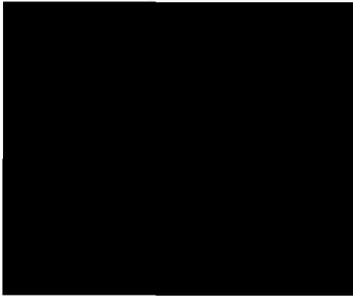




Pension Benefit Guaranty Corporation  
1200 K Street, N.W., Washington, D.C. 20005-4026

November 28, 2014



Re: Appeal 2013- [REDACTED]; [REDACTED]; Case Number 199627; United Airlines, Inc. Pilots Fixed Benefit Income Plan (the "Pilots Plan" or the "Plan")

Dear [REDACTED]

The Appeals Board of the Pension Benefit Guaranty Corporation ("PBGC") reviewed your appeal regarding PBGC's November 29, 2010 benefit determination to [REDACTED]. [REDACTED] authorized the Air Line Pilots Association, International ("ALPA") to represent him in this appeal. Your firm represents ALPA for purposes of [REDACTED]'s appeal.

As summarized next and explained in this decision, the Appeals Board denies the Appeal.

### SUMMARY

The Appeal raises three issues. The first two issues relate to PBGC's responsibility under section 4022(c) of the Employee Retirement Income Security Act of 1974, *as amended* ("ERISA"), to pay eligible Plan participants and beneficiaries additional amounts based on PBGC's recovery from United Airlines Lines, Inc. ("UAL").<sup>1</sup> The third issue concerns whether PBGC should credit a 2004 premium payment back to Pilots Plan assets; the Board's decision could affect benefits PBGC pays under ERISA section 4044.

Issue 1 of the Appeal asserts that PBGC incorrectly determined [REDACTED]'s PBGC-payable benefit due to an error in PBGC's allocation of its recovery from UAL. The Appeal argues that such error not only affected [REDACTED]'s benefits but also resulted in PBGC underpaying an estimated \$90 million to participants and beneficiaries in the Pilots Plan, the

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<sup>1</sup> Title IV of ERISA is codified at 29 United States Code ("U.S.C.") §§ 1301-1461 (2012). This decision generally cites the applicable sections of ERISA without providing the parallel U.S.C. citations.

United Airlines Flight Attendant Defined Benefit Pension Plan (the “Flight Attendant Plan”), the United Airlines Ground Employees Plan (the “Ground Plan”), and the United Airlines Management, Administrative & Public Contact Defined Benefit Pension Plan (the “MAPC Plan”) (collectively referred to as the “UAL Pension Plans” or the “Pension Plans”), all of which are trusted by PBGC.

Issue 2 of the Appeal contends that PBGC undervalued certain recoveries from UAL. Specifically, the Appeal requests that PBGC: (1) correct alleged deficiencies in PBGC’s July 3, 2007 recovery valuation that the Appeal argues resulted in an undervaluation of the 6% Senior Notes and 8% Contingent Notes issued to PBGC;<sup>2</sup> and (2) account for increases in the value of the 6% Senior Notes and 8% Contingent Notes resulting from the October 2010 merger of UAL and Continental Airlines, Inc. (the “UAL-Continental Merger” or “Merger”). In addition, the Appeal requests that the Appeals Board perform an *in camera* review of certain redacted documents provided to ALPA and documents withheld from ALPA in their entirety pursuant to the Freedom of Information Act (“FOIA”); the Appeal claims that these documents relate to the value of the 6% Senior Notes and 8% Contingent Notes.<sup>3</sup> The Appeal also requests that the Appeals Board provide the relevant documents to ALPA in unredacted form.

Issue 3 of the Appeal asserts that PBGC must increase the value of the Pilots Plan assets to account for a \$266,988 premium payment made by the Plan on February 25, 2004.

Finally, the Appeal requests that PBGC issue revised benefit determinations to [REDACTED] and other participants and beneficiaries in the UAL Pension Plans who have been affected by PBGC allocation and valuation errors alleged in the Appeal. The Appeal also requests that the Appeals Board refer this matter to the PBGC Director for a decision if the Board concludes it lacks authority to grant the requested relief or if the Appeals Board is for any reason “disinclined” to grant the requested relief.

As explained in this decision, the Appeals Board finds:

1. PBGC did not err in its allocations of PBGC’s recovery from UAL;
2. PBGC did not err when it valued its recovery, nor is PBGC required to revalue its recovery based on the October 2010 merger of UAL and Continental;<sup>4</sup> and
3. PBGC did not err in its treatment of the Plan’s February 25, 2004 premium payment of \$266,988.

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<sup>2</sup> February 17, 2006 is the Valuation Date for PBGC’s recovery from UAL.

<sup>3</sup> On February 15, 2013, PBGC’s General Counsel granted in part and denied in part your appeal of PBGC’s Disclosure Officer’s decision to withhold certain documents requested by ALPA in a March 26, 2012 FOIA request.

<sup>4</sup> As discussed in this decision, the Appeals Board performed an *in camera* review of certain documents as requested in the Appeal. The Appeals Board finds that such documents are not relevant to the Appeals Board’s decision, nor can the Board release such documents to you.

Therefore, the Appeals Board denies the Appeal.<sup>5</sup> The Board also declines the Appeal's request for referral of the Appeal to the PBGC Director.<sup>6</sup> The Board's decision on this Appeal is the final agency action with respect to [REDACTED] PBGC-payable benefit.

### **PBGC's Determination and The Appeal**

On November 29, 2010, PBGC sent [REDACTED] a benefit determination.<sup>7</sup> PBGC determined that [REDACTED] was entitled to a monthly PBGC-payable benefit of \$2,799.33 based on an assumed benefit commencement date of [REDACTED], 2010 in the form of a Straight Life Annuity with Modified Cash Refund.<sup>8</sup>

Between January 2011 and April 2013, [REDACTED] (individually or through his representatives) requested a number of appeal-filing extensions. The Appeals Board granted these requests. [REDACTED] (individually or through his representatives) also submitted record requests under FOIA.<sup>9</sup>

In 2011, [REDACTED] "appointed ALPA as his designated representative with full power and authority to act on his behalf in connection with a possible appeal."<sup>10</sup> ALPA authorized your firm to represent ALPA in connection with FOIA requests and this appeal.<sup>11</sup>

On April 25, 2013, you appealed [REDACTED]'s benefit determination. You submitted an appeal brief ("Appeal Brief" or "AB") with exhibits ("Appeal Exhibits"). On May 28, 2013, you supplemented the Appeal Brief with an additional letter ("Supplemental Appeal Brief" or "Supp. AB") with exhibits ("Supplemental Appeal Exhibits"). This decision refers to the Appeal Brief, the Supplemental Appeal Brief, and all Appeal Exhibits you provided to the Appeals Board collectively as the "Appeal."

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<sup>5</sup> There is no basis for issuing [REDACTED] a new benefit determination because his PBGC-payable benefit will not change. Similarly, the Appeal does not provide any basis upon which PBGC would issue revised benefit determinations to other Pilots Plan participants and beneficiaries in light of the Appeals Board's decision.

<sup>6</sup> It is within the Appeals Board's discretion to refer matters to the PBGC Director. *See* 29 Code of Federal Regulations ("C.F.R.") § 4003.60. The Board, in its discretion, decided not to refer this Appeal to the PBGC Director because the Board fully addresses the issues in the Appeal.

<sup>7</sup> Part 4003 of PBGC's regulations establishes the rules governing PBGC's issuance of initial benefit determinations and the procedures for requesting and obtaining administrative review. *See* 29 C.F.R. Part 4003, *Rules for Administrative Review of Agency Decisions*. An initial (formal) benefit determination is the letter PBGC issues to communicate the agency's determination of an individual's benefit. *See* 29 C.F.R. § 4003.21. If the individual desires Appeals Board review of his or her benefit, the individual or his or her representative must file an appeal of the agency's determination, or request an extension of time to file an appeal, within 45 days from the date of issuance of the benefit determination. *See* 29 C.F.R. §§ 4003.4, 4003.52.

<sup>8</sup> As stated later, [REDACTED] commenced benefits on January 1, 2014.

<sup>9</sup> *See* 5 U.S.C. § 552.

<sup>10</sup> *See* Appeal Exhibit 32. Plan participant [REDACTED] also appointed ALPA as his representative in connection with a possible appeal. Ultimately, [REDACTED] did not appeal his PBGC benefit determination.

<sup>11</sup> *See generally* Appeal Exhibit 36, the March 26, 2012 Letter from ALPA to PBGC's Disclosure Officer.

## **INTRODUCTION AND BACKGROUND**

PBGC is the United States government agency that provides pension insurance in accordance with ERISA. If a plan sponsor of a tax-qualified defined benefit pension plan is unable to support its plan, PBGC becomes trustee of the plan and pays pension benefits provided by the plan, subject to legal limitations under ERISA.

### **The Pilots Plan and UAL's Bankruptcy**

A predecessor to UAL established the "Group Annuity Program" to provide benefits for eligible employees and beneficiaries effective January 1, 1941.<sup>12</sup> The Group Annuity Program, as it applied to certain eligible pilots, was amended effective January 1, 1976 and named the *United Air Lines, Inc. Pilots' Fixed Benefit Retirement Income Plan*. The last formal plan document that restated all of the Pilots Plan's terms is the *United Airlines Pilot Defined Benefit Pension Plan, 1999 Amendment and Restatement*, Effective as of January 1, 1999.<sup>13</sup>

Facing financial difficulties common to many commercial domestic airlines following the September 11, 2001 terrorist attacks, UAL asked the Air Transportation Stabilization Board (the "ATSB") for a loan guarantee on June 21, 2002. On December 4, 2002, the ATSB rejected UAL's request.<sup>14</sup> On December 9, 2002, UAL and twenty-seven affiliated corporations (collectively referred to as "UAL") simultaneously filed Voluntary Petitions for Relief under Chapter 11 of the United States Bankruptcy Code in the United States Bankruptcy Court, Northern District of Illinois, Eastern Division (the "Bankruptcy Court").<sup>15</sup>

UAL sponsored four pension plans that were covered under Title IV of ERISA: the Pilots Plan, the Flight Attendant Plan, the Ground Plan, and the MAPC Plan.<sup>16</sup> The UAL-sponsored pension plans are collectively referred to as "the Pension Plans" or "the UAL Pension Plans" in this decision. The UAL Pension Plans' assets were held in a master trust.<sup>17</sup>

On June 17, 2004, the ATSB rejected a second request by UAL for a loan guarantee. On August 17, 2004, U.S. Department of Labor ("DOL") Secretary Elaine Chao announced that DOL and UAL agreed that UAL would select an independent fiduciary for the Pension Plans, subject to DOL's approval. Secretary Chao stated, "United Airlines' decision to stop funding its

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<sup>12</sup> See Enclosure 1, *United Airlines Pilot Defined Benefit Pension Plan, 1999 Amendment and Restatement, Effective Beginning January 1, 1999*, through Appendix A, History of the Plan. The Plan names *United Airlines Pilot Defined Benefit Pension Plan* and *United Airlines, Inc. Pilots' Fixed Benefit Retirement Income Plan* are used interchangeably throughout the Plan documents, enclosures and Appeal Exhibits. Both names identify the Pilots Plan.

<sup>13</sup> See Enclosure 1.

<sup>14</sup> See Enclosure 2.

<sup>15</sup> The Appeals Board refers to UAL and its twenty-seven affiliated corporations as "UAL" in this decision.

<sup>16</sup> UAL also sponsored the Employees' Variable Benefit Retirement Income Plan ("Variable Plan"). The Variable Plan later merged into the MAPC Plan.

<sup>17</sup> The Pension Plans' assets were held in the United Air Lines, Inc. Group Investment Trust. See Pension Plans' separate Forms 5500, *Annual Return/Report of Employee Benefit Plan*, ("Forms 5500"), including Schedules B and D, and the attachments to the Schedules B at Enclosure 3.

pension plans made clear the need to appoint an independent fiduciary to represent the interests of workers and retirees.”<sup>18</sup> UAL appointed Independent Fiduciary Services (“IFS”) as the Plan’s fiduciary. DOL agreed to the selection, and the selection was approved by the Bankruptcy Court. IFS’ appointment as fiduciary went into effect on September 17, 2004.<sup>19</sup>

On November 30, 2004, IFS filed a motion in Bankruptcy Court (“IFS Motion”) asserting that all of the minimum funding contribution claims of the Pension Plans should be administrative expenses of the UAL estates, entitled to priority pursuant to the Bankruptcy Code.<sup>20</sup> Alternatively, the IFS Motion asserted that “at the very least, that amount [post-petition benefit accruals] (and any future contributions accruing on account of benefits earned by post-petition labor) should receive administrative expense priority.”<sup>21</sup>

On December 5, 2004, UAL filed an objection to the IFS Motion in Bankruptcy Court.<sup>22</sup> On December 10, 2004, PBGC filed a motion in Bankruptcy Court supplementing the IFS Motion. PBGC asserted “that *all* post-petition minimum funding contributions must be allowed as administrative expenses.”<sup>23</sup> (Emphasis in original.) On or around that time, the Secretary of Labor filed an amicus brief in support of the IFS Motion.<sup>24</sup>

Prior to the Bankruptcy Court’s ruling on the IFS Motion, PBGC initiated termination of the Pilots Plan by issuing a Notice of Determination (“NOD”) to UAL on December 29, 2004.<sup>25</sup> As stated in the NOD, PBGC determined, under ERISA section 4042(a)(4), “that the United Airlines Pilot Defined Benefit Pension Plan (‘Plan’) must be terminated because the possible long-run loss of the corporation with respect to the Plan may reasonably be expected to increase unreasonably if the Plan is not terminated.” The NOD also stated that PBGC sought to establish December 30, 2004 as the Pilots Plan’s termination date under ERISA section 4048.<sup>26</sup>

On March 18, 2005, United States Bankruptcy Judge Eugene R. Wedoff rejected IFS’ position that all minimum funding claims should be accorded administrative priority, stating that “the mere fact that the obligation to make quarterly minimum funding payments came due post-petition does not establish it as an administrative priority.”<sup>27</sup> Judge Wedoff made the following ruling from the bench:<sup>28</sup>

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<sup>18</sup> See Enclosure 4. See also Enclosure 5.

<sup>19</sup> See Appeal Exhibit 3. See also Enclosure 5.

<sup>20</sup> See Appeal Exhibit 3. See also 11 U.S.C. § 503(a).

<sup>21</sup> See Appeal Exhibit 3, IFS Motion at 34.

<sup>22</sup> See Appeal Exhibit 5.

<sup>23</sup> See Appeal Exhibit 4 at 1.

<sup>24</sup> See Appeal Exhibit 6.

<sup>25</sup> See Enclosure 6.

<sup>26</sup> PBGC issued NODs regarding the Ground Plan, MAPC Plan, and Flight Attendant Plans on dates subsequent to the Pilots Plan NOD.

<sup>27</sup> See Appeal Exhibit 7, excerpt of Transcript, at 59.

<sup>28</sup> See Appeal Exhibit 7, excerpt of Transcript, at 56. See also AB at 13. IFS appealed the Bankruptcy Court’s ruling. The appeal was dismissed because PBGC and UAL executed a Settlement Agreement, as discussed *infra*. See Appeal Exhibit 8 (*i.e.*, docket entries for January 3, 2006 and January 17, 2006).

. . . [T]o the extent that United's obligations to the plans arose from services that its employees performed during its bankruptcy case, the obligations are indeed administrative expenses. But to the extent that the obligations arose from services performed before the bankruptcy was filed, the obligations are general unsecured claims not entitled to administrative priority.

In this decision, the Appeals Board refers to two categories of Due and Unpaid Employer Contributions ("DUEC"). The term "Unsecured Priority DUEC" refers to the post-petition "administrative expenses" quoted in Judge Wedoff's ruling. The term "General Unsecured DUEC" refers to pre-petition "general unsecured claims not entitled to administrative priority" quoted in Judge Wedoff's ruling.<sup>29</sup>

On April 22, 2005, PBGC and UAL executed a Settlement Agreement resolving bankruptcy-related disputes in connection with the Pilots Plan, the Flight Attendant Plan, the Ground Plan, and the MAPC Plan.<sup>30</sup> The Settlement Agreement consolidated PBGC's bankruptcy claims against UAL into "a single, prepetition, general, unsecured unfunded liability claim (the 'Unfunded Liability Claim') against the [UAL] bankruptcy estate" and was incorporated into UAL's Plan of Reorganization ("POR").<sup>31</sup> In exchange, UAL agreed to provide the following consideration to PBGC under UAL's proposed POR:

- (1) \$500 million in 6% Senior Subordinated Notes;
- (2) \$500 million in 8% Contingent Senior Subordinated Notes; and
- (3) \$500 million in 2% Convertible Preferred Stock.<sup>32</sup>

The Settlement Agreement also included terms regarding termination of the Pension Plans. Further, the Settlement Agreement included provisions relating to, among other things, restoration rights, release of liens, and UAL's restructuring and POR. The Bankruptcy Court approved UAL's Settlement Agreement with PBGC on May 11, 2005.

