

FRANK J. McGARR, Esq.
Arbitration and Mediation

November 17, 2008

The Honorable James B. Moran
United States District Judge
United States District Court
Northern District of Illinois
Eastern Division
219 South Dearborn Street
Chicago, Illinois 60604

Via UPS Next Day

Re: Quarterly Report of Independent Special Counsel, Chao v. Estate of Frank E. Fitzsimmons, et al., No. 78 C 342 (N.D. Ill., E.D.); Chao v. Robbins, et al., No. 78 C 4075 (N.D. Ill., E.D.); and Chao v. Dorfman, et al., No. 82 C 7951 (N.D. Ill., E.D.)

Dear Judge Moran:

This is to report on my activities during the third quarter of 2008 as Independent Special Counsel appointed pursuant to the Fitzsimmons (Pension Fund) and Robbins and Dorfman (Health and Welfare Fund) consent decrees.

I have attended full Board of Trustees meetings, now held every other month (with additional meetings as noted in my reports), and consulted regularly with Fund executives.

Audit

At the July 15, 2008 Meeting of the Board of Trustees, the Funds' Internal Audit Department presented a report concerning its audit of 2007 payroll processing and of 2007 Health and Welfare Fund claims processing. The overall conclusion of the audit was that adequate administrative and internal accounting controls surrounding these activities were operating during the testing period. Internal Audit also concluded that the controls provide a basis for reliance that payroll and Health and Welfare claims are processed in accordance with Fund policies and procedures.

The 2007 Forms 5500 for both Funds were reviewed by the Board of Trustees' audit committee at their September 10, 2008 Meeting,

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having previously been distributed in draft form to all Trustees, and filed by the October 15th filing date.

Pension Fund

Funding and PPA-Related Issues

As previously reported, in July 2005 the Internal Revenue Service approved the Fund's request for a 10-year extension for amortizing unfunded liabilities. This extension is believed likely to defer for the near term a statutory funding deficiency. The IRS granted the request subject to certain conditions. In general terms, these IRS conditions require the Pension Fund to maintain its existing ratio of assets to liabilities through 2011, and in subsequent years to show moderate annual improvements in that funding ratio.

To meet these IRS imposed conditions, the Board of Trustees determined based on actuarial and legal advice that the Pension Fund needs increased employer contributions. At their November 8, 2005 meeting, the Board accordingly amended the Pension Plan to require such increased contributions (at a rate the Board sets) in collective bargaining agreement renewals as a condition of continued participation, and approved specific rates reflecting 7% annual increases for contracts renewing by December 31, 2006. The Fund so notified all locals and employers participating in the Fund by special bulletin dated November 28, 2005 and held extensive meetings explaining the changes to local unions and employers.

At their November 8, 2006 meeting, again as recommended by the Pension Fund's actuaries to enable the Fund to comply with the funding ratio conditions imposed by the IRS, the Board of Trustees approved 8% per year as the required contribution rate increase for all collective bargaining agreements expiring in 2007. Local unions and participating employers were notified of this rate increase in December 2006.

The Pension Fund's Board of Trustees also asked the negotiators of the United Parcel Service, National Master Freight Agreement and Carhaul agreements to allocate to the Pension Fund fringe benefit contribution increases scheduled for 2006. The negotiators agreed to that allocation. Allocations of increased fringe benefit contributions to the Pension Fund were also made in 2007.

Throughout much of 2007 and at their Meetings held in the first quarter of this year, the Trustees received advice from the Fund's staff, legal counsel and actuaries with respect to the requirements of the Pension Protection Act of 2006 ("PPA"). As the Court is aware, beginning this year, the PPA establishes categories for multiemployer pension plans that correspond to each plan's funded status. The categories are: critical status ("red zone"), endangered status ("yellow zone"), or fully-funded status ("green zone"). Under the PPA, the plan's actuary must certify the plan's status. Although in recent years the Pension Fund's assets have grown and its funded ratios have improved to a certain extent, the actuary determined that if the Pension Fund's amortization extension granted by the IRS were to be disregarded, the Pension Fund would face a statutory funding deficiency. Largely based upon this consideration, and upon the advice of Fund counsel concerning the legal impact under the PPA of an amortization extension granted prior to the January 1, 2008 effective date of that statute, on March 24, 2008, the Fund's actuary certified the Pension Fund to be in critical status.

