
In the Matter of A Trustee Deadlock Between
**Union Trustees of the California Teachers
Association Employees' Retirement Benefits Trust**
and
**Employer Trustees of the California Teachers
Association Employees' Retirement Benefits Trust**

**Award & Opinion
NB3096**

Before

Norman Brand

Appearances

For the Union Trustees
Leonard Carder LLP
by Peter Saltzman, Esq.

For the Association Trustees
Schwartz, Steinsapir, Dohrmann & Sommers, LLP
by Henry M. Willis, Esq.
Richard M. Swartz, Esq.

April 3, 2009

Issue

The Trustees stipulated the following issue:

Should the Union Trustees' motion to treat the California Teachers Association Employees' Retirement Benefits Plan as remaining in the "green zone" for Plan Year 2009 under the terms of the Worker, Retiree, and Employer Recovery Act of 2008 be granted?

Stipulations

1. The California Teachers Association Employees' Retirement Benefits Trust ("the ERB" or "the Plan") is an express trust fund created by a written trust agreement pursuant to Section 302(c)(5) of the Labor Management Relations Act ("the LMRA"), 29 U.S.C. § 186(c)(5), and is an employee pension benefit plan within the meaning of Section 3(2) of the Employee Retirement Income Security Act of 1974 ("ERISA"), 29 U.S.C. § 1002(2).
2. The ERB is run by a bipartite Board, made up of two blocs of Trustees with equal voting rights: those appointed by the California Teachers Association ("the Association Trustees"), on the one hand, and those appointed by the California Staff Organization ("CSO") and the California Associate Staff ("CAS") ("the Union Trustees"), on the other. The Association Trustees are collectively entitled to one vote and the Union Trustees are collectively entitled to one vote.
3. The Board of Trustees has no power to modify the amount or rate of employer contributions established by any collective bargaining agreement. The Plan was adopted by CTA and the Unions and the specific benefits to be provided by the Plan must be consistent with the provisions of the collective bargaining agreements. Both agreements are for three year terms and expire on August 31, 2009. The parties are currently bargaining for successor agreements.
5. The Pension Protection Act of 2006 ("the PPA") classifies pension plans into three categories that measure the adequacy of the plan's funding of its benefit obligations. They are, starting from the most underfunded, "critical status" or the

"red zone," "endangered status" or the "yellow zone," and "other status" or the "green zone." These provisions of the PPA are codified at Section 432 of the Internal Revenue Code (IRC), which is attached as Exhibit G. The statute requires corrective actions for plans in critical or endangered status but none for those in the "green zone." The Plan was in the "green zone" as of January 1, 2008.

6. On January 1, 2009 the Plan's assets had a market value of approximately \$204,000,000 as against \$328,700,000 in estimated pension benefits. This change in the market value of the Plan's assets represents a 26% drop in value in 2008.

7. The Plan had a credit balance—a figure representing the accumulation of prior years' contributions in excess of the minimum required—of roughly \$12,500,000 as of January 1, 2008. The Plan's credit balance had dropped to roughly \$6,100,000 as of January 1, 2009. Mercer projected that the Fund's credit balance would become negative in 2011, based on its assumptions of (a) 8.3% investment return for 2009 and succeeding years, (b) salary increases of 4.5% for 2009 and succeeding years, (c) contributions at the rate of 21.5% of covered employees' pay and (d) administrative expenses of \$531,800. This negative credit balance would represent a funding deficiency in that year.

8. Together, these changes have caused the Plan to be in the "red zone" in 2009.

9. The PPA requires a plan's actuary to certify the plan's funding status within 90 days of the end of the plan year, or in this case, by March 31 of a given year.¹ If a plan is in the "red zone," the PPA further requires trustees to adopt a "rehabilitation plan" meeting the requirements of IRC Section 432(e) within 240 days after the certification date and to provide the bargaining parties with sample funding schedules consistent with the rehabilitation plan within 30 days thereafter, or in this case, by November 27 and December 27 of a given year, respectively. Finally, the PPA requires that, absent agreement by the parties, the trustees must implement a "default" funding schedule within 180 days of the expiration of the collective bargaining agreement in effect on the certification date.

10. In response to the current financial crisis and the extraordinary losses experienced by pension plans in 2008, Congress enacted the Worker, Retiree, and

¹ After the stipulation was entered, the IRS issued a circular permitting the election to remain green in 2009 to be made by April 30, 2009.

Employer Recovery Act of 2008 ("WRERA"), the pertinent provisions of which are attached as Exhibit K. Sections 204 and 205 of WRERA give plan sponsors the options of (1) electing, for the plan year commencing during the one year period beginning on October 1, 2008, to treat a plan's status the same as it was in the preceding plan year, or (2) electing, for a plan year beginning in 2008 or 2009, to extend the period for the funding rehabilitation plan adopted to correct the plan's funding problems from ten to thirteen years.

11. At the Trustee meeting on February 17, 2009, the Union Trustees proposed that the Board of Trustees make an election under WRERA to remain "green" in Plan Year 2009. The Association Trustees opposed that motion, leading to the present deadlock.