On October 26, 2005, the Bankruptcy Court approved PBGC's request to terminate the Pilots Plan as of December 30, 2004.<sup>33</sup> PBGC became trustee of the Pilots Plan on October 26, 2005.

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<sup>29</sup> Appeal Exhibits 13 and 17 use the term "Administrative Priority DUEC," which has the same meaning as "Unsecured Priority DUEC."

<sup>30</sup> See Appeal Exhibit 12. The Settlement Agreement appears as Exhibit 1 to Appeal Exhibit 12, which is the Bankruptcy Court Order Approving Debtors' Emergency Motion to Approve Agreement with PBGC.

<sup>31</sup> See page 5 of the Settlement Agreement in Appeal Exhibit 12.

<sup>32</sup> See pages 1-2 of the Settlement Agreement in Appeal Exhibit 12.

<sup>33</sup> See Enclosure 7, Bankruptcy Court's October 26, 2005 Memorandum of Decision, *In re: UAL Corporation, et al., Debtors*. See also Enclosure 8, Bankruptcy Court's October 26, 2005 Amended Memorandum of Decision on Motion for Summary Judgment. See also Enclosure 9, Bankruptcy Court's October 26, 2005 Order Terminating the United Airlines Pilot Defined Benefit Pension Plan. Through agreements executed by PBGC and UAL, the Ground Plan terminated as of March 11, 2005, and the MAPC Plan and Flight Attendant Plan terminated as of June 30, 2005.

The Bankruptcy Court confirmed UAL's POR on January 20, 2006, and UAL emerged from bankruptcy on February 1, 2006.

UAL merged with Continental Airlines, Inc. on October 1, 2010 and became United Continental Holdings, Inc., which remains an active carrier in the airline industry. The Appeals Board refers to the merged entity as UAL.

When the Pilots Plan terminated on December 30, 2004 ("DOPT"), its total underfunding – *i.e.*, the difference between the values of its assets and its benefit liabilities – exceeded \$2.7 billion. PBGC determined that the Pilots Plan had \$2,878,128,788 in assets and \$5,602,920,319 in benefit liabilities on DOPT, which resulted in unfunded benefit liabilities ("UBL")<sup>34</sup> of \$2,724,791,531 [ $\$5,602,920,319$  (Plan benefit liabilities) –  $\$2,878,128,788$  (Plan assets) =  $\$2,724,791,531$ ].<sup>35</sup>

### **PBGC's Records Concerning [REDACTED]**

PBGC's records contain the following information regarding [REDACTED]:

- [REDACTED] was born on [REDACTED], 1948;
- [REDACTED] began employment with UAL on [REDACTED], 1978;
- [REDACTED] became eligible to participate in the Pilots Plan on [REDACTED], 1979;
- [REDACTED] began a leave of absence on [REDACTED], 1981;
- [REDACTED] was furloughed on [REDACTED], 1981;
- [REDACTED] returned to active employment on [REDACTED], 1983;
- [REDACTED] earned [REDACTED] years of participation as of the Pilots Plan's December 30, 2004 termination date; and
- [REDACTED] began receiving an estimated monthly benefit of \$3,338.30, in the form of a Joint and 75% Survivor Annuity ("J&75%SA") on [REDACTED], 2014.<sup>36</sup>

### **PBGC's Guarantee and Its Limits**

The pension benefit a participant or beneficiary receives from PBGC depends on the plan's provisions; PBGC does not pay more than the plan would have paid (except in limited situations where the plan failed to follow ERISA's requirements). Moreover, PBGC does not guarantee all benefits provided by a pension plan. To be guaranteed, a benefit must, first, be "nonforfeitable," which means that the participant must have satisfied the pension plan's requirements to be

<sup>34</sup> See ERISA § 4001(a)(18) (definition of UBL) and § 4062(b) (liability of a plan sponsor and its controlled group to PBGC for UBL).

<sup>35</sup> See Supplemental Appeal Exhibit S-5A. PBGC initially calculated a larger UBL. The final UBL of \$2,724,791,531 was calculated after PBGC revalued Plan assets.

<sup>36</sup> Because [REDACTED] retired while this Appeal was pending, his monthly benefit payments were "estimated." Following issuance of this decision, [REDACTED] benefit payments are no longer estimated. [REDACTED] monthly benefit amount of \$3,338.30 is now his final monthly PBGC-payable benefit.

eligible for the benefit by the date on which the plan terminates.<sup>37</sup> Not all nonforfeitable benefits are guaranteed; there are statutory and regulatory limits on PBGC's guarantee.

ERISA places a cap, known as the Maximum Guaranteed Benefit ("MGB"), upon the amounts that PBGC guarantees.<sup>38</sup> The amount of an individual's MGB depends on a number of factors, including the year in which the pension plan terminated, the participant's age at the later of DOPT or date of benefit commencement, the form in which the benefit is paid, and the age of the participant's beneficiary if the benefit form includes a survivor benefit.<sup>39</sup> For plans terminating in 2004, as the Pilots Plan did, the MGB is \$3,698.86 per month (\$44,386.32 per year) for a participant who begins receiving PBGC benefits at age 65 in the form of a straight life annuity with no survivor benefit ("SLA"). If the participant is younger than 65 or if a survivor benefit will be paid, the MGB is lower.<sup>40</sup> The Appeal does not raise any issues regarding PBGC's application of the MGB.

Another limit on PBGC's guarantee is the phase-in limit, which provides that PBGC's guarantee of a benefit increase is phased in over five years from the later of the adoption or effective date of the increase.<sup>41</sup> To determine the phase-in limit, PBGC must scrutinize all plan amendments made during the five years before a plan terminates. The Appeal does not raise any issues regarding the phase-in limit.

In many cases, whether a participant or beneficiary receives his or her full plan benefit depends principally on the statutory and regulatory limits on PBGC's guarantee. However, if a plan has enough assets, some participants or beneficiaries may receive more than the guaranteed amount.

### **Allocating a Defined Benefit Pension Plan's Assets and PBGC's Recoveries Under ERISA**

ERISA's six-tier asset allocation structure determines how a terminated pension plan's assets are allocated among various categories of benefits.<sup>42</sup> The six priority categories are referred to as "PC1," "PC2," "PC3," etc. The Plan has no benefits in the first two priority categories (PC1 and PC2), which relate to benefits derived from a participant's own contributions. The next priority category, PC3, covers a participant's or beneficiary's benefits that were "in pay status" (*i.e.*, were being paid) three or more years before the plan's termination date, or that would have been in pay status three years before termination if the participant had retired. PC4 generally covers benefits guaranteed by PBGC that were not assigned to PC2 or PC3. PC5 covers other nonforfeitable benefits (generally, benefits that are greater than the PC3 benefit and are not guaranteed due to the limits described above). PC6 covers all other benefits under the plan (*i.e.*, non-vested benefits).

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<sup>37</sup> See ERISA § 4001(a)(8); 29 C.F.R. § 4022.3(a).

<sup>38</sup> See ERISA § 4022(b)(3).

<sup>39</sup> See 29 C.F.R. §§ 4022.22, 4022.23.

<sup>40</sup> See 29 C.F.R. § 4022.23.

<sup>41</sup> See ERISA § 4022(b)(1), (7); 29 C.F.R. §§ 4022.2 (definition of "benefit increase"), 4022.24, 4022.25.

<sup>42</sup> See ERISA § 4044(a).

A participant or beneficiary who went into pay status (or could have gone into pay status) three or more years before plan termination potentially may receive his or her full plan benefit amount, even if it is not all guaranteed by PBGC; this would occur if all of a participant's or beneficiary's benefit is in PC3 and the plan's assets are sufficient to cover all benefits in PC3.

If a plan's assets do not cover all benefits in PC3, each participant or beneficiary with a PC3 benefit generally will receive a benefit amount based on a pro rata share of the assets.<sup>43</sup> PBGC determined that the Pilots Plan's assets as of DOPT (\$2,878,128,788) covered 82.0617% of the Pilots Plan's benefits in PC3.<sup>44</sup>

Pursuant to ERISA section 4022(c), PBGC may pay some participants and beneficiaries additional amounts based on PBGC's recovery for UBL. For pension plans like the Pilots Plan, in which the outstanding amount of Unfunded Non-Guaranteed Benefits ("UNGB") exceeds \$20 million, the ERISA section 4022(c) amounts payable to participants and beneficiaries are determined based on PBGC's actual recovery on its UBL claims against the plan sponsor. Thus, pursuant to ERISA section 4022(c), PBGC allocated a portion of its UBL recovery from UAL to Pilots Plan benefits that are neither guaranteed by PBGC nor funded by the Plan's assets.

### **PBGC's Revised UAL Plan Asset Audit Slightly Changed the Recovery Allocation**

In 2012, PBGC completed a revaluation of the Pension Plans' assets, which resulted in an increase in assets for all four UAL Pension Plans.<sup>45</sup> Following PBGC's revaluation, PBGC recalculated participants' and beneficiaries' benefits across the four UAL Pension Plans. On or around August 2012, PBGC notified affected participants and beneficiaries of increases to their benefits. Eighteen percent (18%) of participants and beneficiaries in the Pension Plans were entitled to increases in the benefits shown in their benefit determination letters as a result of the revaluation.<sup>46</sup>

██████████ did not receive a notice of an increased benefit or a revised benefit determination following PBGC's revaluation of Pilots Plan assets. When he retired on ██████████, 2014, ██████████ MGB exceeded his PC3 benefit.<sup>47</sup>

<sup>43</sup> See ERISA § 4044(b)(2); 29 C.F.R. § 4044.10(d).

<sup>44</sup> See Supplemental Appeal Exhibit S-5A.

<sup>45</sup> *Id.* PBGC's Office of Inspector General ("OIG") issued an Evaluation Report on November 30, 2011, *PBGC Processing of Terminated United Airlines Pension Plans Was Seriously Deficient*, available at <http://oig.pbgc.gov/pdfs/PA-10-72-1.pdf>. PBGC's revaluation of the Pension Plans' assets was due, in part, to the findings by the OIG. See AB at 8.

<sup>46</sup> See generally FAQ: *UAL Asset Audit Review and Changes to Participants' Benefits*, located on the PBGC website at <http://www.pbgc.gov/wr/bulletin/info/unitedfaq.html>. PBGC stated in the FAQ that "[l]ess than one in five (18 percent) will get any increase at all to their PBGC benefits [across all four UAL Pension Plans]. Even those who do will generally get an increase of less than one percent."

<sup>47</sup> See Enclosure 10, Benefit Statement Worksheet, Line 20. As shown on Line 12 of ██████████ Benefit Statement Worksheet, his guaranteed (PC4) monthly benefit amount is \$3,412.20 as a Joint and 50% Survivor Annuity. As shown on Line 19, ██████████ PC3 monthly benefit amount is \$2,011.34 as a Joint and 50% Survivor Annuity. Because ██████████ elected a Joint and 75% Survivor Annuity, his monthly benefit amount is \$3,338.30. See Line 21 of the Benefit Statement Worksheet.

## ISSUES RAISED IN THE APPEAL

**Issue 1: Whether PBGC incorrectly determined [REDACTED] PBGC-payable benefit due to an error in PBGC's allocation of its recovery from UAL. (AB at 21-30.)**

### The Appeal

The Appeal alleges that PBGC contravened the Settlement Agreement when it allocated \$304,888,813.68 of its total recovery to the Pension Plans' DUEC and premium claims instead of allocating this amount to UBL claims. AB at 21-26, 30. The Appeal asserts that PBGC must allocate its entire recovery to UBL because PBGC waived its claims for DUEC and premiums pursuant to the Settlement Agreement's release of all claims against UAL except a single general unsecured liability claim. AB at 14, 23. The Appeal also contends that the Settlement Agreement's "claims resolution provisions, which were approved by order of the bankruptcy court and incorporated into the UAL POR, represent the law of the case." AB at 22.

The Appeal asserts that participants and beneficiaries across the four UAL Pension Plans are "shortchanged to the tune of an estimated \$90 million" because they would receive \$90 million more in benefits due to additional section 4022(c) allocations if recovery amounts were only allocated to UBL claims.<sup>48</sup> AB at 22. The Appeal requests that the Appeals Board "correct this error" in PBGC's recovery allocation by ruling that "PBGC has a single UBL claim for the total UBL of the four UAL Plans." AB at 5.

The Appeal further asserts that, if the Appeals Board upholds PBGC's conclusion that part of PBGC's recovery should be allocated to DUEC claim amounts, the Board should change PBGC's recovery allocation by classifying all DUEC claims as "general unsecured claims." AB at 26-27. The Appeal contends that, if the Board finds that a portion of PBGC's recovery should be allocated to Unsecured Priority DUEC, the Unsecured Priority DUEC claim amounts should be reduced because: (1) PBGC did not account for post-petition declines in employment at UAL; and (2) PBGC did not properly adjust its Unsecured Priority DUEC claim amounts for a) credit balances available to the Pension Plans as of UAL's bankruptcy petition date and b) UAL's contributions to the Pension Plans after the bankruptcy petition date. AB at 27-30.

### The Appeals Board's Conclusions

The Appeals Board denies Issue 1 of the Appeal. The Board finds that the terms of the Settlement Agreement were limited to UAL's bankruptcy proceeding and did not bind PBGC with regard to its responsibilities under Title IV of ERISA. Bankruptcy claims are often settled rather than litigated to avoid delay, expense, and uncertainty. The bankruptcy claims for the Pension Plans were settled in Bankruptcy Court for a single general unsecured claim for

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<sup>48</sup> With regard to the Appeal's assertion that participants and beneficiaries are entitled to \$90 million more in benefit amounts as a result of PBGC's "waiver," the Appeals Board notes that the Appeal has not provided a calculation of the \$90 million. The Appeals Board finds it unnecessary to determine the correctness of the amount in light of the Board's decision.

simplicity and to facilitate Bankruptcy Court approval and UAL's exit from bankruptcy. As PBGC stated in its May 9, 2005 brief in support of the Settlement Agreement:<sup>49</sup>

These issues over PBGC's claims are complicated, and proceedings to resolve them would necessarily be costly in terms of time and resources. PBGC settled these and other issues with United to avoid the drain on both the agency's and the estate's resources, and so that United can focus its efforts on a successful reorganization.

The Bankruptcy Court approved the Settlement Agreement on May 11, 2005. The Settlement Agreement applied solely to the resolution of disputes in UAL's bankruptcy and to UAL's POR.<sup>50</sup> The Appeals Board concludes that, because the Settlement Agreement is not binding with respect to PBGC's responsibilities under Title IV of ERISA, PBGC is not required to allocate its entire recovery from UAL to PBGC's UBL claims.

The Appeals Board further concludes that PBGC valued and allocated its recovery in accordance with ERISA, PBGC's regulations, and PBGC Operating Policy Manual 8.2-1, *Valuation and Allocation of Recoveries* ("PBGC Policy 8.2-1").<sup>51</sup> In so concluding, the Board rejects the Appeal's contention that PBGC should classify all DUEC claim amounts as "general unsecured claims." The Board also rejects the Appeal's assertion that the Unsecured Priority DUEC claim amounts determined by PBGC must be reduced because they do not properly account for: (1) post-bankruptcy petition declines in employment at UAL; (2) credit balances that arose prior to the bankruptcy petition date; and (3) UAL's contributions to the Pension Plans after the bankruptcy petition date.

### **Background on Issue 1**

#### *PBGC's ERISA Claims*

ERISA generally imposes liability on plan sponsors and the members of their controlled group for three types of claims when an underfunded PBGC-covered pension plan terminates. As the statutory trustee of a terminated pension plan, PBGC has claims against the plan sponsor (e.g., UAL) and its controlled group for the DUEC that were owed to the terminated pension plan.<sup>52</sup> Additionally, a plan sponsor and its controlled group become liable to PBGC for UBL

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<sup>49</sup> See Appeal Exhibit 9 at 7.

<sup>50</sup> See Appeal Exhibit 12.

<sup>51</sup> In this decision, references to PBGC Policy 8.2-1, unless otherwise noted, relate to PBGC Policy 8.2-1, 5th Edition, which was in effect when PBGC completed its revaluation of the Pension Plans.