Under the PPA, trustees of a plan in critical status must develop a "rehabilitation plan" designed to improve the funded status of the plan in accordance with PPA guidelines. Following the PPA-related briefings presented by staff, actuaries and legal counsel during 2007 and the first quarter of 2008, at the March 25, 2008 Meeting, the Board of Trustees approved a rehabilitation plan ("Rehabilitation Plan") as required by the PPA. The plan approved by the Trustees attempts to build upon and incorporate the funding improvement program instituted prior to the January 1, 2008 effective date of the PPA, and designed to ensure compliance with the conditions imposed by the pre-PPA amortization extension. In broad outline, the Rehabilitation Plan approved by the Trustees contains a "Primary Schedule," which will require each contributing employer to agree to five years of 8% annual contribution increases (7% if the increases began in 2006) in order to maintain current benefit levels for the affected bargaining unit. The PPA also requires that a rehabilitation plan contain a "Default Schedule," which must provide for the reduction in what the PPA terms "adjustable benefits." ("Adjustable benefits" under the PPA generally include all benefits other than a contribution based retirement benefit payable at age 65.) Accordingly, the Pension Fund's Rehabilitation Plan includes a Default Schedule providing for 4% annual contribution rate increases and for the loss or reduction of adjustable benefits for bargaining units electing that Schedule. The PPA also provides that if the bargaining parties

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have not chosen any of the schedules established by a rehabilitation plan (*i.e.*, the Primary or Default Schedule) within 180 days following the expiration of the parties' last labor agreement, the Default Schedule will be imposed as a matter of law.

The PPA requires that the Pension Fund notify the plan participants, bargaining parties and the Department of Labor that it has been certified to be in critical status. The Pension Fund's staff has reported that the required critical status notices were mailed on or before April 8, 2008. The PPA also requires that the unions and employers who are parties to labor agreements requiring contributions to the Pension Fund be provided with the Schedules (Primary and Default) of contributions and benefits approved by the Trustees as part of the Fund's Rehabilitation Plan. Staff has reported that the Pension Fund provided these Schedules to the bargaining parties on or before April 1, 2008.

Staff has reported to the Board of Trustees that a high percentage of the contributing employers whose labor agreements expired in 2006 and 2007 agreed to provide follow-on agreements in compliance with the Fund's pre-PPA funding improvement program (requiring 7% annual increases for employers with agreements expiring in 2006 and 8% increases for employers with contracts expiring in 2007); these agreements are also in compliance with the Primary Schedule under the Fund's PPA Rehabilitation Plan. Staff has also reported that by March of this year the National Master Freight Agreement ("NMFA") employers, who account for approximately 48% of the Pension Fund's contribution revenue, have agreed under the new (2008-2013) NMFA that became effective this year to pension contribution rate increases conforming to the requirements of the Fund's Primary Schedule under its Rehabilitation Plan. More recently the Pension Fund's Staff has reported that the new (2008-2013) National Master Automobile Transporters' Agreement (NATA) has been entered and is in compliance with the Primary Schedule; employers contributing under NATA account for approximately 6.5% of the Fund's contribution revenue.

As a result, Staff has informed the Trustees that most contributing employers have agreed to the 7%-8% contribution increases required under the Fund's Rehabilitation Plan Primary Schedule. To date only one employer (with three active Pension Fund participants) has affirmatively elected to agree to the Rehabilitation Plan's Default Schedule (4% contribution increases with the loss of adjustable benefits).

