of a claim with its *value*, which must take into account collectability. If the expected cost of collecting a claim exceeds the expected recovery, its value is zero. PBGC's regulations require assets to be valued at their fair market value at the plan termination date.[17] USAPA never identified a single actual claim against former Plan officials, much less one with collectable *value* in 2003 approaching half a billion dollars. Moreover, Ms. Ranade determined the Plan's investment losses in the pre-termination period to be $325 million. Thus, even if the entire investment loss were caused by a fiduciary breach — a fantastic supposition — USAPA still could not reach the half billion dollar threshold. Because finding a potential claim valued at nearly $500 million dollars is unimaginable under these circumstances, granting USAPA's requested relief could not materially benefit Plan participants.

[16] Tr. at 18:12-14 (Feb. 26, 2013, a.m.).

[17] 29 C.F.R. § 4044.41(b).

CONCLUSION

The Court should enter judgment in favor of PBGC, and against USAPA.

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Respectfully submitted,

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