PBGC regularly reviews and updates its policies in the course of its operations. Between the Pilots Plan's DOPT of December 30, 2004, and PBGC's 2012 completed asset revaluation of the Pension Plans, PBGC twice updated PBGC Policy 8.2-1. PBGC issued Policy 8.2-1, 4th Edition, on September 20, 2007. PBGC issued Policy 8.2-1, 5th Edition, on July 31, 2008. See Enclosure 11. PBGC Policy 8.2-1 was further updated in October 2012 (6th Edition), after the asset revaluation was completed. See Enclosure 12.

<sup>52</sup> See ERISA § 4062(c) (as in effect before January 1, 2008). Section 4062(c) imposes liability for a plan's "accumulated funding deficiencies," as defined under section 302 of ERISA and section 412 of the Internal Revenue Code. Additionally, pursuant to ERISA section 4042(d)(1)(B)(ii), the trustee of a plan "shall have the power to collect for the plan any amounts due the plan, including but not limited to the power to collect from the persons

upon a plan's termination.<sup>53</sup> Finally, PBGC has claims against a "Designated Payor" (e.g., UAL) for premiums that are owed to PBGC under Title IV of ERISA.<sup>54</sup>

Pursuant to PBGC Policy 8.2-1, PBGC allocated the \$1.6 billion recovery it received from UAL among PBGC's UBL, DUEC, and unpaid premium claims for the four UAL Pension Plans. These claims are discussed in more detail below.

*PBGC's UBL claims.* PBGC's UBL claims consist of the liability under ERISA section 4062(b) that a plan sponsor owes to PBGC as of DOPT with respect to its pension plan. Section 4001(a)(18) of ERISA provides the following definition of UBL:

"[A]mount of unfunded benefit liabilities" means, as of any date, the excess (if any) of—

- (A) the value of the benefit liabilities under the plan (determined as of such date on the basis of assumptions prescribed by the corporation [PBGC] for purposes of section 4044), over
- (B) the current value (as of such date) of the assets of the plan . . . .

PBGC calculated the UBL claims for each of the UAL Pension Plans by performing non-serialim valuations of the benefit liabilities and assets as of each UAL Pension Plan's DOPT.<sup>55</sup> As discussed in more detail below, pursuant to section 4022(c) of ERISA, PBGC shares a portion of its UBL recoveries with participants of PBGC-insured terminated pension plans.

*PBGC's DUEC claims.* DUEC are the liabilities under ERISA section 4062(c) for the outstanding balance of the plan's "accumulated funding deficiencies," the minimum amount that a pension plan sponsor and its controlled group are required by law to contribute to the pension plan to avoid excise taxes. The term "accumulated funding deficiencies" in ERISA section 4062(c) refers to a net deficiency in a plan's funding standard account.<sup>56</sup> Prior to the Pension Protection Act of 2006 ("PPA 2006"), ERISA and the Internal Revenue Code (the "IRC") required every employer with a tax-qualified plan to maintain a funding standard account and

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obligated to meet the [minimum funding] requirements of [ERISA] section 302 . . . ." PBGC generally refers to claims for these amounts as DUEC claims.

The Pension Protection Act of 2006 ("PPA 2006") made substantial changes to: (1) the minimum funding provisions under ERISA § 302 and IRC § 412; and (2) the DUEC liability in ERISA § 4062(c). See Pub. L. No. 109-280, § 107(b)(4) (2006). The UAL Pension Plans terminated between December 2004 and June 2005; therefore, the Appeals Board applies the minimum funding requirements as in effect prior to the effective date of PPA 2006 when deciding the Appeal.

<sup>53</sup> See ERISA §§ 4001(a)(18), 4062(b).

<sup>54</sup> See ERISA § 4007(a); 29 C.F.R. § 4007.12. The premiums that are owed to PBGC continue to accrue until the earlier of the distribution of a plan's assets pursuant to a termination procedure or the appointment of a trustee.

<sup>55</sup> The Pension Plans annually reported assets and liabilities on the Schedules B, *Actuarial Information*, of Forms 5500.

<sup>56</sup> ERISA section 302(a) defined "accumulated funding deficiencies," for any plan year, as "the excess of the total charges to the funding standard account for all plan years . . . over the total credits to such account for such years."

contribute at least a required minimum amount until the plan was terminated.<sup>57</sup> The required minimum funding contributions were determined annually by the plan's enrolled actuary. The UAL Pension Plans terminated between December 2004 and June 2005; therefore, the Appeals Board applies the minimum funding requirements and ERISA section 4062(c) as in effect prior to the effective date of PPA 2006 when deciding this Appeal.

Under the minimum funding rules pre-PPA 2006, the funding standard account essentially was a ledger account that consisted of credits and charges (as specified in ERISA and the IRC).<sup>58</sup> A plan sponsor's annual contribution to the plan was required to be sufficient to eliminate any "accumulated funding deficiency" in the plan's funding standard account.<sup>59</sup> That is, the account was required to have a zero or positive balance "as of the end of [the] plan year."<sup>60</sup>

The various charges and credits to the funding standard account were calculated annually.<sup>61</sup> One of the charges to the funding standard account was for normal cost, which directly related to the benefits that the plan participants earned during a plan year. ERISA defines "normal cost" as "the annual cost of future pension benefits and administrative expenses assigned, under an actuarial cost method, to years subsequent to a particular valuation date of a pension plan."<sup>62</sup> Other charges to the funding standard account generally related (at least in part) to the plan's actuarial accrued liability for prior plan years.<sup>63</sup>

A funding standard account also may have included several credits, which have the effect of decreasing future minimum funding requirements that the employer otherwise would have been required to pay to the plan.<sup>64</sup> One credit to the funding standard account was for "the amount considered contributed by the employer to or under the plan for the plan year."<sup>65</sup>

The DUEC liability under ERISA section 4062(c) is owed to a pension plan's ERISA section 4042 trustee upon the plan's termination. PBGC uses its DUEC recovery, which is treated as a Plan asset, to increase the benefit amounts that it pays to plan participants based on ERISA section 4044.

After filing its bankruptcy cases, UAL did not meet its minimum funding requirements under ERISA and the IRC for the MAPC Plan, Ground Plan, and Flight Attendant Plan; thus, PBGC had DUEC claims against UAL for these three plans. In the case of the Pilots Plan, UAL

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<sup>57</sup> See ERISA § 302; IRC §§ 404, 412. The statutory rules impose both a minimum required contribution and a maximum amount that may be deducted annually.

<sup>58</sup> See ERISA § 302(b)(1); IRC § 412(b)(1).

<sup>59</sup> See ERISA § 302(a); IRC § 412(a).

<sup>60</sup> See ERISA § 302(a)(1); IRC § 412(a)(1).

<sup>61</sup> See ERISA § 302(b); IRC § 412(b).

<sup>62</sup> See ERISA § 3(28).

<sup>63</sup> The charges to the funding standard account are listed in ERISA section 302(b)(2) and IRC section 412(b)(2).

<sup>64</sup> See ERISA § 302(b)(3); IRC § 412(b)(3).

<sup>65</sup> See ERISA § 302(b)(3)(A); IRC § 412(b)(3)(A).

met the Plan's entire minimum funding requirement by using the Pilots Plan's credit balance; thus, PBGC had no DUEC claims against UAL for the Pilots Plan.<sup>66</sup>

In the case of the UAL Pension Plans, PBGC asserted that portions of its DUEC claim amounts were entitled to priority treatment under the Bankruptcy Code.<sup>67</sup>

*PBGC's unpaid premium claims.* ERISA requires a plan, plan sponsor, or other "designated payor" to pay premiums to PBGC to finance the termination insurance that PBGC provides to pension plans.<sup>68</sup> As provided under ERISA sections 4006(a)(3)(A)(i), 4006(a)(3)(E), and 4007, and applicable PBGC regulations, UAL was liable for flat-rate and variable-rate premiums owed to PBGC up to the dates PBGC became statutory trustee of the Pension Plans.<sup>69</sup> Premiums for the MAPC Plan and the Ground Plan were not paid in full by the time PBGC became the statutory trustee of these plans. PBGC asserted claims against UAL for premiums due for these two plans.

#### *PBGC Policy 8.2-1*

PBGC Policy 8.2-1 applies to the valuation and allocation of recoveries for all plan terminations under ERISA sections 4041(c) and 4042. PBGC values its recoveries on these claims and allocates the recoveries among the claims under the methodology prescribed by PBGC Policy 8.2-1. One of the purposes of PBGC Policy 8.2-1 is to provide a framework to comply with section 4022(c) of ERISA.

Paragraph F of PBGC Policy 8.2-1 provides the following regarding PBGC claims:

1. **Claim Amounts.** The amounts used for the DUEC, UBL and premium claims shall be the best available amounts as of the time the allocation is done. In bankruptcy cases all claims shall be classified by priority.  
...
3. **Premium Claims.** Premium claims do not include penalties, and are treated as general unsecured claims.  
...

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<sup>66</sup> Credit balances are discussed *infra*. UAL made no contributions to the Pilots Plan while UAL was in bankruptcy.

<sup>67</sup> See Appeal Exhibit 4.

<sup>68</sup> UAL was both the contributing sponsor and plan administrator of the Pension Plans. See generally 29 C.F.R. § 4007.12(a).

<sup>69</sup> See ERISA § 4007(a).

Paragraph G of PBGC Policy 8.2-1 addresses how PBGC's recoveries shall be allocated to PBGC's claims for DUEC, UBL, and unpaid premiums. Paragraph G provides that recovery amounts first are allocated to secured claims. For the UAL Pension Plans, however, there were no secured claims. Recoveries next are allocated to "Priority Bankruptcy Claims." Paragraph G.2.b. of PBGC Policy 8.2-1, which addresses priority claims, states:

**Priority Bankruptcy Claims.** Any recovery value remaining after the allocation to secured claims shall be allocated as of the Valuation Date to priority bankruptcy claims in order of their priority. Except in highly unusual circumstances, the UBL claim for purposes of this allocation shall be treated as having no priority. If the value of the recovery is not sufficient to cover claims of equal priority, the value shall be allocated pro-rata based on the amounts of such claims.

If any recovery amounts remain after secured and priority bankruptcy claims are satisfied, the amounts are allocated pro-rata among general unsecured claims for DUEC, UBL, and unpaid premiums as of the Valuation Date. *See* paragraph G.2.d of PBGC Policy 8.2-1.

*PBGC's Recovery Valuation and Allocation for the UAL Pension Plans*

PBGC determined that the total value of PBGC's recovery from UAL was \$1,615,326,919 as of the February 17, 2006 Valuation Date.<sup>70</sup> PBGC's selection of February 17, 2006 as the Valuation Date and PBGC's valuation of its recovery is explained in more detail in Issue 2.

In accordance with PBGC Policy 8.2-1, PBGC determined the DUEC, UBL, and unpaid premium claim amounts as of the Valuation Date for each of the four terminated UAL Pension Plans. In its March 25, 2009 Revised Recovery Allocation Memorandum, PBGC limited the Unsecured Priority DUEC claim amounts to each Plan's unpaid "normal cost" that arose between UAL's bankruptcy petition date and that Plan's termination date.<sup>71</sup> The amount allocated to General Unsecured DUEC reflected the remainder of the DUEC claim. Of the total UAL Pension Plans' DUEC claim amounts of \$1.154 billion, PBGC classified approximately \$185 million as Unsecured Priority DUEC claims and \$969 million as General Unsecured DUEC claims for purposes of the recovery valuation.<sup>72</sup>

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<sup>70</sup> *See* Appeal Exhibit 13.

<sup>71</sup> *See* Appeal Exhibit 17.

<sup>72</sup> *Id.*

The following chart shows the **claim amounts** (determined as of the February 17, 2006 Valuation Date) that PBGC assigned to the four UAL Pension Plans for purposes of the Recovery Valuation:<sup>73</sup>

<b>Claim</b>	<b>Pilots Plan</b>	<b>MAPC Plan</b>	<b>Flight Attendant Plan</b>	<b>Ground Plan</b>
<b>UBL</b>	\$2,840,000,000.00	\$2,471,000,000.00	\$2,003,200,000.00	\$2,899,400,000.00
<b>Unsecured Priority DUEC</b>	\$0.00	\$124,773,945.00	\$24,306,560.00	\$35,500,701.00
<b>General Unsecured DUEC</b>	\$0.00	\$411,628,185.00	\$167,517,918.00	\$390,108,501.00
<b>Unpaid Premiums</b>	\$0.00	\$4,678,172.50	\$0.00	\$3,114,450.62

PBGC applied PBGC Policy 8.2-1 to determine the recovery amount to be allocated to each PBGC claim. Because there were no secured claims, PBGC's recovery from UAL first was allocated to the Unsecured Priority DUEC claim for each UAL Pension Plan. PBGC's recovery funded 100% of the Unsecured Priority DUEC claim amounts (as of the Valuation Date) because the total Unsecured Priority DUEC of \$185 million is less than PBGC's total recovery of \$1.615 billion as of the Valuation Date. Next, PBGC allocated the remaining recovery value pro rata (as of the Valuation Date) among PBGC's remaining general unsecured claims across all four UAL Pension Plans, *i.e.*, the General Unsecured DUEC claims, the UBL claims, and the total premium claims.

Pursuant to the allocation method prescribed by PBGC Policy 8.2-1, PBGC: (1) allocated the \$1.615 billion total recovery (as of the Valuation Date) among the claims shown in the above table; and (2) discounted the recovery value of each claim from the Valuation Date to each plan's DOPT using the discount rate assumptions in paragraph G. of PBGC Policy 8.2-1.<sup>74</sup> PBGC's Revised Recovery Allocation Memorandum detailed the discounted values, as of each Plan's DOPT, of the recovery amounts that PBGC determined for each of PBGC's claims.

<sup>73</sup> *Id.*

<sup>74</sup> The four UAL Pension Plans had the following DOPTs: Pilots Plan—December 30, 2004; Ground Plan—March 11, 2005; MAPC Plan—June 30, 2005; and Flight Attendant Plan—June 30, 2005.

The chart below shows the **recovery amounts** that were allocated to each claim as of each Plan's DOPT.<sup>75</sup>

<b>Recovery</b>	<b>Pilots Plan</b>	<b>MAPC Plan</b>	<b>Flight Attendant Plan</b>	<b>Ground Plan</b>
<b>UBL</b>	\$357,824,729.67	\$294,931,197.15	\$251,484,479.15	\$357,369,386.47
<b>Unsecured Priority DUEC</b>	\$0.00	\$121,947,955.60	\$23,756,043.78	\$34,286,203.53
<b>General Unsecured DUEC</b>	\$0.00	\$52,871,269.86	\$21,516,711.86	\$49,514,443.71
<b>Unpaid Premiums</b>	\$0.00	\$600,884.32	\$0.00	\$395,301.02

*PBGC's Determination of Section 4022(c) Amounts for the UAL Pension Plans*

Section 4022(c) of ERISA establishes the mechanism by which PBGC shares a portion of its UBL recovery with participants. To determine the amount to be shared with participants, PBGC multiplies the outstanding amount of benefit liabilities of the pension plan by the "applicable recovery ratio" for that pension plan. When the "outstanding amount of benefit liabilities" for a plan, as defined under ERISA section 4001(a)(19), exceeds \$20 million (such as in the Pilots Plan), the term "applicable recovery ratio" under section 4022(c)(2) means the ratio of the value, as of DOPT, of PBGC's recovery under ERISA section 4062 to the amount of that plan's UBL. PBGC applies PBGC Policy 8.2-1 to determine the value of PBGC's recovery for use in the applicable recovery ratio.

Following PBGC's revaluation of Pilots Plan assets, ERISA section 4022(c) amounts increased from \$179,278,052 to \$179,571,087. The increase in the Pilots Plan's assets and the increased ERISA section 4022(c) amount resulted in larger PBGC-payable benefits for certain eligible participants and beneficiaries.<sup>76</sup>

<sup>75</sup> See Appeal Exhibit 17. See page 3 of the March 25, 2009 Revised Recovery Allocation Memorandum and pages 4-7 of the Recovery Allocation Spreadsheet at Appeal Exhibit 17.

<sup>76</sup> See Supplemental Appeal Exhibit S-5A.

## Discussion

### **A. PBGC properly applied Title IV of ERISA and PBGC Policy 8.2-1 in allocating its recovery.**

The Appeal's primary argument in Issue 1 is that PBGC improperly allocated a portion of its recovery from UAL for the four UAL Pension Plans to: (1) DUEC claims filed by PBGC on behalf of the MAPC Plan, Flight Attendant Plan, and Ground Plan; and (2) PBGC's claims for premiums owed to PBGC for the MAPC Plan and Ground Plan. The Appeal argues that, pursuant to the Settlement Agreement, PBGC's entire recovery from UAL should have been allocated to UBL claims. AB at 21-26, 30. The Appeal also argues that, if the Appeals Board finds that any recovery should be allocated to a DUEC claim, the entire DUEC claim amount should be classified as General Unsecured DUEC and no DUEC should be classified as Unsecured Priority DUEC. AB at 26-27.

