TESTIMONY OF GERALD GRINSTEIN

Chief Executive Officer

DELTA AIR LINES

BEFORE A HEARING OF THE

UNITED STATES SENATE COMMITTEE ON FINANCE

On

Preventing the Next Pension Collapse: Lessons from the United Airlines Case

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Mr. Chairman and Members of the Committee, thank you for the opportunity to appear today. My name is Jerry Grinstein. I have served on Delta Air Lines' Board of Directors since 1987 and have been Chief Executive Officer since 2004.

On behalf of the 80,000 active and retired employees of Delta Air Lines and their families, we appreciate the spotlight that you Mr. Chairman, Senator Baucus, and the other members of the Finance Committee are putting on the crisis facing the airline industry and its pension plans. The current pension funding rules are not workable in the current airline environment and they need to be fixed. Those rules require funding contributions on a schedule that can be volatile and unmanageable, with the most significant contributions often occurring at precisely the time a company can least afford it. For an airline like ours that is transforming itself -- thanks in large part to the sacrifice and hard work of Delta people -- to survive in the rapidly evolving world of commercial air transportation, the pension funding quagmire creates a potentially insurmountable barrier to our ability to restructure successfully outside of court supervision. That in turn adds instability to the major hub-and-spoke carriers who provide a vital link in our nation's transportation system, especially for small communities.

The continued leadership of this Committee will be crucial in crafting a set of rules that allow Delta and other traditional national network carriers to pay their employees the retirement benefits they have earned over many years of work while at the same time providing the Pension Benefit Guaranty Corporation (PBGC) a greater margin of protection from unexpected liabilities. Such liabilities have arisen recently as competitive pressures reshaping our industry have caused some airlines to enter bankruptcy, then to transfer their very large pension obligations to the PBGC as part of their effort to exit the process. As this committee works toward comprehensive improvements in our nation's retirement system, we urge you to craft a narrow, targeted solution to the unique pension situation facing many of our nation's airlines as they work hard to transform themselves outside of bankruptcy.

Delta stands ready to meet the challenges of a permanently and fundamentally changed aviation marketplace. We have a business strategy that sets us firmly on course for long-term viability and we have accomplished much over the last few years. However, one of the two biggest factors that will determine whether we can successfully complete our transformation outside of bankruptcy is the pension cloud now hanging over our company and many other traditional legacy carriers.

In 2004, with the help of this Committee, Congress provided airlines with temporary relief from the current law "deficit reduction contribution" requirements. These difficult requirements threatened to exhaust our airline's liquidity reserves by forcing large, immediate contributions to our pension plans when we could least afford it. Congress recognized that bankruptcies would have a greater adverse impact on employees and could result in the transfer of unfunded pension benefit obligations to the PBGC. Because everyone understood that a comprehensive solution was needed, the 2004 funding relief for airlines was intended to be only a temporary, stopgap measure.

The Isakson-Rockefeller bill (S. 861) provides a framework that balances the need for reasonable and affordable pension funding requirements for airlines, while still protecting the PBGC. Under this legislation, airlines that limit their pension liabilities by freezing pension benefits (or agreeing to immediately fund any future benefit accruals) and freezing growth in the PBGC guarantee, would still be required to fund their unfunded pension liabilities. However, they would be allowed to do so on an affordable schedule over the next 25 years using stable, long-term assumptions. The legislation would give airlines a greater chance to transition to a less volatile pension plan structure in a way that fully honors the benefits earned by airline workers over many years.

The Isakson-Rockefeller bill provides airlines the time to complete the transformation required to survive in today's economy in a responsible fashion that protects employees, the government, and our national economy. Let me emphasize at the outset that the Isakson-Rockefeller bill does not involve any kind of a Federal bailout for Delta or any of the other airlines. Delta is not seeking to avoid its obligations to our employees; what we seek is a solution that helps us to honor them. In contrast, two carriers now in bankruptcy -- United and US Airways -- have received court recognition of the immense competitive pressure to eliminate pension obligations in order to attract financing. The termination of those pension plans – which involves shifting of massive liabilities to the PBGC – might be characterized as a bailout but the Isakson-Rockefeller bill will simply allow airlines to fund their pension plans themselves.