As reflected in a report presented by Staff at the Trustees' September 10, 2008 Meeting, this leaves a residual group of approximately 550 bargaining units whose employers have so far failed to submit agreements that comply with either the Primary or the Default Schedules under the Fund's Rehabilitation Plan. These "non-complying" employers account for approximately 17,000 of the Pension Fund's active participants (out of a total of 94,000 actives). Under the PPA, employers who do not agree to the contribution increases required by one of the Fund's Rehabilitation Plan Schedules are subject to a 5% "surcharge" on their existing (agreed) contributions obligations; these statutory surcharges, unlike contributions, are not benefit bearing. Staff has reported to the Trustees that the "non-complying" employers have been billed for the surcharges, and that the vast majority of them are paying the surcharges as billed. The rest will be pursued for collection, including litigation if necessary.

At the July 15 and September 10, 2008 Board of Trustees Meetings, Staff also presented reports concerning certain employers and bargaining units who may have triggered "Rehabilitation Plan Withdrawals" from the Pension Fund. Under the Pension Fund's Rehabilitation Plan adopted pursuant to the PPA, a Rehabilitation Plan Withdrawal ("RPW") generally occurs where an employer ceases to have an obligation to contribute to the Fund at one or more of its locations or facilities, but continues to do the same type of work for which contributions were previously required. The consequence for a bargaining unit incurring an RPW is the loss of PPA adjustable benefits (*i.e.*, the loss of all benefits other than a contribution-based benefit payable at age 65).

Financial Information - Investment Returns

The Pension Fund's investment return for the third quarter 2008 was (9.08)%.

The Fund's financial group prepared for the Trustees a comparison of the Pension Fund's performance to the TUCS¹ universe results published for the second quarter of 2008. This comparison

¹"TUCS" is the Trust Universe Comparison Service. Its Custom Large Funds Universe is composed of plans with assets exceeding \$3 billion.

(showing percent returns on investment) is summarized in the following tables:

Pension Fund's Composite Return

	<u>2nd Quarter Ended</u> <u>June 30, 2008</u>	<u>One Year Period Ending</u> <u>June 30, 2008</u>	<u>Three Year Period Ending</u> <u>June 30, 2008</u>
TUCS 1 st Quartile	(0.37)	(2.12)	9.01
TUCS Median	(0.78)	(4.27)	7.86
TUCS 3 rd Quartile	(1.00)	(5.39)	6.65
Fund's Composite Return	(1.57)	(8.36)	6.43

Pension Fund's Total Equity Return

	<u>2nd Quarter Ended</u> <u>June 30, 2008</u>	<u>One Year Period Ending</u> <u>June 30, 2008</u>	<u>Three Year Period Ending</u> <u>June 30, 2008</u>
TUCS 1 st Quartile	(0.76)	(9.33)	9.07
TUCS Median	(1.14)	(11.19)	7.72
TUCS 3 rd Quartile	(1.79)	(13.23)	6.76
Fund's Total Equity Return	(1.95)	(14.84)	7.21

Pension Fund's Fixed Income Return

	<u>2nd Quarter Ended</u> <u>June 30, 2008</u>	<u>One Year Period Ending</u> <u>June 30, 2008</u>	<u>Three Year Period Ending</u> <u>June 30, 2008</u>
TUCS 1 st Quartile	(0.70)	8.11	4.55
TUCS Median	(0.97)	6.69	4.21
TUCS 3 rd Quartile	(1.44)	5.29	3.82

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Fund's			
Fixed			
Income			
Return	(0.88)	7.18	4.44

The Fund's named fiduciaries (Goldman Sachs Asset Management and Northern Trust Global Advisors, Inc.) submit monthly investment reports to the Trustees, summarized below (showing percent returns on investment:

Goldman Sachs Asset Management

	<u>Year-to-Date as of</u> <u>Sept. 30, 2008</u>	<u>Third Quarter</u> <u>2008</u>	<u>July</u> <u>2008</u>	<u>Aug.</u> <u>2008</u>	<u>Sept.</u> <u>2008</u>
Goldman Sach's Composite Return	(20.48)	(12.85)	(1.83)	(0.55)	(10.73)
Benchmark Composite Return	(18.11)	(10.11)	(0.84)	0.08	(9.43)
Goldman Sach's Total Fixed Income Return	(2.58)	(3.34)	(0.30)	0.60	(3.63)
Benchmark Fixed Income Return	(2.36)	(2.87)	(0.42)	0.76	(3.19)

Goldman Sach's third quarter 2008 composite return included a (12.53)% return on U.S. equities ((14.93)% large cap and (11.22)% on small cap U.S. equities), (19.14)% on international equities and 1.76% on real estate.