The Appeals Board rejects the Appeal's argument that the Settlement Agreement in UAL's bankruptcy case controls PBGC's determinations regarding the valuation and allocation of PBGC's recovery from UAL. The Settlement Agreement concerns the resolution of PBGC's claims in UAL's bankruptcy for purposes of facilitating UAL's exit from bankruptcy. The Settlement Agreement does not control how PBGC allocates its recovery in the context of Title IV of ERISA, nor does the Settlement Agreement govern PBGC's determination of the amounts that PBGC shares with participants and beneficiaries pursuant to ERISA section 4022(c).<sup>77</sup>

#### *PBGC Reserved Its Regulatory Rights Under Title IV of ERISA*

The Appeal contends that, by agreeing to settle for a single claim in the Settlement Agreement, "PBGC waived and released all other claims against United . . . ." AB at 14. Specifically, the Appeal argues that PBGC waived its right to allocate any recovery to DUEC and premiums under its allocation policy.

The Appeals Board disagrees. "[W]aiver is the 'intentional relinquishment or abandonment of a known right.'"<sup>78</sup> Neither the terms of the Settlement Agreement nor the statements made in open court by any of the interested parties in the bankruptcy case support the Appeal's theory that PBGC waived its regulatory rights under ERISA and PBGC's regulations and policies.

Rather, the Board finds that PBGC agreed to "a single prepetition, general, unsecured unfunded liability claim . . . against the [UAL] bankruptcy estate" for purposes of a bankruptcy distribution under UAL's POR, and that the record shows PBGC and other interested parties did not intend the Settlement Agreement to control PBGC's determinations under section 4022(c).

Specifically, at the May 10, 2005 bankruptcy court hearing to approve the Settlement Agreement (the "hearing"), UAL's attorney stated that "both PBGC and United represent that

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<sup>77</sup> See ERISA section 4022(c)(4) (determinations under ERISA section 4022(c) shall be made by PBGC and "shall be binding unless shown by clear and convincing evidence to be unreasonable").

<sup>78</sup> See *Kontrick v. Ryan*, 540 U.S. 443, 458 FN 13 (2004); see also *United States v. Olano*, 507 U.S. 725, 733 (1993) (quoting *Johnson v. Zerbst*, 304 U.S. 458, 464 (1938)).

nothing prevents United and PBGC . . . from complying with the PBGC/UAL agreement, nothing is intended to affect the PBGC's regulatory rights . . . ."<sup>79</sup> In addition, an attorney representing ALPA stated that "[i]t is clear that the PBGC has reserved, as obviously they would have to in any event, its regulatory powers, whatever they may be."<sup>80</sup> PBGC's former Chief Counsel also stated that "nothing affects PBGC's regulatory rights."<sup>81</sup> Importantly, the "Additional Terms and Conditions" of the Settlement Agreement expressly states: "[m]oreover, nothing affects PBGC's regulatory rights."<sup>82</sup>

Under the Settlement Agreement, PBGC's claims for minimum funding and premiums are "deemed to be settled and released" solely for purposes of UAL's bankruptcy case.<sup>83</sup> The parties settled PBGC's claims in the bankruptcy case to avoid unnecessary delay and expense; the Settlement Agreement reflected this narrow purpose. The Settlement Agreement did not require PBGC to deviate from its standard procedures to value claims and allocate its recovery under ERISA. The Board finds that PBGC did not waive any of its rights with respect to the process for valuing and allocating its recovery under ERISA.

#### *The Law-of-the-Case Doctrine Does Not Apply*

The Appeal argues that the Settlement Agreement controls PBGC's allocation of its recovery under the "law-of-the-case" doctrine. The Appeal contends that the law-of-the-case doctrine requires PBGC to allocate the entire recovery to UBL.

The United States Supreme Court has explained the law-of-the-case doctrine as follows:<sup>84</sup>

Although we have described the "law of the case [a]s an amorphous concept," "[a]s most commonly defined, the doctrine posits that when a court decides upon a rule of law, that decision should continue to govern the same issues in subsequent stages in the same case."

The Appeals Board concludes that the law-of-the-case doctrine is inapplicable to the issues raised in the Appeal. PBGC's actions in allocating its recovery under ERISA are distinct from UAL's bankruptcy proceedings. Neither PBGC's allocation under PBGC Policy 8.2-1 nor this Appeal are "subsequent stages" of UAL's bankruptcy case. In contrast to PBGC's exercise of its statutory responsibilities under ERISA, the Settlement Agreement was reached as part of UAL's restructuring activities in Bankruptcy Court and assisted UAL's efforts to confirm a Plan of Reorganization under Chapter 11 of the Bankruptcy Code.

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<sup>79</sup> See Appeal Exhibit 11 at 15.

<sup>80</sup> See Appeal Exhibit 11 at 32.

<sup>81</sup> *Id.*

<sup>82</sup> See Paragraph 9, Exhibit 2 to the Bankruptcy Court's May 11, 2005 order approving the Settlement Agreement in Appeal Exhibit 12. The Bankruptcy Court's order states that "[t]he terms and conditions enumerated in Exhibit 2 ["Additional Terms and Conditions"] to this Order are hereby incorporated into the Agreement as though set forth herein." See Paragraph 4 of the Bankruptcy Court's May 11, 2005 Order in Appeal Exhibit 12.

<sup>83</sup> See Paragraph 7 of the Settlement Agreement in Appeal Exhibit 12.

<sup>84</sup> *Pepper v. United States*, 131 S.Ct. 1229, 1250 (2011) (citations omitted).

In addition, no hearing was held on the merits of the allocation of assets under ERISA; rather, the May 10, 2005 Bankruptcy Court hearing and subsequent May 11, 2005 ruling regarding the Settlement Agreement related solely to whether the Settlement Agreement was in the best interest of the bankruptcy estate (UAL) and within the range of likely litigation outcomes.<sup>85</sup> Based on the record available to the Appeals Board, there is no indication that the Bankruptcy Court scrutinized or even considered the appropriate allocation between UBL, DUEC, and premium claims. Accordingly, the law-of-the-case doctrine does not apply.

### *PBGC Appropriately Applied PBGC Policy 8.2-1*

In opposition to the applicability of PBGC Policy 8.2-1, the Appeal argues that “PBGC cannot use the Policy’s methodology to supplant the known value of the DUEC and premium claims (which is zero), particularly when doing so harms participants in the UAL Plans.” AB at 26.

The Appeal recognizes that ERISA “builds in a measure of deference” to PBGC’s determinations under section 4022(c) by providing that those determinations “shall be binding unless shown by clear and convincing evidence to be unreasonable.” Nevertheless, the Appeal asserts that PBGC’s application of PBGC Policy 8.2-1 is not entitled to deference because PBGC Policy 8.2-1, “which was never the subject of notice and comment rulemaking, does not have the force and effect of law or regulation.” AB at 26.

The Appeals Board disagrees with the Appeal’s contention that PBGC cannot rely on PBGC Policy 8.2-1. Congress expressly delegated to PBGC the authority to make determinations under section 4022(c) of ERISA. To calculate the applicable recovery ratio for a pension plan under section 4022(c), PBGC must determine the “value of the recoveries of the corporation under section 4062” for such plan. PBGC applies Policy section 8.2-1 in making these determinations.

Moreover, not all agency guidance requires notice and comment rulemaking. The Administrative Procedure Act (“APA”) provides that certain rules, such as general statements of policy or rules of agency procedure or practice, are excepted from the notice and comment rulemaking requirement.<sup>86</sup> Thus, the APA contemplates the issuance of agency guidance in a broader format than the rulemaking process.<sup>87</sup>

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<sup>85</sup> See Appeal Exhibit 11 at 72. “The court . . . is supposed to compare the settlement terms with the probable cost and benefits of litigation, and only to deny approval of the settlement if the settlement is below the range of likely litigation outcomes.” See also Appeal Exhibit 12.

<sup>86</sup> See 5 U.S.C. § 553.

<sup>87</sup> See generally PBGC Policy 1.1-1, *PBGC Benefits Administration Policy Governance and Review*, at Enclosure 13.

APA section 553, *Rule making*, provides:

...

- (b) General notice of proposed rule making shall be published in the Federal Register, unless persons subject thereto are named and either personally served or otherwise have actual notice thereof in accordance with law. The notice shall include—
  - (1) a statement of the time, place, and nature of public rule making proceedings;
  - (2) reference to the legal authority under which the rule is proposed; and
  - (3) either the terms or substance of the proposed rule or a description of the subjects and issues involved.

*Except when notice or hearing is required by statute, this subsection does not apply—*

- (A) *to interpretative rules, general statements of policy, or rules of agency organization, procedure, or practice; or*
- (B) when the agency for good cause finds (and incorporates the finding and a brief statement of reasons therefor in the rules issued) that notice and public procedure thereon are impracticable, unnecessary, or contrary to the public interest.

...

(Emphasis added.)

As quoted above, the agency is not required to provide an opportunity to comment for rules that fall within the exception to the notice requirement, such as “interpretive rules” or “general statements of policy.” Consistent with the APA, PBGC has issued a number of policies, including PBGC Policy 8.2-1. PBGC Policy 8.2-1 describes the framework upon which PBGC allocates its recoveries to its various claims under ERISA.

PBGC determined that the values of its ERISA claims for DUEC, premiums, and UBL are greater than zero; therefore PBGC allocated its recoveries to those claims pursuant to PBGC Policy 8.2-1. For these reasons, the Appeals Board finds that PBGC reasonably exercised its discretion in allocating the UAL Pension Plans’ recoveries to UBL, Unsecured Priority DUEC, General Unsecured DUEC, and premium claims in accordance with PBGC Policy 8.2-1.

**B. PBGC was not required to adjust Unsecured Priority DUEC claim amounts to reflect declines in UAL employment.**

The Appeal asserts that, assuming the Board rejects its waiver argument in subpart A of this Issue 1, PBGC should have reduced the amount of PBGC's claims for Unsecured Priority DUEC "to reflect the post-petition decline in employment." AB at 27. As the Appeal points out, if the Unsecured Priority DUEC claim amounts were reduced, PBGC's allocation of its recovery to UBL claims necessarily would increase. The Appeal contends that "the Bankruptcy Ruling is clear on this point: the post-petition normal cost amount entitled to administrative priority represents the benefits *actually earned* as a result of post-petition employment, not the benefits projected to be earned." AB at 28. (Emphasis in original.) In addition, the Appeal construes the Revised Recovery Allocation Memorandum as evidence that "PBGC acknowledged that its recovery allocation must be consistent with the [March 18, 2005] Bankruptcy Court Ruling on the IFS Funding Motion." AB at 16.

The Board rejects the Appeal's conclusions that the Unsecured Priority DUEC claim amounts PBGC determined must be reduced to reflect post-petition declines in UAL employment. Pursuant to PBGC Policy 8.2-1, PBGC's recoveries are allocated among its claims for DUEC, UBL, and unpaid premiums. Paragraph F.1. of PBGC Policy 8.2-1 states that PBGC must use the "best available amounts" of PBGC's claims when the allocation is completed, which occurs as of the Valuation Date. Recoveries are allocated first to secured claims, then to "priority bankruptcy claims," including DUEC claims.<sup>88</sup>

PBGC's determinations under PBGC Policy 8.2-1 are used for PBGC's determinations under ERISA section 4022(c) and are documented in valuation and allocation memoranda. As addressed in the discussion of subpart A of this Issue 1, PBGC Policy 8.2-1 establishes the procedures for PBGC's valuation and allocation of recoveries in order to comply with section 4022(c) of ERISA; section 4022(c)(4) states that PBGC's "determinations shall be binding unless shown by clear and convincing evidence to be unreasonable."

In its Revised Recovery Allocation Memorandum dated March 25, 2009, PBGC revised the amounts of priority bankruptcy claims to amounts "reflect[ing] the normal cost portion of the post petition DUEC, not the entire post petition DUEC amount."<sup>89</sup> PBGC used estimates of the normal cost portion of the post-petition DUEC for each of the UAL Pension Plans as the "priority bankruptcy claims" under PBGC Policy 8.2-1 to which recoveries would be allocated.<sup>90</sup>

For each of the UAL Pension Plans, actuarial valuations were prepared and Forms 5500 Schedules B were filed for the 2002, 2003, and 2004 plan years.<sup>91</sup> In estimating the normal cost

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<sup>88</sup> See PBGC Policy 8.2-1.G.2.

<sup>89</sup> See page 2 of the Revised Recovery Allocation Memorandum dated March 25, 2009 at Appeal Exhibit 17. See also ERISA § 3(28).

<sup>90</sup> See Appeal Exhibit 17.

<sup>91</sup> See ERISA § 103, *Annual Reports*. Section 103(d) of ERISA specifies that an actuarial statement must include a broad range of information pertaining to a pension plan, including, among other items, a plan's "normal costs." The Form 5500 Schedule B presents the plan's actuarial statement and opinions required under section 103 of ERISA. The enrolled actuary is required to certify that the report is complete and accurate to the best of his knowledge. *Id.*

for the revised allocation, PBGC used these actuarial calculations prepared by UAL Pension Plans' actuaries. PBGC determined that the unfunded post-petition normal costs for each UAL Pension Plan at its termination date represented the Priority DUEC Claim for that Plan. PBGC did not adjust the normal cost amounts that were reported on the Forms 5500, Schedules B, for any declines in active employee populations that occurred between the beginning and end of a particular plan year. If declines in employment occurred during any particular year, the Plan's enrolled actuary would reflect those declines in each plan's annual report for the following year. These entries were made annually and represented the actuary's "best estimate of anticipated experience under the plan."<sup>92</sup>

These "priority bankruptcy claim" amounts that PBGC determined using the normal cost portion of the post-petition DUEC under PBGC Policy 8.2-1 were set forth in Table A of the Revised Recovery Allocation Memorandum.<sup>93</sup> PBGC, in determining these amounts, used the "best available amounts" as of the completion of the allocation under PBGC Policy 8.2-1.<sup>94</sup>

PBGC's decision to limit the "priority bankruptcy claim" amounts to the normal cost portion of the post-petition DUEC is consistent with the description of the claims that PBGC asserted in the UAL bankruptcy cases in November 2005, subsequent to the Bankruptcy Court's March 18, 2005 ruling.<sup>95</sup> The Bankruptcy Court did not, however, address the amount of PBGC's Unsecured Priority DUEC claims under the Bankruptcy Code, stating that "[a] hearing will be required to establish the amount of contributions payable post-petition that were attributable to pre-petition services and that amount attributable to post-petition services."<sup>96</sup> No hearing occurred because the Settlement Agreement was executed in April 2005.<sup>97</sup> Moreover, the Bankruptcy Court never addressed whether PBGC's administrative expense [Priority DUEC] claims must be reduced to reflect post-petition declines in employment.

The Appeal nonetheless argues that, in allocating the recovery from UAL, PBGC should have applied the portion of the holding in *PBGC v. Sunarhauserman, Inc.* that addressed adjustment to the normal cost component of the post-petition expenses to account for declines in the company's workforce.<sup>98</sup> The Appeals Board rejects this argument. The Board finds significant differences between the circumstances of UAL and those present in *Sunarhauserman*. In *Sunarhauserman*, over the course of a single plan year, the plan sponsor declared bankruptcy,

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See also 2004 Form 5500, Schedule B, *Actuarial Information*, and Instructions to the 2004 Form 5500, Schedule B, *Actuarial Information*, on the Department of Labor's website at: <http://www.dol.gov/ebsa/5500main.html#2004>.

<sup>92</sup> See ERISA § 103(a)(4)(B)(ii).

<sup>93</sup> See Appeal Exhibit 17.

<sup>94</sup> See PBGC Policy 8.2-1.F.1.

<sup>95</sup> The 2009 Revised Recovery Allocation Memorandum uses the post-petition normal costs for each UAL Pension Plan. See, e.g., Supplemental Appeal Exhibit S-5G at Paragraphs 6 and 9 (Statement of the Pension Benefit Guaranty Corporation in Support of Its Amended Claim (Claim No. 34511) for Minimum Funding Contributions).

<sup>96</sup> See Appeal Exhibit 7, at 69.

<sup>97</sup> IFS appealed the Bankruptcy Court's Ruling and PBGC, as the statutory trustee of the UAL's plans, became the appellant. The appeal was dismissed because PBGC and UAL executed the Settlement Agreement. See Appeal Exhibit 8.