DELTA'S LONG ROAD TO RECOVERY

The nation's airlines have been hit by a series of crises, starting with September 11 and its aftermath to the latest plague on our industry – record high fuel costs. Since the year 2000, the nation's airlines have lost close to $33 billion – Delta alone has lost $8.5 Billion and now has over $20 Billion in long term debt. Several carriers, including two that represent over 20 percent of the U.S. airline market, are operating in bankruptcy. With newer low-cost carriers now claiming 30 percent of the domestic travel market, it is clear that the traditional legacy carriers must bring their operating costs into line with these competitors -- competitors that do not provide defined benefit pension plans. The traditional national network airlines understand that we have no choice but to reduce costs or cease to exist.

Delta began making tough but necessary changes in 2002, and by the end of 2004, we had achieved $2.3 billion in annual revenue and cost benefits. However, appreciating that we were not in a cyclical downturn, but rather in a permanently and fundamentally changed aviation marketplace – due, in part, to changed customer preferences, low-cost carriers, and online fare shopping – we launched a new strategic plan in September 2004 that focuses on winning back customer trust and achieving viability. We are on our way to doing both Our goals are to improve the customers' travel experience and also build on the $2.3 billion already achieved to reach a total of $5 billion in annual revenue and cost improvements by 2006, as compared to

2002. In the face of harsh financial realities and increasingly fierce competition, the people of Delta Air Lines are proving their mettle as we transform our company into the right airline for a new era. While a long, tough road still lies ahead, we already have made remarkable progress. We have now targeted all components of that $5 billion goal. A crucial element of the savings has been the shared sacrifice of all of Delta's employees, including, regrettably, the loss of jobs. Today, Delta's workforce is about 56,000 – a decrease of 23,000 employees since September 11, 2001. The job reductions have been spread across the entire company, with our executive ranks trimmed by 25 percent during that period. Delta now has the lowest ratio of total Officer and Director level positions to total employees among the six largest airlines.

In 2001 Delta was a leader in compensation in our industry. Since that time our people have taken the painful steps necessary to adjust our pay and benefits going forward to levels more realistic for the changed environment in which we operate. Last fall, Delta pilots approved a contract providing a crucial $1 billion in annual savings including a one third pay cut for five years with no snap back provisions. Delta's other employees also have experienced their fair share of pay cuts – with a company wide pay cut of 10 percent in January – following 5 years with no general increase to our pay plans. As of April 1, 2005, Delta's frontline employee groups rank in the bottom tier of the largest airlines in top of scale pay rates. In 2004, Delta's top 5 executives ranked third to last in total cash compensation among major carriers, including Southwest, AirTran and Jet Blue.

Part of our plan has also been to trim benefits across the board. We have achieved substantial savings in our health care benefits – totaling more than $300 million over the 2003-2005 period. Premiums for family coverage for Delta employees increased from zero in 2002 to approximately $2400 per year in 2005.

We have also reduced future pension benefit accruals for both pilots and non pilots in order to proactively rein in our future expenses for retirement benefits. In 2003, Delta converted its traditional defined benefit final average earnings plan for non-pilots to a cash balance plan, which resulted in significant pension cost reduction. Unlike many companies who have undertaken such a transition, however, we did not ignore the interests of our employees in this conversion. To address the concerns of long term employees who are close to retirement, Delta is providing a seven year transition period during which employees will earn the better of the two benefits. It is important to both Delta and its employees that the Isakson-Rockefeller bill preserves Delta's ability to maintain this transition period.

As part of the pilot negotiations concluded last year, Delta's pilots agreed to freeze service accrual under their defined benefit plan and implement a significantly less costly defined contribution plan. This freeze will also result in significant annual savings for Delta. Because of the significant pay reductions agreed to by the pilots, there is minimal benefit accrual expected in this plan for several years. Once again however, it is important to both Delta and its pilots that S. 861 preserves this "soft freeze" approach agreed to in good faith by both parties.

In addition to these steps, we have reduced other benefits such as paid vacation and sick leaves with the net effect that Delta employees are working longer and harder for much less – all in an effort to regain a competitive position in a marketplace that has fundamentally changed.

