

FRANK J. McGARR, Esq.
Arbitration and Mediation

August 13, 2009

The Honorable Milton I. Shadur
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 Shadur:

This is to report on my activities during the second quarter of 2009 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.

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.

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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 which were scheduled for 2006. The negotiators agreed to that allocation. Allocations of increased fringe benefit contributions to the Pension Fund were also made in 2007.

As explained in previous reports, the multiemployer plan funding rules of the Pension Protection Act of 2006 ("PPA") became effective on January 1, 2008. On March 24, 2008, the Fund's actuary certified the Fund to be in "critical status" under the PPA for the 2008 plan year; on March 31, 2009, the actuary certified that the Fund remains in critical status for the 2009 plan year. As a result of the initial critical status certification, the Trustees adopted a "rehabilitation plan" as the PPA requires for critical status plans. 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 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.

Staff has reported to the Trustees that as of May 2009, a vast majority of the Fund's active members were covered by collective bargaining agreements that have come into compliance with the Fund's rehabilitation plan. Almost all of the compliant employers and bargaining units have agreed to adopt the rehabilitation plan's Primary Schedule (generally requiring 7-8% annual contribution increases for five years and maintaining current benefit levels). As of the Trustees' May 12, 2009 Meeting, only 5 bargaining units, comprising a total of 40 active participants, have agreed to adopt the rehabilitation plan's Default Schedule (4% annual increases and elimination of PPA adjustable benefits). As of May 2009, approximately 25 bargaining units, comprising approximately 390 participants, have had the Default Schedule imposed on them by operation of law under the PPA, due to their failure to agree to be bound by either Primary Schedule or the Default Schedule within 180 days of the expiration of the units' last collective bargaining agreement.

Contributing employers who have not agreed to be bound by one of the Schedules created by the Rehabilitation Plan are required under the PPA to pay a non-benefit bearing surcharge to the Fund on their contractual pension contribution obligation. Under the PPA, the surcharge was 5% of the pension contribution obligation during 2008, and was increased to 10% as of January 1, 2009. Staff has reported that (1) as noted, most employers are in compliance with the Rehabilitation Plan and are *not* incurring surcharges, and (2) as of May 2009, most of the employers who are incurring the surcharges are also voluntarily paying them. Thus Staff reported at the May 12, 2009 Trustees' Meeting that only 12 employers are delinquent in paying their surcharges, and that the total surcharge delinquency of these 12 employers was less than \$23,000; these employers are being pursued under the Fund's delinquent account

collection procedures, including litigation where necessary. (It should be noted that surcharged employers - *i.e.*, those not compliant with the Rehabilitation Plan - are not necessarily subject to the Default Schedule under which the affected participants incur a loss of PPA adjustable benefits. Under the PPA, the Default Schedule is imposed on the bargaining parties only after the lapse of 180 days from the expiration of a non-compliant collective bargaining agreement. As reported above, only approximately 25 bargaining units, comprising approximately 390 participants, have so far incurred the Default Schedule through this PPA-mandated process.)

At the May 12, 2009 Board of Trustees Meeting, 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).

Although it thus appears the Pension Fund has reported progress in securing increased employer contributions and controlling benefits as required of "critical status" plans under the PPA, the financial information presented below also makes clear that the Fund has suffered serious investment losses in the general stock market and economic downturn that commenced in 2008. In addition, Staff has reported that, for plan year 2008, the Pension Fund will be unable to satisfy the funding ratio targets that are a condition of the amortization extension granted to the Fund by the IRS in 2005 (described above, pp. 1-2). Staff has also reported, with the concurrence of the Trustees, that the Pension Fund has filed an application with the IRS requesting a waiver of the funding ratio targets for 2008, in view of the unexpected economic decline that has occurred. The Trustees have also directed Staff to continue to monitor and pursue additional regulatory or legislative initiatives that may assist the Pension Fund in addressing the funding problems created by recent conditions in the general economy and stock markets.

Financial Information - Investment Returns

The Pension Fund's investment return for the second quarter 2009 was 15.04%.

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 2009. This comparison (showing percent returns on investment) is summarized in the following tables:

Pension Fund's Composite Return

	<u>2nd Quarter Ended</u> <u>June 30, 2009</u>	<u>One Year Period Ending</u> <u>June 30, 2009</u>	<u>Three Year Period Ending</u> <u>June 30, 2009</u>
TUCS 1 st Quartile	11.91	(15.57)	(1.20)
TUCS Median	10.80	(18.81)	(2.73)
TUCS 3 rd Quartile	8.64	(20.16)	(3.59)
Fund's Composite Return	15.04	(18.11)	(4.01)