<sup>98</sup> See 126 F.3d 811 (6th Cir. 1997).

froze the accruals in its pension plan, terminated its pension plan by agreement with PBGC, and terminated the employment of over 85 percent of the active participants in its pension plan. Consequently, in *Sunarhauserman*, the projected normal cost at the beginning of the plan year bore little resemblance to the actual costs of benefits accruing during the year due to the significant workforce reductions, freeze in benefit accruals, and lack of future plan years to reflect these changes.

In contrast, UAL maintained the UAL Pension Plans for several years after UAL and its affiliated corporations filed bankruptcy petitions (*i.e.*, the Pilots Plan terminated at the end of the 2004 plan year and the other Pension Plans terminated during the 2005 plan year).<sup>99</sup> UAL “devoted the first twenty months of its [bankruptcy] cases to formulating a business plan that would have enabled it to exit bankruptcy successfully without terminating its employees’ pension plans.”<sup>100</sup> UAL made required contributions to the UAL Pension Plans during that 20-month period. UAL employees continued to accrue benefits under the UAL Pension Plans during the bankruptcy in contrast to the post-petition freeze of the pension plan in *Sunarhauserman*.

In summary, the Appeals Board concludes that PBGC properly applied PBGC Policy 8.2-1 in determining Unsecured Priority DUEC for the UAL Pension Plans. In reaching this decision, the Appeals Board finds that PBGC used the “best available amounts” for purposes of allocating recoveries to the Unsecured Priority DUEC claims pursuant to PBGC Policy 8.2-1.

**C. PBGC appropriately applied Credit Balances and post-bankruptcy petition Plan contributions to reduce pro rata the Unsecured Priority DUEC claim amount and General Unsecured DUEC claim amount.**

The Appeal argues that PBGC must first reduce its Unsecured Priority DUEC claim amounts for “available credit balances existing on the [bankruptcy] petition date and . . . post-petition cash contributions” prior to any reduction of General Unsecured DUEC claims. AB at 29. The Appeal contends that PBGC did not properly apply available credit balances and post-petition contributions because, in plan years in which credit balances and contributions did not satisfy the minimum funding requirements, PBGC applied them pro rata to Unsecured Priority DUEC and General Unsecured DUEC claim amounts. *Id.* Instead of a pro rata allocation, the Appeal asserts that available credit balances and post-petition contributions “must be applied first to priority claims; *only if and when priority claims have been paid in full* should any amounts be allocated to non-priority claims.” *Id.* (Emphasis in original.)

The Appeal recognizes, however, that “ERISA rules contain restrictions regarding the plan year or plan years to which credit balances and funding contributions may be allocated.” AB at

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<sup>99</sup> Although UAL Pension Plans’ Annual Forms 5500 Schedules B may not have precisely reflected the workforce declines that occurred between the beginning and end of a particular plan year, the Pension Plans’ actuaries accounted for those declines that occurred during a prior plan year when they determined the normal cost for the current plan year. Thus, UAL’s case does not present the kind of situation present in *Sunarhauserman*, where “there are no future plan years in which the workforce reductions and freeze in benefit accruals will be reflected.” See 126 F.3d at 820.

<sup>100</sup> See Appeal Exhibit 5 at 4.

29-30, note 70. For this reason, the Appeal asserts that “assuming *arguendo* that both the credit balances and post-petition contributions must be applied first to the 2003 plan year until 2003 funding requirements are satisfied, they should be applied first to normal cost and only applied to non-normal cost after normal cost for that year is paid in full.” *Id.*

The Appeals Board rejects these arguments. As discussed below, the Board concludes that PBGC properly applied the funding provisions in ERISA in calculating DUEC claim amounts, and properly applied PBGC policy in allocating PBGC’s recovery to those DUEC claims.

PBGC’s DUEC claim is based on section 4062(c) of ERISA, which imposes liability for a plan’s accumulated funding deficiencies. Generally, an accumulated funding deficiency in the plan’s funding standard account arises if charges such as normal costs and unfunded past service liabilities exceed credits such as employer contributions. The excess is the accumulated funding deficiency.<sup>101</sup> For purposes of determining whether an accumulated funding deficiency exists, contributions are “credited against unpaid required installments in the order in which such installments are required to be paid.”<sup>102</sup> Because unpaid installments of minimum funding accrue interest until satisfied, ERISA requires contributions to be credited to installments beginning with the oldest installment due.<sup>103</sup>

During its bankruptcy, UAL’s post-petition contributions and available credit balances reduced its minimum funding obligations to the Pension Plans. As reflected in the Forms 5500 Schedules B, UAL satisfied the minimum funding requirements for the 2002 plan year, with each UAL Plan having a credit balance that could be applied to future plan years. Specifically, the Pilots Plan’s credit balance was sufficient to meet the minimum funding requirements for the 2003 and 2004 plan years. As a result, there were no accumulated funding deficiencies for the Pilots Plan as of its December 30, 2004 DOPT, and no DUEC claims arose under section 4062(c) of ERISA.

The Flight Attendant Plan’s credit balance and UAL’s contributions were sufficient to meet the minimum funding requirements for the 2003 plan year. The Flight Attendant Plan’s credit balance and UAL’s post-petition contributions were insufficient to meet the minimum funding requirements for the 2004 and 2005 plan years. As a result, the Flight Attendant Plan had accumulated funding deficiencies for those years, and a DUEC claim arose under section 4062(c) of ERISA.

The MAPC and Ground Plans’ credit balances and UAL’s post-petition contributions were insufficient to meet the minimum funding requirements for the 2003, 2004, and 2005 plan years. As a result, the MAPC and Ground Plans had accumulated funding deficiencies for those years, and DUEC claims arose under section 4062(c) of ERISA.

In determining its claims for DUEC, PBGC was required to credit UAL’s post-petition contributions and each Plan’s existing credit balance against the oldest unpaid contributions that

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<sup>101</sup> See ERISA § 302(a); IRC § 412(a).

<sup>102</sup> See ERISA § 302(e)(2)(C); IRC § 412(m)(2).

<sup>103</sup> See ERISA § 302(e)(2); IRC § 412(m)(2).

were owed to the Plan during the applicable plan year.<sup>104</sup> PBGC's method for calculating its Unsecured Priority DUEC claim is summarized in the DUEC calculation worksheets attached to the Revised Recovery Valuation.<sup>105</sup> For plan years during UAL's bankruptcy in which accumulated funding deficiencies arose, PBGC determined the number of days that each plan was funded for the plan year and number of days that each plan was not funded and derived the unfunded fraction of the plan year. For each plan year, PBGC applied the unfunded fraction to each Plan's post-petition normal cost to determine the amount of its Unsecured Priority DUEC claim.<sup>106</sup>

UAL's post-petition contributions had the effect of improving the funding of the UAL Pension Plans and thus facilitated UAL's goal, during the initial months of the UAL bankruptcy, of maintaining the Pension Plans. Accordingly, the Board finds that PBGC's pro rata method of apportioning funding obligations between normal and non-normal costs for purposes of its Unsecured Priority DUEC claim amount was consistent with UAL's efforts to continue funding the Pension Plans.

In contending that PBGC's RVG must reduce the amounts PBGC assigned to Unsecured Priority DUEC in allocating PBGC's recovery, the Appeal incorporates by reference the arguments that UAL made to the Bankruptcy Court. In those proceedings, UAL asserted that its administrative obligation for pensions accruing due to post-petition employment should be offset against the sum of (i) UAL's pension funding credits as of the petition date, and (ii) UAL's post-petition minimum funding contributions.<sup>107</sup> As noted above, the Bankruptcy Court did not determine the amount of PBGC's Unsecured Priority DUEC claim.

The Appeals Board concludes that PBGC's methodology for determining Unsecured Priority DUEC was reasonable notwithstanding that UAL advocated a different methodology.<sup>108</sup>

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<sup>104</sup> See ERISA § 302(e)(2)(C). See also IRC § 412(m)(2)(C).

<sup>105</sup> See Appeal Exhibit 17.

<sup>106</sup> For example, the Ground Plan's accumulated funding deficiencies for the 2003 plan year was \$86,044,933, because the existing credit balance (\$333,714,934) and UAL's contributions for the plan year (\$52,400,000) were \$86,044,933 less than the Ground Plan's minimum funding requirement. PBGC, using the ratio of payments made to total amount owed, calculated that the Ground Plan was funded for 302.5654 of 365 days of the 2003 plan year and unfunded for the remaining 62.4346 days. This resulted in an unfunded fraction of 0.17105 [ $62.4346 \text{ (days)} \div 365 \text{ (days)} = 0.17105$ ]. PBGC applied the unfunded fraction to the Ground Plan's normal cost for 2003 of \$29,863,582 to determine the unfunded normal cost and carried the amount forward with 9.25% interest, resulting in an unfunded normal cost portion of DUEC for 2003 of \$6,660,845. The remainder of the accumulated funding deficiencies for 2003, about \$80 million, was treated as the non-normal portion of the plan's DUEC (*i.e.*, General Unsecured DUEC). If there were no post-petition contributions or credit balances available for crediting against charges in a post-petition plan year, the unfunded fraction is 1 and the entire normal cost would be claimed as an Unsecured Priority DUEC amount.

<sup>107</sup> AB at 29.

<sup>108</sup> UAL's arguments to the Bankruptcy Court concerning the treatment of its minimum funding contributions and the UAL Pension Plans' credit balances centered upon the equitable powers of bankruptcy courts. Particularly, UAL cited court decisions that involved section 1123(b)(6) of the Bankruptcy Code, which grants bankruptcy courts residual authority to approve reorganization plans, including the approval of "any . . . appropriate provision not inconsistent with the applicable provisions of [the Bankruptcy Code]."

The equitable authority of bankruptcy courts, under section 1123(b)(6) and other provisions of the Bankruptcy Code, is limited. As the Supreme Court has often stated, "[c]reditors' entitlements in bankruptcy arise in the first instance

Finally, the Appeal suggests that PBGC should treat credit balances and UAL's contributions similarly to PBGC's recovery, and, therefore, the credit balances and UAL's contributions should reduce Unsecured Priority DUEC amounts before they reduce General Unsecured DUEC amounts. The Appeal refers to paragraph F.2.a. of PBGC Policy 8.2-1, Sixth Edition, which provides that "[a]mounts that are paid to the plan as ordinary contributions after DOPT are treated as a recovery and are allocated entirely to the DUEC claim (first to secured DUEC, then to priority DUEC, and last to any general unsecured DUEC)." Not only does paragraph F.2.a. of PBGC Policy 8.2-1 not apply to this Appeal because UAL did not make post-DOPT funding contributions to any of the UAL Pension Plans, the Board also notes that this paragraph went into effect after the revaluation of the Pension Plans.<sup>109</sup>

Neither pre-DOPT contributions that UAL made to the UAL Pension Plans nor the credit balances are recoveries. Rather, they are amounts that arose from contributions made to the ongoing UAL Pension Plans prior to DOPT pursuant to ERISA and the IRC. PBGC Policy 8.2-1 directs how PBGC's recoveries should be allocated; this policy does not apply to pre-DOPT contributions to the Pension Plans or existing credit balances.

After careful review and consideration of all of the assertions in Issue 1 of the Appeal, the Appeals Board finds that PBGC's determinations of Priority and General Unsecured DUEC amounts based on PBGC Policy 8.2-1 and PBGC's allocation of its recovery based on that Policy were reasonable and consistent with the requirements in ERISA section 4022(c). The Board accordingly denies Subparts A, B, and C in Issue 1 of the Appeal for the reasons explained above.

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from the underlying substantive law creating the debtor's obligation, subject to any qualifying or contrary provisions of the Bankruptcy Code." See *Travelers Casualty and Surety Co. of America v. Pacific Gas & Electric Co.*, 549 U.S. 443, 450 (2007) (citing *Raleigh v. Illinois Dep't of Revenue*, 530 U.S. 15, 20 (2000)).

PBGC's DUEC claim is defined in ERISA. The Appeal has not cited, nor has the Appeals Board found, any qualifying or contrary provisions in the Bankruptcy Code that would affect how credit balances or minimum funding contributions for a pension plan are credited to a plan's funding standard account for purposes of calculating PBGC's DUEC claim under section 4062(c) of ERISA. The equitable powers that the Bankruptcy Code grants to bankruptcy courts accordingly are inapplicable to how PBGC treats credit balances and UAL's minimum funding contributions for purposes of determining DUEC claim amounts.

<sup>109</sup> The Board observes that the rule in paragraph F.2.a. of PBGC Policy 8.2-1 for post-DOPT employer contributions involves special circumstances that are distinguishable from Issue 1 of the Appeal. ERISA section 4062(c) provides that an employer's liability for DUEC is determined under the assumption that "no additional contributions (other than those already made by the termination date) were made for the plan year in which the termination date occurs or for any previous plan year . . ." Based on this statutory language, PBGC does not make any offset for post-DOPT employer contributions when it determines DUEC amounts. Because the post-DOPT contributions represent actual cash payments that were received by the terminated pension plan, PBGC decided to treat the post-DOPT contributions as DUEC recoveries. In contrast to post-DOPT employer contributions, the employer's pre-DOPT contributions (1) have the effect of reducing the DUEC amounts that PBGC calculates, but (2) do not otherwise impact upon how PBGC allocates its recoveries to specific PBGC claims.

**Issue 2: Whether: (a) the February 17, 2006 Valuation Date was improper; (b) PBGC's valuation of the 6% Senior Notes and 8% Contingent Notes was flawed; or (c) the UAL-Continental Merger in October 2010 required PBGC to revalue the 6% Senior and 8% Contingent Notes. (AB at 30-40; Supp. AB at 6-12.)**

**The Appeal**

On July 3, 2007, PBGC completed its valuation of the recovery it received from UAL under the Settlement Agreement.<sup>110</sup> The Appeal argues that PBGC's valuation of the 6% Senior Subordinated Notes (the "6% Senior Notes") and 8% Contingent Senior Subordinated Notes (the "8% Contingent Notes") (collectively, the "Notes") that PBGC received from UAL contained deficiencies for two reasons.

First, the Appeal alleges that PBGC's decision to value the Notes as of February 17, 2006 is unreasonable. The Appeal asserts the following:

Here, the choice of the February 17, 2006, valuation date established by PBGC to value the 6% Senior Notes and the 8% Contingent Notes—a date that was less than three weeks after United emerged from bankruptcy, more than a year before the "deadline" under then-applicable internal guidance, more than three years before the first measuring period with respect to the 8% Contingent Notes, and more than six years before final benefit determinations were issued to the several thousand Pilot Plan participants whose benefits are affected by the valuation—is clearly unreasonable under the facts of this case.

Supp. AB at 6.

Second, the Appeal alleges that PBGC's initial valuation of the Notes was flawed to the extent that the valuation did not consider the possibility of UAL undergoing a "fundamental change" (such as a merger) and the impact a fundamental change would have on the value of the Notes. AB at 37-38; Supp. AB at 7. In particular, the Appeal claims that PBGC failed to account for the provisions in the Notes that required mandatory prepayment at par upon any fundamental change, and thus also failed to account for the possibility of an increase in the value of the Notes upon such a fundamental change. In essence, the Appeal argues, "it was common knowledge . . . that the airline industry was likely to experience mergers and consolidations in the foreseeable future . . . ." The Appeal asserts that PBGC should have known that the recovery was likely to become more valuable and PBGC should have adjusted its initial valuation of the recovery accordingly. AB at 35.

The Appeal claims that even if PBGC's initial valuation of the Notes was not flawed, the 6% Senior Notes and 8% Contingent Notes must be revalued because the October 1, 2010 UAL-Continental Merger constituted an "extraordinary material change of circumstances" that increased the value of PBGC's recovery significantly. Supp. AB at 7. The Appeal argues that it would be clearly unreasonable and an abuse of discretion for PBGC not to revalue the recovery.

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<sup>110</sup> See Appeal Exhibit 13.

AB at 40. The Appeal asserts that, by not revaluing the Notes, PBGC foreclosed Pilots Plan participants from “shar[ing] in PBGC’s good fortune” of UAL’s increased value and profitability resulting from the UAL-Continental Merger. AB at 37.

The Appeal also asks the Appeals Board to review, *in camera* and unredacted, certain documents withheld or provided in redacted form to ALPA by PBGC that the Appeal asserts “undoubtedly contain relevant and valuable information” related to the “incremental value” of the Notes. Supp. AB at 11. The Appeal further requests that the Board provide “unredacted copies of relevant records, and provide ALPA with an opportunity to review and make a further submission to the Appeals Board based on those documents.” *Id.*

### **The Appeals Board’s Conclusions**

The Appeals Board denies Issue 2 of the Appeal. The Board concludes that the valuation date of February 17, 2006 is appropriate because all significant uncertainties regarding PBGC’s recovery from UAL were removed as of that date. The Board rejects the Appeal’s claim that PBGC’s valuation was incorrect. The Board, finding that the Appeal does not establish that PBGC used an unreasonable discount rate or otherwise erred in the valuation of the Notes, denies the Appeal’s claim that PBGC’s valuation of the 6% Senior Notes and 8% Contingent Notes was flawed.