We have also attained significant savings and debt restructuring assistance from vendors, suppliers, aircraft lessors, debt holders and others.

These actions have already made our airline fully one-third more productive and cost-effective, without diminishing Delta's ability to generate revenue. At the same time, Delta has achieved high levels of customer satisfaction despite the sometimes massive changes occurring throughout our operations. Delta was ranked among the top three airlines by J.D. Power and Associates 2005 Airline Satisfaction study and second in customer satisfaction in a recent Department of Transportation report.

Delta has made great progress in improving our cost structure -- and those accomplishments have been possible only with the support of Delta people at every level, throughout the company. Despite this extraordinary effort, however, our company's most recent financial results show continued high losses. A key cause of those disappointing results is skyrocketing fuel prices – which have jumped by as much as 30 percent since the first of the year. Fuel is Delta's second highest expense after salary and benefits. With every one cent increase in average jet fuel cost per gallon adding $25 million to Delta's annual costs, higher fares can offset only a fraction of the impact of the increased fuel costs. If you factor out the high fuel costs, a dramatically different financial picture emerges at Delta. Excluding fuel and special items, Delta has succeeded in reducing unit costs for mainline operations by almost 13 percent during the last quarter when compared to the previous year.

The low-cost carriers' basic advantage is just that – low costs. While the going is rough and often painful, Delta and other legacy carriers are tenaciously pursuing their own cost reductions and we show no signs of stopping. We can and will continue to work to control our costs – and as I have said – the employees of Delta have stepped up to make cost control a reality. When we finally reach our desired cost structures, we will be a formidable competitor, but we can only achieve that end if the problems and uncertainty surrounding our pension plans are resolved.

THE PENSION CLOUD

Without changes in the pension funding rules, all of our efforts to transform ourselves out of court could be to no avail. There is no question that the single biggest uncertainty that may well determine whether or not Delta can successfully restructure outside of bankruptcy court is the pension cloud that hangs over the company.

At Delta, we maintain two primary defined benefit pension plans – the Pilots Retirement Plan and the Delta Retirement Plan for our non-pilot employees and these plans have historically been well funded. We measure the ERISA funded status of these plans as of July 1 of each year. As recently as July 1, 2001, both these plans had a funded status ratio of 100% or better for ERISA current liability purposes. Largely as a result of a short period of negative and below expected investment returns and a steady fall in the interest rate used for measuring liabilities, however, the funded status of our defined benefit plans has taken a turn for the worse. The result is that the funded status for both plans declined to about 75% for current liability purposes at July 1, 2004, the most recent ERISA funding measurement date. Thus, Delta's qualified defined benefit pensions, which had no current liability under-funding as of July 1, 2001, are under-funded by approximately $2.6 billion dollars on a current liability basis as of July 1, 2004. This increase in liability did not result from failing to make contributions to the plans. We have not sought a funding waiver and have always made required contributions. For 2005, the estimated funding for those plans is about $275 million, most of which has already been paid. Without changes in the funding rules, we project that we will be required to contribute a total of $2.6 billion to our qualified defined benefit pension plans from 2006 to 2008. Simply put, we cannot afford a cash crunch of this magnitude, certainly not in the current economic environment confronting airlines, and no amount of sacrifice of future compensation can solve this problem since the vast majority of this funding relates to service already accrued in the past.

Now, some have asked why we didn't put more money in the pension trusts in the late 1990s when we were making money. That is a good question, and the simple answer is that the pension funding rules discouraged additional funding of plans that were determined to be fully funded. As the members of this committee know, pension funding rules are designed both to keep plans funded, by requiring a minimum annual funding, and also to keep companies from avoiding income tax by putting excess cash into plans on a tax-favored basis. The determination of minimum and maximum tax deductible funding is completed once per year and for the late '90s, the minimum required contribution as well as the maximum deductible contribution for Delta's plans were both zero.

Although the Bush Administration has proposed various reforms to the pension funding rules, including lower required contributions for some plans, these proposals will not be sufficient to solve the unique and immediate problems for the airlines. Indeed, some of these proposals could push airlines into bankruptcy and accelerate the transfer of unfunded pension liabilities to the PBGC.