Northern Trust Global Advisors, Inc.

	<u>Year-to-Date as of</u> <u>Sept. 30, 2008</u>	<u>Third Quarter</u> <u>2008</u>	<u>July</u> <u>2008</u>	<u>Aug.</u> <u>2008</u>	<u>Sept.</u> <u>2008</u>
Northern Trust's Composite Return	(21.02)	(11.35)	(1.57)	(0.17)	(9.78)
Benchmark Composite Return	(19.07)	(10.31)	(1.16)	0.16	(9.40)
Northern Trust's Total Fixed Income Return	(9.66)	(4.97)	(1.30)	0.04	(3.75)

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Northern Trust's third quarter 2008 composite return included a (9.99)% return on U.S. equities ((10.38)% large cap and (6.04)% on small cap U.S. equities), (22.41)% on international equities and 4.04% on real estate.

The Fund's financial group reported asset allocation of the Pension Fund as whole as of September 30, 2008 as follows: 68% equity, 30% fixed income, 2% other and 0% cash. The financial group also reported that for the third quarter of 2008 the return on the indexed fixed income account was (0.56)%. The return on the passive equity account for the third quarter of 2008 was (8.34)%.

Financial Information - Net Assets
(Dollars shown in thousands.)

The financial report prepared by Fund staff for the nine months ending September 30, 2008 shows net assets as of that date of \$21,161,712, compared to \$26,805,847 at December 31, 2007, a decrease of \$5,644,135 compared to an increase of \$739,852 for the same period last year. The \$6,383,987 difference is due to \$5,891,715 less investment income combined with \$492,272 more net operating loss.

The Fund's staff report further notes that for the nine months ended September 30, 2008, the Fund's net asset decrease from operations (before investment income) was \$1,354,138 compared to a decrease of \$861,866 for the same period in 2007, or a \$492,272 unfavorable change. This change in net assets from operations (before investment income) was attributable to:

a) (\$454,966) less contributions, primarily due to the UPS withdrawal,

b) (\$36,926) more benefits paid, due to an increase in average monthly benefits and

c) (\$380) more general and administrative expenses.

During the six months ended September 30, 2008 and 2007, the Fund withdrew \$1,284,699 and \$871,591, respectively, from investment assets to fund the cash operating deficit.

Financial Information - Participant Population

The September 30, 2008 report prepared by Fund staff further notes that the eight-month average number of Full-Time Equivalent (FTE) memberships decreased 35.44% from August 2007 to August 2008 (going from 145,305 to 93,806). During that period, the average number of retirees increased by 0.06% (from 212,109 to 212,246).

Named Fiduciaries

Officers of the Named Fiduciaries, Goldman Sachs Asset Management and Northern Trust Global Advisors, Inc. met with the Board of Trustees during this quarter to discuss portfolio matters including asset allocation.

The Fund's financial group reported to the Board of Trustees at their September 10, 2008 meeting on investment expenses incurred through the second quarter of 2008. These investment expenses (fiduciary, custodial and investment management fees) totaled \$35,390,925 through the second quarter of 2008 compared to \$37,282,735 for the same period in 2007, a 5.1% decrease.

Bankruptcies and Litigation

The Fund's Executive Director continued to report to the Trustees on employer bankruptcies, including interim recoveries collected in the Funds' ongoing pursuit of claims for contributions and withdrawal liability against Consolidated Freightways Corporation and related entities. Approximately \$59.5 million has been collected to date from Consolidated Freightways companies.