The Appeals Board also denies the Appeal’s claim that PBGC must revalue the Notes due to the UAL-Continental Merger that occurred 6 years after the Plan terminated. Under PBGC Policy 8.2-1.H.2, PBGC’s Recovery Valuation Group (“RVG”)<sup>111</sup> has the sole discretion to decide whether to revalue PBGC’s recovery from UAL.<sup>112</sup> The RVG did not decide to revalue the UAL recovery.

The Board considered the Appeal’s assertions that the 2010 UAL-Continental Merger was an extraordinary material change of circumstances that would provide a basis for the Board to refer this Appeal issue to the RVG. The Appeals Board finds no extraordinary material change of circumstances occurred; thus, the Board concludes that no referral to the RVG is necessary or appropriate.

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<sup>111</sup> The RVG is an interdepartmental group within PBGC responsible for reviewing large and complex recovery valuations. See PBGC Policy 8.2-1.

<sup>112</sup> As explained earlier, citations to PBGC Policy 8.2-1 refer to the 5th Edition, unless otherwise noted.

## Background on Issue 2

### *The Settlement Agreement and PBGC's Recovery Valuation*

Under the Settlement Agreement, among other terms, the reorganized UAL was to distribute to PBGC the "PBGC Securities," which are defined as follows:<sup>113</sup>

#### 2. Consideration to PBGC.

- a. United's proposed plan of reorganization (the "POR") shall provide for the distribution of the following property to PBGC (collectively, the "PBGC Securities"):
  - (i) \$500 million 6% Senior Subordinated Notes described more fully on Exhibit A (the "Senior Notes").
  - (ii) \$500 million 8% Contingent Senior Subordinated Notes described more fully on Exhibit B (the "Contingent Notes")
  - (iii) \$500 million 2% Convertible Preferred Stock, described more fully on Exhibit C (the "Preferred Stock").

Exhibit A of the Settlement Agreement provides that the 6% Senior Notes would be unsecured and due in 2031 (*i.e.*, a 25-year term), with interest payable semi-annually in either additional Senior Notes (in-kind payments) or UAL common shares through December 2011. Thereafter, interest would be payable only in cash. The 6% Senior Notes contained a "Mandatory Prepayment" provision requiring "Mandatory prepayment at par upon a 'fundamental change'; no prepayment obligations for mergers in which the Issuer is the surviving entity."<sup>114</sup>

Exhibit B of the Settlement Agreement describes the terms of the 8% Contingent Notes, which were to be issued in tranches of \$62.5 million each (up to 8 tranches) within 45 days of the end of any given fiscal year in which there is a "Trigger Date." "Trigger Date" is defined as any June 30 or December 31, beginning December 31, 2009, on which the EBITDAR<sup>115</sup> exceeded \$3.5 billion. Interest would begin accruing on the Trigger Date, payable in cash on a semi-annual basis. Each tranche would be due 15 years from its respective Trigger Date. The Settlement Agreement also included a "Mandatory Prepayment" provision requiring "mandatory prepayment at par upon a 'fundamental change'; no prepayment obligations for mergers in which the Issuer is the surviving entity."<sup>116</sup>

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<sup>113</sup> See Settlement Agreement at Appeal Exhibit 12.

<sup>114</sup> *Id.* See also discussion of Mandatory Prepayment provisions *infra* at subpart B of the Discussion section of this Issue 2.

<sup>115</sup> EBITDAR is the earnings before interest, taxes, depreciation, amortization, and restructuring or rent costs.

<sup>116</sup> See Settlement Agreement at Appeal Exhibit 12.

Exhibit C of the Settlement Agreement provides that UAL would issue PBGC 5 million shares of Convertible Preferred Stock at an issue price of \$100 per share. The terms of the Convertible Preferred Stock provide that a 2% annual coupon is to be paid in-kind on a semi-annual basis and the holder may convert the preferred stock into common stock at any time two years after issuance of the stock. The Convertible Preferred Stock contains a Mandatory Redemption provision requiring mandatory redemption upon a “fundamental change” except for mergers in which UAL is the surviving entity. The Appeal does not dispute PBGC’s valuation of the Convertible Preferred Stock.<sup>117</sup>

The terms of the Settlement Agreement were incorporated into a February 1, 2006 Indenture (the “February 2006 Indenture”) among UAL Corporation (the “Issuer”), United Air Lines, Inc. (the “Guarantor”), and The Bank of New York Trust Company, N.A., as Trustee (the “Trustee”).<sup>118</sup>

In valuing the recovery it received from UAL, PBGC established February 17, 2006 as the Valuation Date because it determined that significant uncertainties as to the value of PBGC’s recovery had been removed as of that date.<sup>119</sup> PBGC engaged Greenhill Securities (“Greenhill”) to value the 6% Senior Notes, the 8% Contingent Notes, and the 2% Convertible Preferred Stock. Greenhill completed its valuation by the February 17, 2006 Valuation Date. PBGC’s valuation of its recovery was documented in a PBGC staff memorandum dated June 29, 2007. On July 3, 2007, PBGC’s Recovery Valuation Group concurred with PBGC staff’s recovery valuation.<sup>120</sup>

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<sup>117</sup> *Id.*

<sup>118</sup> See Enclosure 14, February 2006 Indenture.

<sup>119</sup> See Appeal Exhibit 13 at 4.

<sup>120</sup> See Appeal Exhibit 13.

PBGC determined that its recovery totaled \$1,615,326,919. The recovery is broken out as follows:<sup>121</sup>

### PBGC's Recovery from UAL

Date Received	Recovery	Value of Recovery as of 2/17/2006 Valuation Date
February 2, 2006	\$398,498,011.24 in stock <sup>122</sup> (11,103,316 shares at \$35.89 closing price)	\$399,415,103
February 3, 2006	2% Convertible Preferred Stock with \$500 million face value	\$346,743,189
February 4, 2006	\$450,000,000 in cash <sup>123</sup>	\$450,897,534
February 16, 2006	6% Senior Notes with \$500 million face value <sup>124</sup>	\$235,036,055
February 17, 2006	8% Contingent Notes up to \$500 million face value	\$126,000,000
March 8, 2006	\$30,320,468 in stock (810,491 shares at \$37.41 closing price)	\$30,232,339
September 22, 2006	\$19,579,827 in stock (703,804 shares at \$27.82 closing price)	\$18,948,957
May 25, 2007	\$8,631,321 in stock (226,425 shares at \$38.12 closing price)	\$8,053,742
<b>TOTAL</b>		<b>\$1,615,326,919</b>

### PBGC Recovery by Type and Percentage of Total Recovery

Recovery	Value of Recovery as of 2/17/2006 Valuation Date	Percentage of Total Recovery
6% Senior Notes	\$235,036,055	14.55%
8% Contingent Notes	\$126,000,000	7.80%
2% Convertible Preferred Stock	\$346,743,189	21.47%
Other (Common Stock, Cash)	\$907,547,675	56.18%
<b>TOTAL</b>	<b>\$1,615,326,919</b>	<b>100.00%</b>

<sup>121</sup> See pages 4-5 of PBGC's June 29, 2007 Recovery Valuation and Allocation Memorandum at Appeal Exhibit 13.

<sup>122</sup> See Attachment 6 to Appeal Exhibit 13.

<sup>123</sup> PBGC received \$450 million, which represented 45% of its general unsecured claim. See *OIG Final Report, Review of PBGC Claims Sale* (August 31, 2006), at <http://oig.pbgc.gov/pdfs/PA-0029.pdf>.

<sup>124</sup> PBGC mistakenly listed \$235,000,000 as face value in one instance. See June 29, 2007 Recovery Valuation and Allocation Memorandum, Appeal Exhibit 13 at 5.

### *The October 1, 2010 UAL-Continental Merger*

On May 2, 2010, UAL and Continental entered into an Agreement and Plan of Merger.<sup>125</sup> UAL and Continental merged on October 1, 2010, and became United Continental Holdings, Inc. PBGC informed UAL that the merger constituted a “Fundamental Change” under the February 2006 Indenture, thus triggering UAL’s obligation under the Mandatory Prepayment provision of the 6% Senior Notes to immediately pay 100% of the principal plus accrued and unpaid interest.<sup>126</sup> UAL disagreed that the Merger constituted a Fundamental Change; UAL and PBGC subsequently entered into negotiations to resolve this dispute.

PBGC and UAL reached an agreement culminating in the Amended and Restated Indenture, dated as of January 11, 2013 (the “Amended Indenture”).<sup>127</sup> The Amended Indenture restructured the 6% Senior Notes and the 8% Contingent Notes. Among other things, the following amendments were made:<sup>128</sup>

- The 6% Senior Notes were restated into two classes of 6% Senior Notes, without changing the principal balance:
  - 50% of the Senior Notes would mature on July 15, 2026; and
  - the remaining 50% of the Senior Notes would mature on July 15, 2028.
- The 8% Contingent Notes would be issued in a single tranche of \$400 million due July 15, 2024.

### *Relevant Statutory Provisions*

The value of PBGC’s recovery on PBGC’s claims against the Plan is significant because it affects the recovery ratio defined in ERISA section 4022(c)(3). Under ERISA section 4022(c)(1) and (2), the portion of PBGC’s recovery allocable to the Plan’s participants and beneficiaries is the product derived by multiplying (A) the outstanding amount of benefit liabilities under the plan (including interest calculated from the termination date), by (B) the applicable recovery ratio. For plans like the Pilots Plan, for which outstanding benefit liabilities exceeded \$20 million, the applicable recovery ratio is the ratio of (i) the value of PBGC’s recovery under ERISA section 4062 in connection with the plan, to (ii) the amount of unfunded benefit liabilities under such plan as of the termination date.<sup>129</sup> ERISA section 4022(c)(4) provides that determinations under section 4022(c) shall be made by PBGC, and that such determinations shall be binding unless shown by clear and convincing evidence to be unreasonable.

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<sup>125</sup> See <http://www.sec.gov/Archives/edgar/data/100517/000119312511042335/d10k.htm>.

<sup>126</sup> See Appeal Exhibit 24.

<sup>127</sup> See Supplemental Appeal Exhibit S-9E; see also Supplemental Appeal Exhibit S-9D.

<sup>128</sup> See Supplemental Appeal Exhibits S-9F, S-9G, S-9H.

<sup>129</sup> See ERISA § 4022(c)(3)(C).

### *PBGC Policy 8.2-1*

PBGC Policy 8.2-1 defines the Valuation Date for purposes of valuing recoveries as the earlier of the date when all significant uncertainties as to the values of the recoveries are removed or the last day of the 16<sup>th</sup> full calendar month following the date of trusteeship of the plan.

Further, PBGC Policy 8.2-1.H.2 provides that “[s]ubsequent adjustments to the value of recoveries shall be made only in situations in which the valuation was based on a material mistake of fact or if there has been an extraordinary material change of circumstances.” The policy contemplates, for example, a mistake of fact such as “an employer’s having substantial assets that were not taken into account at the time the recoveries were valued.” In addition, the policy contemplates an extraordinary material change of circumstances as “a substantial unexpected recovery in a legal action pertaining to a terminated and trustee pension plan.” In such a case, “[t]he RVG has sole discretion in determining whether a valuation was based on a material mistake of fact or whether there has been an extraordinary material change of circumstances concerning a valuation, and whether or not to adjust the recovery value.”<sup>130</sup>

#### Discussion

##### **A. PBGC’s decision to value its recovery as of February 17, 2006 was proper.**

The Appeal asserts that PBGC was unreasonable in its selection of February 17, 2006 as the Valuation Date for its recovery from UAL.

For plans like the Pilots Plan, in which outstanding benefit liabilities exceed \$20 million, PBGC’s actual recovery on the UBL claim against the Plan sponsor and its controlled group directly affects the ERISA section 4022(c) benefit amounts that PBGC pays. Accordingly, it is important that PBGC value the recovery on its UBL claim correctly.

To determine ERISA section 4022(c) amounts, PBGC must value its UBL recovery for the pension plan as of the plan’s DOPT. Frequently, however, significant uncertainties exist at DOPT as to the value of PBGC’s UBL recovery. This often necessitates PBGC’s use of a Valuation Date that is after DOPT. When a recovery is valued on a post-DOPT Valuation Date, PBGC discounts the recovery value on the Valuation Date to its DOPT value based on the interest rate assumptions established in PBGC’s asset allocation regulation.

Under longstanding PBGC policy, the Valuation Date for valuing a recovery is generally “the earlier of: (a) the date when all significant uncertainties as to the value of the recoveries are removed; or (b) the last day of the 16th full calendar month following the date of trusteeship of the plan.”<sup>131</sup>

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<sup>130</sup> See PBGC Policy 8.2-1.H.2.

<sup>131</sup> See PBGC Policy 8.2-1.D.1.

PBGC established February 17, 2006 as the Valuation Date for determining the Plan's recovery, which was approximately fourteen months after the Plan's DOPT. PBGC concluded that significant uncertainties as to the value of PBGC's recovery had been removed as of February 17, 2006 because: (1) PBGC had received the bulk of the UAL common stock from its UAL bankruptcy claim and the market in UAL stock had been established (UAL exited bankruptcy on February 1, 2006); (2) PBGC had completed its claim sale to Deutsche Bank and received \$450 million cash consideration; and (3) PBGC had received the Preferred Stock and Senior Notes.<sup>132</sup>

The Appeal, however, objects to the February 17, 2006 Valuation Date as unreasonably earlier than the "February 28, 2007 'deadline'" established by PBGC Policy 8.2-1. AB at 35. The Appeal asserts the following:

PBGC rushed to value its employer liability recovery, establishing a valuation date that was a mere 17 days after UAL emerged from Chapter 11; a year before the February 28, 2007, "deadline" established by its valuation Policy; more than four years before PBGC issued a benefit determination to [REDACTED]; and more than six years before PBGC issued revised benefit determinations to many participants in the UAL Plans whose benefits were affected by the recovery valuation.

*Id.*

The Appeal's reference to the "February 28, 2007 'deadline'" in PBGC's Valuation Policy – as well as to several other later events – is immaterial with respect to the proper application of PBGC Policy 8.2-1. Although February 28, 2007 is the latest Valuation Date possible under PBGC Policy 8.2-1, PBGC would have used that date only if significant uncertainties remained as of February 28, 2007. Because PBGC determined that all significant uncertainties as to the value of the recovery was removed as of February 17, 2006, the correct deadline established by PBGC Policy 8.2-1 is February 17, 2006.

The Appeal questions the February 17, 2006 Valuation Date with respect to the 6% Senior Notes and the 8% Contingent Notes, but does not dispute the basic facts that underlie PBGC's determination that significant uncertainties had been removed as of the February 17, 2006 Valuation Date. AB at 39. Specifically, the Appeal does not dispute that: (1) PBGC received the Notes before the Valuation Date, and (2) the Notes stated the amounts payable by UAL to PBGC under specified conditions on specified future dates.

Although the Appeal disagrees with how PBGC valued the Notes, the Appeal does not provide any evidence indicating that the Notes could not be reasonably valued as of February 17, 2006. Thus, the Appeals Board rejects the Appeal's claim that the Valuation Date was improper.

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<sup>132</sup> See June 29, 2007 Recovery Valuation and Allocation Memorandum, Appeal Exhibit 13 at 4.

**B. PBGC's valuation of the 6% Senior Notes and 8% Contingent Notes was not flawed.**

The Appeal argues that PBGC's recovery valuation failed to consider "the possibility the UAL would undergo a fundamental change" (such as a merger), and the "potentially significant financial upside" that may occur from a fundamental change triggering the Mandatory Prepayment obligation. AB at 33, 37-39; Supp. AB at 6-7.

As discussed below, the Board rejects the Appeal's conclusion that PBGC's valuation of the 6% Senior Notes and 8% Contingent Notes was flawed.