12. If the Arbitrator does not vote in favor of the deadlocked motion and the Plan is certified as "critical" on March 31, 2009, then under the PPA:

- the Plan would be required to send notice of its critical status to plan participants, the bargaining parties, the Pension Benefit Guaranty Corporation and the Department of Labor by April 30, 2009;
- upon 30 days notice by the Plan, CTA would be required to pay a surcharge of five percent on all contributions in 2009, increasing to a 10% surcharge in subsequent years until the effective date of a collective bargaining agreement that includes terms consistent with a rehabilitation plan adopted by the trustees;
- the trustees would be required, by November 27, 2009, to develop a rehabilitation plan and, by December 27, 2009, to provide to the bargaining parties funding schedules, including a "default" schedule, which, if adopted, would reasonably be expected to enable the plan to emerge from critical status within a ten year "rehabilitation period" commencing on January 1, 2010; and
- the bargaining parties—CTA, CAS and CSO—would have through February 27, 2010, or 180 days after the expiration of their collective bargaining agreements on August 31, 2009, to reach agreement on benefits and pension contributions consistent with the rehabilitation plan. Should the bargaining parties fail to reach agreement by that date, the Trustees would be required to implement the default schedule.

13. If the Arbitrator votes in favor of the deadlocked motion, and if the Plan is subsequently certified as "critical" on March 31, 2010, as projected, then under the PPA:

- the Plan would be required to send notice of its critical status to plan participants, the bargaining parties, the Pension Benefit Guaranty Corporation and the Department of Labor by April 30, 2010;
- CTA would not be required to pay a surcharge in 2009, but upon 30 days notice by the Plan it would be required to pay a surcharge of five percent on all contributions in 2010, increasing to a 10% surcharge in subsequent years, until the effective date of a collective bargaining agreement that includes terms consistent with a rehabilitation plan adopted by the trustees;
- the trustees would be required, by November 27, 2010, to develop a rehabilitation plan and, by December 27, 2010, to provide to the bargaining parties funding schedules, including a "default" schedule, which, if adopted, would reasonably be expected to enable the plan to emerge from critical status within a ten year "rehabilitation period" commencing on January 1, 2012 (or, if earlier, on the January 1 following the expiration of the collective bargaining agreement in effect on March 31, 2010.).
- the bargaining parties—CTA, CAS and CSO—would have up to 180 days after the expiration of the collective bargaining agreement in effect on March 31, 2010, to reach agreement on benefits and pension contributions consistent with the rehabilitation plan. Should the bargaining parties fail to reach agreement by that date, the Trustees would be required to implement the default schedule. As an example, if the bargaining parties were to reach agreement on new three-year agreements in 2009, then the deadline for the bargaining parties to agree on a funding schedule consistent with the rehabilitation plan would be extended to February 27, 2013.

The Arguments for Freezing the Plan in Green Status

The Union Trustees assert the following benefits to freezing the Plan in green zone status for 2009:

1. If the bargaining parties adopt a voluntary rehabilitation plan, the red zone rules, restrictions, and expenses associated with going red could be avoided entirely.
 - a. The Plan Actuary recommended “trustees and bargaining parties consider electing green freeze and adopting a “voluntary” funding rehabilitation plan during 2009 bargaining to avoid red zone.” (Ex. H, p. 3)
 - b. A prudent fiduciary must consider that the bargaining parties have never failed to reach agreement. There is a high probability that they will adopt a voluntary funding rehabilitation plan, and they may consider reductions in early retirement benefits.
 - c. If the bargaining parties fail to agree on a voluntary rehabilitation plan the Trustees can move to revoke the election, with the approval of IRS, which undoubtedly would be given.
2. Not freezing the Plan in the green zone and going into the red zone in 2009 would breach the trustees fiduciary duties because:
 - a. It will require preparation and filing of a multitude of funding reports, creating the rehabilitation plan, and special government filings which will cost considerable trust resources for actuarial and legal work.
 - b. It will be perceived as giving the employer an unfair advantage at the bargaining table by putting imposed benefit cuts on the table. Once the costs of red zone filings have been incurred there will be less of an incentive to bargain a voluntary plan and a greater

likelihood the “default plan” will have to be imposed.

- c. It will cause more early retirements than would otherwise have occurred because it puts future early retirement benefits in jeopardy. This increase in early retirements will cause further actuarial losses to the Plan.
- d. It is inappropriate to commit the Plan to the inflexible red zone rules when economic conditions are in turmoil.

The Association Trustees assert the following reasons for not freezing the Plan in green status for 2009:

1. Without a voluntary funding plan in place it would be imprudent.
 - a. It allows the bargaining parties the opportunity to postpone addressing the Plan’s funding problems.
 - b. Delay in addressing the funding problems necessarily entails higher costs. There is a time value of money. The Plan must make deeper benefit cuts to achieve the same savings if those cuts are delayed.
 - c. Freezing green allows more people to opt for early retirement both because they have a longer time to make plans and because new people age into eligibility.
 - d. Freezing green reduces the options for the bargaining parties. They cannot reduce “adjustable benefits,” such as the subsidized early retirement, unless the Plan is in the red zone.
2. Remaining in the red zone allows the Plan more options for rehabilitation at an earlier date.
 - a. It forces the bargaining parties to address the Plan’s financial difficulties more quickly.