With respect to more recent bankruptcies, the Executive Director has reported that on June 13, 2008, Performance Transportation Services, Inc. and its affiliates ("PTS"), which had been operating in a Chapter 11 bankruptcy in the Western District of New York for some time, ceased operations and commenced a liquidation. At the time of its shutdown, PTS contributed to the Pension Fund on behalf of 825 employees and to the Health & Welfare Fund on behalf of 608 employees. The Executive Director has also reported that on June 29, 2008, Alvan Motor Freight, Inc. ("Alvan") filed a Chapter 11 proceeding in the Eastern District of Michigan with the intention of ceasing operations and liquidating its assets. Alvan contributed to the Pension Fund on behalf of 422 employees and to the Health & Welfare Fund on behalf of 191 employees. Staff has

indicated that it will prepare and pursue claims related to these employer bankruptcies.

Health and Welfare Fund

Pharmacy Benefit Manager Selection

At the direction of the Trustees, the Health and Welfare Fund's Staff has studied options and proposals with regard to entering into a new Pharmacy Benefits Manager ("PBM"). Medco currently performs PBM services for the Health and Welfare Fund, but Medco's agreement will expire at the end of this year. At the July 15, 2008 Board of Trustee Meeting, following presentations by Staff concerning various PBM options and proposals, the Trustees approved acceptance of a PBM contract proposal submitted by Caremark/CVS, effective January 1, 2009. This acceptance is contingent upon execution of a formal agreement and completion of arrangements by Caremark/CVS to assure compliance with the terms of this new PBM contract by January 1, 2009.

Financial Information (Dollars in thousands.)

The Health and Welfare Fund's financial summary for the third quarter of 2008 is compared below with interim financial information for the same periods of 2007:

	<u>3rd Quarter Ended September 30,</u> <u>2008</u>	<u>2007</u>
Contributions	\$885,402	866,864
Benefits	773,344	751,573
TeamCare admin- istrative ex- penses	22,323	21,912
General and ad- ministrative expenses	28,767	28,120
Net operating income (loss)	60,968	65,259

Investment in- come (loss)	(50,050)	58,737
Increase (De- crease) in net assets	10,918	123,996
Net assets, end of period	1,094,477	1,031,975
Eight-month average participants (FTEs)	95,636	96,095

For the nine months ended September 30, 2008, the Health and Welfare Fund's net asset increase before investment income was \$60,968 compared to an increase of \$65,259 for the same period in 2007, or a \$4,291 unfavorable change:

(a) \$18,538 more contributions, primarily due to an extra week of billing combined with an increase in rates,

(b) (\$21,771) more benefits,

(c) (\$411) more TeamCare administrative fees, and

(d) (\$647) more general and administrative expenses.

Net investment income for the nine months ended September 30, 2008 was \$108,787 less than for the same period last year. This decrease resulted primarily from \$109,042 unfavorable change in realized/un-realized gain (loss) offset by \$279 more interest and dividend income.

During the nine months ended September 30, 2008 and 2007, the Fund transferred \$86,926 and \$62,625, respectively, to investments (Mellon Bank) as the operations generated positive cash flows for those periods.

The enclosed report entitled "Central States Funds Financial and Analytical Information" prepared by the Fund's financial group as of September 30, 2008 shows the investment asset allocation as 76% fixed income and 24% equity.

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This report also notes that the eight month average number of Full-Time Equivalents (FTE) memberships decreased 0.48% from August 2007 to August 2008 (going from 96,095 to 95,636). During that period, the average number of retirees covered by the Health and Welfare Fund decreased by 12.31% (from 16,379 to 14,362).

Article V (H)

As required by Article V(H) of the Health and Welfare Fund Consent Decree, the Health and Welfare Fund has paid during the third quarter of 2008 the following for professional services and expenses for the Independent Special Counsel:

July	\$ 0.00
August	\$241.50
September	\$ 0.00

I will be glad to provide additional details regarding any aspect of my activities as Independent Special Counsel. Should you have any questions or comments, please do not hesitate to contact me.

Sincerely,



FRANK J. MCGARR,

Enclosure

cc: Mr. Gregory F. Jacob (w/encl.) **Via UPS Next Day**
Mr. Michael Schloss (w/encl.) **Via UPS Next Day**
Mr. Thomas Nyhan
Mr. William Nellis