The Mandatory Prepayment clause required UAL to offer to redeem all the outstanding notes at a redemption price of par plus accrued interest if UAL experienced a "fundamental change." "Fundamental Change" is defined as follows:<sup>133</sup>

"Fundamental Change" means the occurrence of any of the following: (a) any sale, conveyance, transfer or disposition of more than 50% of the property or assets of the Company and its Subsidiaries on a consolidated basis . . . (b) any merger or consolidation to which the Company is a party, except for (x) a merger which is effected solely to change the state of incorporation of the Company or (y) a merger in which the Company is the surviving Person, the terms of the Notes are not changed or altered in any respect, the Notes are not exchanged for cash, securities or other property or assets and, after giving effect to such merger, the holders of the capital stock of the Company as of the date of this Indenture shall continue to own the outstanding capital stock of the Company possessing the voting power (under ordinary circumstances) to elect a majority of the Board; (c) the Termination of Trading; or (d) the Company's approval of a plan of liquidation or dissolution.

The "Mandatory Prepayment" clause is a common term in debt securities and was, therefore, required under the Settlement Agreement, which provides:<sup>134</sup>

- b. **Indenture.** The documentation of the PBGC Securities shall include default and remedy provisions that are customarily found in public market securities and covenants that contain the most beneficial terms contained in any other securities of similar or junior ranking issued under [UAL's proposed plan of reorganization].

The Appeal asserts that PBGC included, among other provisions, the Mandatory Prepayment provision to be "sure that it would receive additional compensation if UAL prospered." AB at 37. The Mandatory Prepayment obligation, however, is only triggered by a "Fundamental Change." As quoted earlier, the Fundamental Change provision only contemplates events in which either UAL is no longer in existence or has a risk of diminished

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<sup>133</sup> See Enclosure 14, February 2006 Indenture, at 4-5.

<sup>134</sup> See page 2 of the Settlement Agreement at Appeal Exhibit 12.

financial capacity. Thus, the nature of the Mandatory Prepayment provision is to hedge against risk, not to capture any incremental value occurring from a favorable event.

The Appeal contends that PBGC should have considered the possibility of UAL undergoing a fundamental change, and the potentially significant upside that may occur, particularly because “it was common knowledge in the industry (and known specifically by PBGC), that the airline industry was likely to experience mergers and consolidations in the foreseeable future.”<sup>135</sup> AB at 35.

The Appeals Board observes that UAL’s 10-K filing for 2006 acknowledged the possibility of future consolidations in the airline industry, although it did not indicate that UAL itself was likely to undergo a consolidation:<sup>136</sup>

From time to time the U.S. airline industry has undergone consolidation, as in the recent merger of U.S. Airways and America West, and may experience additional consolidation in the future. . . . If other airlines participate in merger activity, those airlines may significantly improve their cost structures or revenue generation capabilities, thereby potentially making them stronger competitors of United.

To support its claims related to the UAL/Continental merger, the Appeal references a statement made by PBGC Senior Financial Analyst Craig Yamaoka in a July 27, 2007 UAL Corporation Probability Analysis (the “Yamaoka Analysis”).<sup>137</sup> The Yamaoka Analysis was completed in July 2007, more than a year after both the Valuation Date and UAL’s reorganization. Although the Yamaoka Analysis does not relate to PBGC’s recovery valuation, the Appeal cites it for the proposition that PBGC knew that “there is likely to be ‘a wave of consolidation’ in the airline industry, and that UAL is a ‘likely benefactor’ of any such future consolidation.”<sup>138</sup> AB at 33.

The statements made in both the UAL 10-K filing and in the Yamaoka Analysis acknowledge the possibility of future consolidations in the airline industry. However, these documents do not indicate the probability of such consolidations (or even whether the

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<sup>135</sup> The Appeal also points out that, in December 2006, “[a]ccording to press reports, UAL and Continental Airlines are in preliminary talks about a possible merger.” AB at 32. The Board notes that such “preliminary talks” did not commence until nine months after the February 17, 2006 Valuation Date. Moreover, a merger of those two airlines was not inevitable. In fact, Continental broke off merger negotiations with UAL in 2008, after UAL reported financial losses due in part to high fuel costs. *See generally* Andrew Ross Sorkin & Micheline Maynard, *Continental Abandons Merger Talks with United*, N.Y. Times, April 28, 2008, at Enclosure 15.

<sup>136</sup> *See* Enclosure 16 at 16. Copies of UAL’s Form 10-K filings beginning with UAL’s 1993 fiscal year are available at the “Investor Resources” tab, at: <http://www.unitedcontinentalholdings.com>.

<sup>137</sup> *See* Appeal Exhibit 23, Attachment 4.

<sup>138</sup> *Id.* The purpose of the Yamaoka Analysis was to estimate, in 2007, whether UAL would survive five years after the termination dates of the UAL Pension Plans, the earliest of which was December 31, 2004. In predicting whether UAL could do so, the analysis cited merger or consolidation as one of six factors in the estimate. The Yamaoka Analysis demonstrates, at most, that PBGC was aware, in July 2007, that mergers and consolidations within the airline industry were possible.

consolidations were more likely to occur than not). Nor do the documents indicate whether such consolidations would include UAL or how they would affect UAL, if at all.

Moreover, the possibility of future consolidation in the airline industry was just one of many factors that could have significantly impacted the value of the Notes. PBGC received the 6% Senior Notes and 8% Contingent Notes as part of UAL's Plan of Reorganization, and the Notes were unsecured and only valuable if UAL could successfully emerge from bankruptcy and become sufficiently profitable to make the Notes' required payments. Thus, the Notes were risky and might never be fully paid; PBGC's valuation took into account this risk.

The financial and business risks for UAL and the airline industry are indicated in UAL's Form 10-K filing for the fiscal year ended December 31, 2006, which was filed on March 29, 2007.<sup>139</sup> The following are some, but not all, of the "Risks Related to the Company's [UAL's] Business" that the 10-K filing disclosed:<sup>140</sup>

- Continued periods of historically high fuel costs or significant disruptions in the supply of aircraft fuel could have a material adverse impact on the Company's operating results. . . .
- Additional terrorist attacks or the fear of such attacks, even if not made directly on the airline industry, could negatively affect the Company and the airline industry. . . .
- The airline industry is highly competitive and susceptible to price discounting. . . .
- Additional security requirements may increase the Company's costs and decrease its traffic. . . .
- The Company's results of operations fluctuate due to seasonality and other factors associated with the airline industry. . . .
- The Company's initiatives to improve the delivery of its products and services to its customers, reduce costs, and increase its revenues may not be adequate or successful. . . .
- Union disputes, employee strikes and other labor-related disruptions may adversely affect the Company's operations. . . .
- The Company's high level of fixed obligations could limit its ability to fund general corporate requirements and obtain additional financing, could limit its flexibility in responding to competitive developments and could increase its vulnerability to adverse economic and industry conditions. . . .
- The Company is subject to economic and political instability and other risks of doing business globally.

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<sup>139</sup> See Enclosure 16.

<sup>140</sup> *Id.* at 15-20.

The following facts were also material to PBGC's valuation of the Notes:<sup>141</sup>

- “On the Effective Date [of UAL’s reorganization], the Company [UAL] secured access to \$3.0 billion in secured exit financing . . . which consisted of a \$2.45 billion term loan, a \$350 million delayed draw term loan and a \$200 million revolving credit line.”<sup>142</sup> These secured debt instruments would have priority with respect to their payment in relation to the unsecured Notes that PBGC received if UAL sought bankruptcy protection in the future.
- The 6% Senior Notes and the 8% Contingent Notes had lengthy maturation periods: 25 years for the 6% Senior Notes and 15 years after the issue date for the 8 potential \$62.5 million tranches of 8% Contingent Notes.<sup>143</sup>
- The 6% Senior Notes required only the payment of interest during the time period before they matured.<sup>144</sup>
- The 8% Contingent Notes required UAL to meet triggering EBITDAR results. No tranches of the 8% Contingent Notes would be issued if EBITDAR triggers were not met.<sup>145</sup>

Despite the many factors that significantly affected the value of the Notes, the Appeal argues that PBGC’s Valuation was flawed particularly because “[t]he PBGC/Greenhill valuation did not discuss the possibility that UAL would undergo a fundamental change . . . nor did it discuss the impact that any such change would have on the value of the securities. . .” AB at 37. For the reasons given below, the Appeals Board rejects the Appeal’s claim that PBGC improperly valued the Notes.

PBGC contracted with Greenhill as its financial advisor during the course of UAL’s bankruptcy proceeding to assist in valuing the 6% Senior Notes, the 2% Convertible Preferred Stock, the 8% Contingent Notes, and realized and unrealized PBGC recovery on unsecured claims.<sup>146</sup> The Appeal provides no evidence that Greenhill lacked knowledge about the financial condition of UAL or the airline industry in general. Likewise, the Appeal makes no claim or assertion that Greenhill lacked the expertise to properly value the Notes.

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<sup>141</sup> *Id.*

<sup>142</sup> *Id.* at 5.

<sup>143</sup> *Id.* at 102.

<sup>144</sup> *Id.*

<sup>145</sup> *Id.*

<sup>146</sup> See Appeal Exhibit 13, Attachment 4. One of the tasks Greenhill performed for PBGC was to facilitate PBGC’s sale of the preferred UAL stock that PBGC received under its settlement with UAL. In its report to the OIG, IFS, retained by the OIG to review the claims sale, stated that “Greenhill appeared to be thorough, competent, and critical to the success of the claims sale;” and that the claims sale was “perceived in the market as successfully executed.” See OIG Final Report, *Review of PBGC Claims Sale* (August 31, 2006), at <http://oig.pbgc.gov/pdfs/PA-0029.pdf> at 6, 8.

PBGC's June 29, 2007 Recovery Valuation and Allocation Memorandum shows that Greenhill valued the 6% Senior Notes "using a cost of capital range of 10.0% to 12.0%."<sup>147</sup> Greenhill likewise valued the 8% Contingent Notes "using a cost of capital range of 10.0% to 12.0% and assuming issuance dates based on an extended EBITDAR projection."<sup>148</sup> PBGC selected the midpoint present value of the estimated present range value for each security in completing its valuation.<sup>149</sup>

In valuing securities, factors such as the economic health of the airline industry and UAL's financial condition are generally reflected in the discount rate determined to be appropriate for the Notes because a basic element of the discount rate is the assessment of risk – the uncertainty of when and how much cash flow (or other income) will be received. Thus, the purpose of the discount rate is to provide a best estimate of the risk based on a holistic assessment of the risk factors (often made by comparison to similar notes in the market). Relevant considerations in establishing the appropriate discount rate for the Notes include, for example, the value of below investment grade airline unsecured debt securities in the market, comparable notes in the market, historical volatility in the operating results of the airline industry, and the maturity length of the Notes.<sup>150</sup>

The Appeal does not provide any evidence to suggest that Greenhill, a financial expert in valuations, determined an unreasonable discount rate or used an incorrect methodology to value the Notes. Although Greenhill's valuation report does not provide a "line-by-line" accounting of the particular values of each term of the Notes (*e.g.*, the maturity date, interest rate, call option, etc.), the lack of a line-by-line reporting does not establish that Greenhill's valuation using its "cost of capital" approach was flawed. Furthermore, the Appeals Board finds no reason to conclude that the "Mandatory Prepayment" clauses in the Notes were so significant as to warrant a special discussion in the Greenhill valuation.

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<sup>147</sup> See Appeal Exhibit 13, Attachment 4, at 7.

<sup>148</sup> *Id.* at 8.

<sup>149</sup> *Id.* at 11.

<sup>150</sup> See *e.g.*, Chris Hamilton, *Developing Appropriate Capitalization and Discount Rates*, Valuation Strategies, March/April 2004, at 3, 7, available at 2004 WL 542200. The article provides the following general discussion:

Cost of capital is the expected rate of return that the market requires to attract funds to a particular investment. It is based on expected returns relative to market prices. . . .

The cost of capital is market driven: it is the competitive rate of return available in the market on a comparable investment. The most important component of comparability is risk. Risk is the degree of certainty, or lack of it, that the investor will realize the expected returns at the times specified. *Because risk cannot be observed directly, analysts have developed several ways to estimate it using available market data* (generally based on some past period). . . .

In valuation theory, the discount rate represents the total expected return an investor would require on the monies invested in the particular investment given the level of risk in the ownership interest. Risk can be broken down into two categories: business risk and financial risk. Business risk is the uncertainty associated with the operations of the business and its industry environment. This component of risk is defined as the variability associated with the expected future operating income of a business. The second component, financial risk, relates to the business use of financial leverage in its capital structure. . . .

(Emphasis added.) (Internal citation omitted.)

Under ERISA section 4022(c)(4), PBGC's determination of the value of the Notes "shall be binding unless shown by clear and convincing evidence to be unreasonable." The Appeals Board finds that the Appeal provided only conjecture, not clear and convincing evidence, that PBGC's valuation of the Notes was flawed. Furthermore, in reviewing this issue, the Appeals Board did not identify any error in the valuation of the Notes that would require the valuation to be redone. Thus, the Appeals Board denies the Appeal on this second assertion under Issue 2 that PBGC improperly valued the Notes.

Related to this issue is the Appeal's request that the Appeals Board review, *in camera* and in unredacted form, certain documents that were released either heavily redacted or withheld in their entirety from ALPA, addressing the post-merger "incremental value" of the Notes. Supp. AB at 11. The Appeal points out specific examples of documents either entirely withheld or heavily redacted:

- JP Morgan's post-merger (June 20, 2011) analysis of the Notes . . .
- A second JP Morgan post-merger (July 22, 2011) analysis of the Notes . . .
- JP Morgan High Yield Asset Management Managed Portfolio Market Valuation as of 4/30/2011. . .
- Records reflecting communications among PBGC advisors JP Morgan and Blackstone and PBGC financial analysts regarding the Notes . . . .

*Id.* The Appeal also asks the Appeals Board to provide unredacted versions of relevant records, and "provide ALPA with an opportunity to review and make a further submission to the Appeals Board based on those documents." *Id.*

ALPA requested the documents specified in the Appeal in a March 26, 2012 FOIA request. In its May 21, 2012 and November 5, 2012 letters, PBGC's Disclosure Officer denied the FOIA request, in part, and provided redacted versions of the documents specified in the Appeal. ALPA appealed the partial denial on December 4, 2012. In a February 15, 2013 decision, PBGC's General Counsel stated that the documents specified in the Appeal were redacted due to FOIA Exemption 5, which "protects from disclosure 'inter-agency or intra-agency memorandums or letters which would not be available by law to a party other than an agency in litigation with the agency.'" <sup>151</sup> As the General Counsel's decision letter stated, the decision is the Agency's last action with respect to the FOIA appeal; the Appeals Board has no authority to review the General Counsel's February 15, 2013 FOIA appeal decision.

Moreover, the Appeals Board reviewed the unredacted versions of the documents specified in the Appeal and determined that they are not relevant to the Board's decision on this issue. Thus, the Board denies the Appeal's request for an opportunity to review the specified documents in their unredacted form.

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<sup>151</sup> See February 15, 2013 decision from PBGC General Counsel, Judith R. Starr, at Appeal Exhibit 45 and Supplemental Appeal Exhibit S-4.

**C. The UAL-Continental Merger in October 2010 did not require PBGC to revalue its recovery based on increases in value of the 6% Senior and 8% Contingent Notes.**

The Appeal argues that the UAL-Continental Merger qualifies as an extraordinary material change of circumstance, and that for PBGC to decide not to revalue its recovery would be “Clearly Unreasonable And An Abuse Of Discretion.” Supp. AB at 7. The Appeal also contends that there exists an extraordinary material change of circumstances as a result of “improved financial results attributable to the [UAL-Continental] merger.” AB at 38.

The Appeals Board rejects the Appeal’s conclusion that the UAL-Continental Merger qualifies as an extraordinary material change in circumstances.

Pursuant to paragraph H.2. of PBGC Policy 8.2-1, PBGC will only consider revaluing recoveries when there has been either: (1) a material mistake of fact, or (2) an extraordinary material change of circumstances. The policy is also clear that the determination of whether there has been a material mistake of fact or an extraordinary material change of circumstances is within the sole discretion of the RVG. Even in those instances where the RVG finds there has been either a material mistake of fact or extraordinary material change of circumstances, Policy 8.2-1 does not require PBGC to revalue the recoveries, but provides that it is within the RVG’s sole discretion whether to perform a revaluation. As stated in the Board’s conclusion above, under PBGC Policy 8.2-1, the RVG has the “sole discretion” in the Agency to revalue the recoveries. Thus, it is not within the Appeals Board’s jurisdiction to supersede any RVG decision on whether to revalue PBGC’s recovery.<sup>152</sup>

The RVG did not decide to revalue the UAL recovery. Although the Appeal recognizes that “the decision to perform a new valuation is discretionary,” it asserts that “it would be arbitrary, capricious, and an abuse of that discretion for PBGC to fail to do so in this case.” AB at 40. The Appeals Board disagrees with the Appeal’s position that there was an abuse of discretion. Moreover, the Board does not believe that the Policy’s conditions for a revaluation, *i.e.*, a material mistake of fact or an extraordinary material change of circumstances, were present in this case. Thus, the Board does not find it necessary to ask the RVG to consider revaluing the recovery.