As recent events amply demonstrate, transferring such liabilities to the PBGC has a number of onerous results.

- Employees and retirees can lose benefits they have already earned because PBGC's insurance program covers only basic pension benefits and is subject to annual dollar caps.

- In a bankruptcy scenario, airline employees (and employees of companies dependent on airlines) are likely to suffer further reductions in pay, benefits and jobs and airline creditors and investors will inevitably lose money.

- Each new airline bankruptcy exacerbates the risk of a downward spiral where airlines race to shed their pension obligations because courts have approved their competitors doing so.

- A further string of bankruptcies among the national network carriers – and the resulting disruption and chaos that would ensue – will hurt the economy, and weaken our vital air transportation network, including especially service to smaller cities which are generally not served by low-cost carriers.

- Finally, transferring further liabilities to PBGC will, at a minimum lead to higher PBGC premiums on those employers that voluntarily maintain plans (potentially undermining the entire defined benefit system) and could ultimately lead to a taxpayer bailout of the agency.

Absent an appropriate legislative resolution, economic reality and competitive pressures are likely to force other major airlines with defined benefit pensions to follow the bankruptcy path that United and US Airways have recently followed. We at Delta don't want that result and are working very hard to avoid it. It is not what is best for our company, for our employees, for our customers, for our shareholders or for our country.

THE ISAKSON-ROCKEFELLER SOLUTION (S. 861)

We are at a crossroads. We cannot control the world we live in, but we must adapt to it. There are two paths Delta and other traditional carriers can follow. The first path some would paint as the easy road for corporate executives to take – file bankruptcy, dump pension liabilities on the PBGC and emerge a nimbler competitor on the other side. That view ignores the many painful realities that bankruptcy entails, but the fact is that bankruptcy courts have recognized that additional financing to successfully exit the process is nearly impossible when legacy pension funding costs have not been dealt with. Their actions in the United and US Airways cases have further altered the competitive landscape in a profound way, helping those carriers rid themselves of billions in liabilities, which makes them poised to be much more effective competitors.

The second path is to evolve and adapt to the new world airlines must survive in. Delta is committed to making the tough choices that will make it possible for our company to survive. The path we want to follow involves honoring the commitments we have made to our employees and retirees over the 75 years that Delta has been in existence. Our ability to follow this path is directly linked to Congressional action to give us pension funding rules that will enable us to resolve this crisis responsibly.

S. 861, the Isakson-Rockefeller bill (and its House companion – H.R. 2106), provide the type of change in pension law that is needed to allow airlines to take the right path. The theory of the bill is quite simple. When an airline commits to freeze a plan or immediately pay for any newly accrued benefits and institutes protection for the PBGC, the government will not require very large contributions that may have the counterproductive effect of driving the airline into bankruptcy. Under this legislation, airlines that freeze pension accruals would still be required to fund the existing unfunded pension liabilities, but would be allowed to do so under a more affordable schedule over the next 25 years using stable, long-term assumptions. Under the bill, the airlines would continue to make sizeable contributions each year to reduce their otherwise frozen unfunded liability, thus reducing the potential future liability for the PBGC. The goal is to establish a payment schedule for the unfunded liability that is both more affordable and practical -- properly balancing the interests of four stakeholders – employees, the federal government, the companies and the traveling public.

A number of strict requirements -- beyond the required freeze -- would be imposed on airlines that choose this approach – all designed to protect the PBGC. For example, any benefit increases above the frozen level would have to be funded immediately and no successor defined benefit plan would be permitted. In addition, the PBGC's guaranteed level of benefits would be limited to the amount the PBGC would have guaranteed had the plan terminated instead of freezing. In other words, the PBGC monthly benefit guarantee would not increase beyond the level in effect when the plan froze.

The approach taken in S. 861 (and H.R. 2106 a House companion bill) has a number of advantages for employees, the federal government and the parties that finance the PBGC, and it decreases the likelihood of PBGC insolvency.