- b. It provides more tools to address the Plan's financial difficulties. It requires surcharges; it gives the Plan and bargaining parties the ability to reduce adjustable benefits; it motivates bargaining through the legal requirement to impose a "default" rehabilitation plan.

Discussion

ERISA sets the standard by which I must decide whether to vote for or against the Union Trustees' motion. Under ERISA §404(a)(1) I must discharge my duties "solely in the interests of the participants and beneficiaries." Under ERISA §404(a)(2) I must act:

with the care, skill, prudence, and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims.

It is in the interest of the participants to preserve the Plan's ability to provide their vested benefits. The financial circumstances in which the Plan finds itself are dire. It lost 26% of its assets in 2008 and is currently operating in the same economic turmoil that affects the entire world. It would take a wildly improbable 64% return on assets in 2009 to overcome the Plan's current funding deficiencies. The Plan has no power to increase Employer contributions to overcome its funding deficiencies.² Absent the power of federal law, which gives Plans in the red zone

² Article V, Section A of the Trust Agreement says the "Trustees shall have no power to modify the amount or rate of Employer Contributions established by any applicable collective bargaining agreement."

a form of “emergency power,” the Plan must rely entirely on the bargaining parties to negotiate a rehabilitation plan that will return it to adequate funding.

By electing to freeze its green status, the Plan loses its statutory “emergency power” to impose a rehabilitation plan, if the parties do not negotiate one, for two years. It loses its ability to impose a surcharge for at least a year.³ These losses have a significant cost to the Plan because of the time value of money. They may also have a significant cost to participants because the benefit cuts required in a rehabilitation plan get deeper as their implementation date is delayed. The Union Trustees’ argue there is a high probability the bargaining parties will adopt a voluntary rehabilitation plan that will prevent the Plan from going into the red zone in 2010.⁴ Having the bargaining parties agree on a rehabilitation plan and avoiding the expense and dislocation of going into the red zone is certainly desirable.

The question for a Trustee, however, is whether it is prudent to risk a significant increase in cost and the loss of surcharges when there is an unquantified probability that the need for Trustee action can be avoided entirely. Since a Trustee must act solely in the interests of the participants and beneficiaries, there must be some specific benefit to the participants and beneficiaries to justify taking the risk that the bargaining parties will adopt a rehabilitation plan that avoids red status in 2010. The Union Trustees argue the cost of red status justifies the risk, but they do not quantify those costs. Nor do

³ The Union Trustees note that the Plan could ask for permission to revoke its election from IRS, and that it would likely get permission. It is not clear how that would affect the timing of the surcharge and the mandatory rehabilitation plan.

⁴ While they argue freezing green will prevent many early retirements, that is speculative. On the other hand, freezing green will permit more people to take early retirement because they will age into it. The Plan Actuary was unable to quantify the effect of these possibilities in his testimony.

they quantify the probability of success, so that a risk adjusted value can be assigned to freezing green.⁵ The costs of delay and the lost surcharge have been quantified by the Plan Actuary and are substantial. Thus, an unquantified probability and an unknown cost saving must be weighed against significant known delay costs. It is not prudent to accept a risk without being able to quantify the value of success when the certain cost of delay is known. Thus, I deem it both prudent and in the interest of the participants and beneficiaries to vote against the motion.

There is no doubt that the decision to freeze green or go red affects the collective bargaining process. But that is not a proper consideration for a Trustee. All that a Trustee can do is avoid making a decision until the outcome of bargaining is known, or the decision cannot be delayed further without losing the right to decide. I offered to wait until the last moment to issue my decision, in the hope it would motivate the bargaining parties to agree to a rehabilitation plan before knowing if either side was advantaged. Since the Trustees declined the offer, it would not be proper for me to delay my decision or make it conditional on the parties not reaching agreement on a rehabilitation plan before the decision to freeze green status must be made.

⁵ It is impossible to quantify the risk and the avoided costs precisely, but more than speculation is necessary to make a prudent decision. Moreover, given the magnitude of the delay and foregone surcharge costs, it is implausible that the increased administrative costs of going red would provide a counterbalance to the delay costs.

Award

I break the deadlock by voting against the motion. The Union Trustees' motion to treat the California Teachers Association Employees' Retirement Benefits Plan as remaining in the "green zone" for Plan Year 2009 under the terms of the Worker, Retiree, and Employer Recovery Act of 2008 is not granted.

San Francisco, CA

A handwritten signature in black ink that reads "Norman Brand". The signature is written in a cursive style with a large initial "N" and a long, sweeping underline.

April 3, 2009

Norman Brand