As addressed previously, the Board finds no basis for concluding that PBGC’s initial valuation of February 17, 2006 was flawed. The Board thus concludes that there was no material mistake of fact in the initial valuation that warranted its revaluation. The only other basis for revaluing the Notes is an extraordinary material change of circumstances. PBGC Policy 8.2-1.H.2 states: “An example of an extraordinary material change of circumstances would be a substantial unexpected recovery in a legal action pertaining to a terminated and

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<sup>152</sup> PBGC’s “Rules for Administrative Review of Agency Decisions” authorize the Appeals Board to review certain initial determinations made by PBGC, including PBGC’s determinations of benefits payable to individual participants. 29 C.F.R. §§ 4003.1 and 4003.51. That regulation, however, does not provide the Appeals Board with blanket authority to review all actions PBGC officials must take in their official duties. For example, the Appeals Board does not review the actions PBGC takes on fiduciary breach claims, positions taken by PBGC in litigation, or court settlements made by PBGC. Likewise, the Appeals Board has no authority to change the date of plan termination decided in court or by plan and PBGC officials.

trusted pension plan.” Here, there was no unexpected recovery but merely a renegotiation of the Notes, as reflected in the Amended Indenture. Thus, the Board finds that the scenario presented in the example in PBGC Policy 8.2-1 of what would constitute “an extraordinary material change of circumstances” (*i.e.*, an unexpected recovery in a legal action) is not present in this case.

Further, the Board disagrees that UAL’s achievement of its financial target earlier than PBGC initially predicted is an “extraordinary material change of circumstances.” As the Board notes in subpart B of Appeal Issue 2, there were many factors and future events that could significantly impact UAL’s financial condition after emerging from bankruptcy. UAL could have defaulted on its commitments under the Notes, which would have rendered the 6% Senior Notes and 8% Contingent Notes worthless.<sup>153</sup> The Appeals Board concludes that the UAL-Continental Merger and UAL’s financial condition four years after PBGC’s Valuation Date were the products of ordinary market forces that occurred after the Valuation Date and does not constitute an “extraordinary material change of circumstances.”

The Valuation Date provisions in PBGC Policy 8.2-1 effectively provide that, absent an extraordinary material change of circumstances, PBGC should suffer the loss or be credited with the gain on changes to the market value of its recoveries after the Valuation Date.<sup>154</sup> The Appeals Board would not expect an appellant to claim that PBGC’s RVG must reconsider a valuation based on a market event or events that made the Notes less valuable. Likewise, the market events that caused an increase in the value of the Notes do not require the RVG to exercise its discretion and increase the value of PBGC’s recovery. Further, it would be disruptive to Plan participants and beneficiaries if PBGC-payable benefit amounts were to fluctuate – to potentially larger or smaller amounts – based on future changes to the values of the notes, securities, and other financial instruments that PBGC may receive as its recovery.

If the Appeals Board had concluded that the standards under PBGC Policy 8.2-1 for a revaluation of PBGC’s recovery were met, the Board would have asked the RVG to consider revaluing the recovery. However, having found no “material mistake of fact” or “extraordinary material change of circumstances” exists here, the Board concludes that a referral to the RVG is not necessary. Accordingly, the Appeals Board denies Issue 2 of the Appeal.

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<sup>153</sup> UAL’s Form 10-K filing for 2006 contained numerous examples of business and financial risks that could have affected the value of the Notes after the February 17, 2006 Valuation Date including a second UAL bankruptcy filing, disruptions in fuel supply, international crises impacting fuel costs, outbreaks of war, Federal Reserve action, terrorism, and its high level of debt, among other factors.

<sup>154</sup> PBGC’s treatment of recoveries under PBGC Policy 8.2-1 is similar to PBGC’s treatment of pension plan assets under ERISA section 4044(c). ERISA section 4044(c) provides 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 [DOPT] shall be credited to, or suffered by, the [PBGC].”

**Issue 3: Whether PBGC should adjust the value of the Pilots Plan assets to include a \$266,988 premium payment for the 2004 plan year. (Supp. AB at 12-13.)**

**The Appeal**

The Appeal contends that the value of the Plan assets at DOPT must be increased to include the \$266,988 premium payment made from the Pilots Plan's assets on February 25, 2004. Supp. AB at 12-13. The Appeal argues that, under 29 C.F.R. section 4007.12(b), a plan has no liability for premiums imposed by ERISA for the plan year in which PBGC initiates a termination proceeding. *Id.*

The Appeal states that UAL's \$266,988 premium payment on behalf of the Pilots Plan was paid using Pilots Plan assets during the plan year PBGC initiated termination of the Pilots Plan. Based on these facts, the Appeal asserts the following:

. . . [A]ll amounts with respect to plan year 2004 premiums, interest, or penalties that were either (1) paid with Pilot Plan assets prior to or on the Plan termination date, or (2) treated as a liability that reduced the amount of Plan assets available for the Section 4044 allocation, should, under the language of § 4007.12(b), be credited back to the Pilot Plan for purposes of the Section 4044 allocation.

Supp. AB at 13.

**The Appeals Board's Conclusion**

The prior Plan Administrator made three premium payments for plan year 2004 from the Pilots Plan's assets. PBGC credited the last two payments (made in 2005) back to the Plan. The Appeals Board concludes that PBGC is not required to credit back to the Plan the \$266,988 premium payment made on February 25, 2004, which occurred more than ten months before the Plan's termination on December 30, 2004. Therefore, the Board denies Issue 3 of the Appeal.

**Background on Issue 3**

ERISA's requirement that all single-employer defined benefit pension plans covered by PBGC pay premiums to PBGC is a central feature of PBGC's insurance program. ERISA section 4007 governs the payment of such premiums, and provides: "The designated payor of each plan shall pay the premiums imposed by the corporation under this title with respect to that plan when they are due." ERISA section 4007(e)(1) defines "designated payor" in the case of a single-employer plan as the contributing sponsor or the plan administrator. Thus, premiums can be made from contributing sponsor assets (not plan assets) or, more commonly, by the plan administrator from plan assets.

Under PBGC's regulation, 29 C.F.R. section 4007.12(a), "[p]ursuant to section 4007(e) of ERISA, both the plan administrator and the contributing sponsor of a single-employer plan are liable for premium payments." The estimated flat-rate premium payment for plan year 2004 was

due to PBGC on March 1, 2004, and the remaining flat-rate premium and the variable-rate premium payments for plan year 2004 were due on October 15, 2004.<sup>155</sup> Records available to the PBGC show that Pilots Plan assets were used to make three premium payments (flat-rate and variable-rate) for the Pilots Plan for the 2004 plan year.<sup>156</sup> The following chart summarizes these premium payments and when they were made.

### Premium Payments for the 2004 Plan Year

	Payment Due Date	Date of Payment	Payment Amount
<b>Estimated Flat-Rate Premium</b>	March 1, 2004	February 25, 2004	\$266,988
<b>Remaining Flat-Rate Premium and Variable-Rate Premium</b>	October 15, 2004	February 7, 2005	\$11,422,062
		April 11, 2005	\$177,188
		<b>Total Paid in 2005</b>	<b>\$11,599,250</b>

PBGC determined that approximately \$11.6 million in PBGC premiums were inappropriately paid on behalf of the Pilots Plan.<sup>157</sup> Therefore, PBGC credited back to the Plan \$11,599,250. PBGC did not determine that the \$266,988 premium payment made before DOPT (February 2004) was inappropriately paid on behalf of the Pilots Plan.<sup>158</sup>

### Discussion

Under PBGC's 1988 premium payment regulation, in effect before April 10, 2014, "the obligation to pay the premiums (and any interest or penalties thereon) imposed by ERISA . . . shall be an obligation solely of the contributing sponsor and the members of its controlled group, if any" *for any plan year in which* a plan administrator or PBGC initiates termination of a pension plan.<sup>159</sup> As the preamble to the 1988 premium regulation explained, "[t]his special rule

<sup>155</sup> See page 8 of PBGC's 2004-R Premium Payment Package, which can be found on the PBGC website at: [http://www.pbgc.gov/documents/2004\\_Final\\_Form\\_Instructions.pdf](http://www.pbgc.gov/documents/2004_Final_Form_Instructions.pdf).

<sup>156</sup> See Appeal Exhibit 35 at 9.

<sup>157</sup> See Supplemental Appeal Exhibit S-7D, May 11, 2012 KPMG Evaluation Report for the Plan Asset Evaluation for the United Airlines Pension Plans, at 50.

<sup>158</sup> *Id.* The \$266,988 premium payment was not included in the \$11.6 million amount referenced in this Exhibit.

<sup>159</sup> See 29 C.F.R. § 4007.12(b) (2005); See also 29 C.F.R. § 2610.26(b) on page 25 of Enclosure 17. The Board notes that until the April 10, 2014 amendment, the 1988 premium regulation remained substantially the same since its promulgation in 1988. Before April 10, 2014, the 1988 premium regulation was amended only to replace the word "Act" with "ERISA."

The current version of 29 C.F.R. section 4007.12(b) reflects an amendment that became effective on April 10, 2014, after the Appeal was filed. See Enclosure 18. The regulation now reads:

After a plan administrator issues (pursuant to section 4041(a)(2) of ERISA) the first notice of intent to terminate in a distress termination under section 4041(c) of ERISA or PBGC issues a notice of determination under section 4042(a) of ERISA, the obligation to pay the premiums (and any interest or penalties thereon) imposed by ERISA and this part for a single-employer plan shall be an obligation solely of the contributing sponsor and the members of its controlled group, if any.

is necessary because, in these circumstances, paying premiums from plan assets is generally tantamount to PBGC paying itself; *i.e.*, using plan assets for premium payments will increase PBGC's liability for guaranteed benefits."<sup>160</sup> The preamble thus indicated that the regulation was intended to protect PBGC's insurance funds by requiring sponsors to pay premiums from corporate assets rather than from plan assets.

Although a plan sponsor may incur a liability to PBGC for premiums payable in the last plan year before plan termination, PBGC does not interpret the 1988 premium regulation as *prohibiting* plan administrators from using plan assets to pay PBGC premiums. Further, the 1988 premium regulation did not *require* PBGC to return such premium payments back to the plan, even though PBGC has discretion to restore payments of premiums to a plan's assets. Consistent with the text of the 1988 premium regulation, the preamble to the 1988 premium regulation recognized PBGC's discretionary authority with respect to its treatment of premium payments from plan assets.<sup>161</sup>

The PBGC *may* treat as legally ineffective any payment made from plan assets in violation of [29 C.F.R. section 4007.12(b)], and reserves its right in such circumstances to obtain payment from the plan's contributing sponsor and members of the contributing sponsor's controlled group.

(Emphasis added.)

PBGC Policy 4.5-1, *Treatment of Plan Liability for Premiums*, clarified PBGC's position by providing that, as a general rule, when a plan uses plan assets to pay premiums, PBGC will not return those payments to the plan or treat the payments as plan assets, even if they were not an obligation of the plan.<sup>162</sup> PBGC Policy 4.5-1 also recognizes that, in "rare instances," PBGC may exercise its discretionary authority to treat payments from plan assets as legally ineffective and seek payment from the plan sponsor and the members of its controlled group.

The Appeals Board concludes that nothing in PBGC's regulations or policies requires PBGC either to treat the \$266,988 premium payment as legally ineffective or to seek the payments from the plan sponsor. In the context of distress or PBGC-initiated terminations, PBGC will often have little or no recourse to the plan's sponsor for premium payments.

Although PBGC was not required to credit back the \$11,599,250 in premium payments (*i.e.*, the portion of premium payments for the plan year 2004 that was made in 2005, which was *after*

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The current regulation is significant because it changes the date on which the obligation to pay the premiums shifts from either the contributing sponsor or plan administrator to solely the contributing sponsor. The former regulation provides that the obligation shifts at the beginning of the applicable plan year (*i.e.*, the plan year in which a plan administrator issues a notice of intent to terminate or PBGC issues a notice of determination). The current regulation, however, provides that the obligation shifts only *after* the plan administrator issues a notice of intent to terminate or PBGC issues a notice of determination.

<sup>160</sup> See 53 FR at 24912.

<sup>161</sup> *Id.*

<sup>162</sup> See generally Enclosure 19, PBGC Policy 4.5-1 (Sept. 26, 2013). See also Enclosure 20, Transmittal Record 2013-11, which provides background regarding PBGC Policy 4.5-1.

DOPT), the Board finds that PBGC's decision to do so was reasonable and within the agency's discretion. Likewise, the Board finds that PBGC's decision not to credit back to Plan assets the \$266,988 premium payment made on February 25, 2004, more than ten months before DOPT, was reasonable and also within the Agency's discretion. Thus, the Board denies Issue 3 of the Appeal.

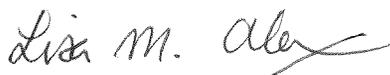
Finally, the Board notes that even if the \$266,988 payment were added to Pilots Plan assets, benefits funded in PC3 would only increase by 0.0076%.<sup>163</sup> [REDACTED] PC3 benefit is less than his PBGC-guaranteed benefit; thus, crediting back the premium payment would not impact [REDACTED] benefit.

## DECISION

Having applied the Plan's provisions, the provisions of ERISA, and PBGC's regulations and policies to the facts in this case, the Appeals Board denies the Appeal. This decision is PBGC's final Agency action on the Appeal. [REDACTED] may seek review of this decision in an appropriate U.S. District Court.

If you have any questions, please contact PBGC's Authorized Plan Representative at 1-800-400-7242.

Sincerely,



Lisa M. Alexander  
Member, Appeals Board

Cc: Captain [REDACTED] (without enclosures and with redaction of pilot's name in footnote 10)

Twenty Enclosures:

- (1) United Airlines Pilot Defined Benefit Pension Plan, 1999 Amendment and Restatement, Effective Beginning January 1, 1999 (97 pages)
- (2) Air Transportation Stabilization Board letter to UAL, dated December 4, 2002 (3 pages)
- (3) UAL Pension Plans' Forms 5500 (Annual Returns/Reports of Employee Benefit Plans), Schedules B (Actuarial Information), Attachments to the Schedules B, and Schedules D (DFE/Participating Plan Information), for the 2002, 2003, 2004, and 2005 Plan Years, as applicable (538 pages)
- (4) U.S. Department of Labor News Release, dated August 17, 2004 (1 page)
- (5) Fiduciary Services Agreement between UAL and IFS, and related Bankruptcy Court documents (30 pages)

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<sup>163</sup> By the Board's calculations, if an additional \$266,988 were added to the Pilots Plan assets, no Plan participant would have a funded PC3 benefit that increases by over \$1.00 per month due to the IRC section 415(b)(1)(A) limit.

- (6) Notice of Determination for the Pilots Plan, dated December 29, 2004 (1 page)
- (7) Bankruptcy Court's October 26, 2005 Memorandum of Decision (9 pages)
- (8) Bankruptcy Court's October 26, 2005 Amended Memorandum of Decision on Motion for Summary Judgment (17 pages)
- (9) Bankruptcy Court's October 26, 2005 Order Terminating the United Airlines Pilot Defined Benefit Pension Plan (2 pages)
- (10) Benefit Statement Worksheet for [REDACTED] (4 pages)
- (11) PBGC Policy 8.2-1, *Valuation and Allocation of Recoveries*, 5th Edition, 4th Edition, and 3rd Edition (30 pages)
- (12) PBGC Policy 8.2-1, *Valuation and Allocation of Recoveries*, 6th Edition (11 pages)
- (13) PBGC Policy 1.1-1, *PBGC Benefits Administration Policy Governance and Review*, 2nd Edition (8 pages)
- (14) February 1, 2006 Indenture among UAL Corporation, United Air Lines, Inc., and The Bank of New York Trust Company, N.A., as Trustee (87 pages)
- (15) Andrew Ross Sorkin & Micheline Maynard, *Continental Abandons Merger Talks with United*, N.Y. Times, April 28, 2008 (3 pages)
- (16) U.S. Securities and Exchange Commission Form 10-K filing by UAL for fiscal year ended December 31, 2006 (112 pages)
- (17) PBGC's 1988 Payment of Premiums regulation (32 pages)
- (18) PBGC's 2014 Payment of Premiums regulation (16 pages)
- (19) PBGC Policy 4.5-1, *Treatment of Plan Liability for Premiums*, 1st Edition (3 pages)
- (20) PBGC Transmittal Record 2013-11, *Treatment of Plan Liability for Premiums* (2 pages)