- **For Employees and Retirees.** Employees benefit because they will receive the full benefits they have accrued prior to the freeze rather than often seeing their benefits reduced if liabilities were transferred to the PBGC. Moreover, finding a solution to the airlines' current pension crisis means that airlines are more likely to return to economic health (by restructuring outside of bankruptcy), preserve jobs and fund their own pension commitments rather than relying upon the PBGC to do so.

- **For the Financial Backers of the PBGC.** The PBGC and those companies paying PBGC premiums benefit because the approach in S. 861 provides airlines with a way to maintain their pension programs and continue to fund their pension benefits and pay PBGC premiums without having to resort to shifting liabilities to the PBGC. Just as important, addressing the airline pension problem significantly decreases the likelihood of the need for a taxpayer bailout of the PBGC. Even if an airline electing to use the provisions of S. 861 should later falter, the PBGC (and the taxpayers) should be better off because PBGC's benefit guarantees are fixed at the time of the pension freeze, airlines will have made intervening contributions to close their pension funding gaps, and any subsequent benefit accruals will have been immediately 100 percent funded.

- **For the Traveling Public and the Economy.** The traveling public which relies on our nation's air transportation system for business and personal travel and as the engine of our economy would benefit from a stable, healthy, competitive airline industry which includes the network carriers who provide the vital link to and from small cities as well as an important source of jobs.

- **For Delta and Other Major Network Airlines.** Once the pension funding schedule is based on a more manageable, affordable schedule, the nation's carriers would be able to honor employees' already hard-earned pension benefits and at the same time continue to pursue, outside of court supervision, the transformation plans now underway that are essential for survival in the new aviation marketplace.

Let me emphasize once again that the path we propose does not involve Federal subsidies for Delta. To the contrary, we believe it is the other path – the one that others have been forced to follow – that involves a form of subsidy by relying on the PBGC to fulfill benefit promises that the bankrupt company cannot. We think the path we want to take is a better path -- better for the PBGC, better for our employees, better for our customers, better for the overall air transportation system and better for the economy as a whole.

ACTION IS NEEDED NOW

The help of this Committee is required to follow that better path. Existing pension rules require airlines to make huge contributions at a time when we can least afford it. In order to have a much greater chance to transform ourselves outside of bankruptcy, the existing rules must be changed. As they are today and as they would be under the Administration's proposals, pension funding rules only push us closer to following in the footsteps of United and US Airways – and we have seen where the realities of the marketplace lead when that happens.

To some extent, the legacy airlines are responsible for the situation we now face – not having adequately anticipated the impact of low-cost carriers or the internet fare shopping. However, the problems faced by the airline industry are clearly not entirely of our own making. No one could have anticipated the attacks of September 11, 2001 or its aftermath. We could not have anticipated fuel costs rising to unprecedented levels. We could not have anticipated a string of our major competitors marching into bankruptcy court and shedding billions of dollars of pension obligations and potentially emerging from bankruptcy free of those liabilities to compete with us.

Our industry has fundamentally and structurally changed and we need the help of this committee to walk the path that makes sense – for all our stakeholders. Excess capacity, fuel prices, the economy, bankruptcy developments, possible sales of assets or other actions, plus a hundred more possibilities, all could create long chains of actions and reactions within the airline industry. But if we can know that our future pension funding obligations will be reasonable and affordable, then we will have the opportunity to compete with discount carriers (and with United and US Airways) on a more level playing field, while also having the chance to provide the pension benefits our employees and retirees have earned over their careers.

CONCLUSION

The perilous issues facing our industry, including those I've just reviewed, matter not only to airlines and airline employees, but also to the public who depends upon them. The U.S. air transportation system provides a vital service for businesses and other organizations as well as families and friends across our nation.

It is clear that airlines must transform in order to survive in today's economy. Delta has embraced that change. With prompt adoption of S. 861, this can be done in a responsible fashion that protects employees, the government and our national economy. The alternative may be an industry in continued distress and a wholesale shift of airline pension liabilities to the PBGC.

Mr. Chairman and members of the Committee, we thank you for the opportunity to present our views. We look forward to working with the Committee on a resolution of the pension funding challenges facing our nation's airlines.