Pension Fund's Total Equity Return

	<u>2nd Quarter Ended</u> <u>June 30, 2009</u>	<u>One Year Period Ending</u> <u>June 30, 2009</u>	<u>Three Year Period Ending</u> <u>June 30, 2009</u>
TUCS 1 st Quartile	21.28	(25.77)	(6.82)
TUCS Median	18.83	(27.15)	(7.67)
TUCS 3 rd Quartile	17.62	(28.25)	(8.27)
Fund's Total Equity Return	18.45	(26.44)	(8.31)

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

Pension Fund's Fixed Income Return

	<u>2nd Quarter Ended</u> <u>June 30, 2009</u>	<u>One Year Period Ending</u> <u>June 30, 2009</u>	<u>Three Year Period Ending</u> <u>June 30, 2009</u>
TUCS 1 st Quartile	6.93	6.52	6.62
TUCS Median	5.40	4.22	5.92
TUCS 3 rd Quartile	4.08	2.18	5.25
Fund's Fixed Income Return	4.22	6.33	6.71

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>June 30, 2009</u>	<u>2nd Quarter</u> <u>2009</u>	<u>Apr.</u> <u>2009</u>	<u>May</u> <u>2009</u>	<u>June</u> <u>2009</u>
Goldman-Sach's Composite Return	9.42	19.35	11.22	6.87	0.41
Benchmark Composite Return	7.73	18.96	11.73	6.27	0.19
Goldman Sach's Total Fixed Income Return	10.32	7.81	3.23	2.88	1.52
Benchmark Fixed Income Return	9.80	7.68	3.78	2.47	1.26

Goldman Sach's second quarter 2009 composite return included a 21.58% return on U.S. equities (15.82% large cap and 26.08% on small cap U.S. equities), 21.73% on international equities and 35.82% on real estate.

Northern Trust Global Advisors, Inc.

	<u>Year-to-Date as of</u> <u>June 30, 2009</u>	<u>2nd Quarter</u> <u>2009</u>	<u>Apr.</u> <u>2009</u>	<u>May</u> <u>2009</u>	<u>June</u> <u>2009</u>
Northern Trust's Composite Return	9.38	18.52	10.80	6.58	0.36
Benchmark Composite Return	7.05	17.67	10.43	6.35	0.20
Northern Trust's Total Fixed Income Return	12.06	10.72	4.54	4.37	1.47
Benchmark Fixed Income Return	9.58	7.72	3.78	2.53	1.24

Northern Trust's second quarter 2009 composite return included a 17.85% return on U.S. equities (16.98% large cap and 22.29% on small cap U.S. equities), 28.22% on international equities and 27.91% on real estate.

The Fund's financial group reported asset allocation of the Pension Fund as whole as of June 30, 2009 as follows: 69% equity, 28% fixed income, 2% other and 1% cash. The financial group also reported that for the second quarter of 2009 the return on the indexed fixed income account was 1.66%. For the second quarter of 2009 the passive equity account had a return of 15.98%.

Financial Information - Net Assets

(Dollars shown in thousands)

The financial report prepared by Fund staff for the six months ending June 30, 2009 shows net assets as of that date of \$17,484,709, compared to \$17,358,652 at December 31, 2008, an increase of \$126,057 compared to a decrease of \$3,063,363 for the same period last year. The \$3,189,420 difference is due to \$3,255,004 more investment income offset by \$65,584 more net operating loss.

The Fund's staff report further notes that for the six months ended June 30, 2009, the Fund's net asset decrease from operations (before investment income) was \$973,016 compared to a decrease of \$907,432 for the same period in 2008, or a \$65,584 unfavorable change. This change in net assets from operations (before investment income) was attributable to:

- a) (\$44,458) less contributions, primarily due to a decrease in FTEs offset by an increase in contribution rates,
- b) (\$21,193) more benefits paid, and
- c) \$67 less general and administrative expenses.

During the six months ended June 30, 2009 and 2008, the Fund withdrew \$1,053,473 and \$839,864, respectively, from investment assets to fund the cash operating deficit.

Financial Information - Participant Population

The June 30, 2009 report prepared by Fund staff further notes that the five-month average number of Full-Time Equivalent (FTE) memberships decreased 14.5% from May 2008 to May 2009 (going from 93,149 to 79,642). During that period, the average number of retirees decreased by 0.1% (from 212,357 to 212,053).

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 May 12, 2009 meeting on investment expenses incurred through the first quarter of 2009. These investment expenses (fiduciary, custodial and investment management fees) totaled \$11,510,141 through the first quarter of 2009 compared to \$17,091,973 for the same period in 2008, a 32.7% decrease.

Bankruptcies and Litigation

The Funds' 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 \$68.5 million has been collected to date from Consolidated Freightways companies.

YRC

YRC, Inc. and its affiliates ("YRC") are trucking subsidiaries of YRC Worldwide, the product of a merger between Yellow

Transportation and Roadway. YRC is the single largest contributing employer to both the Pension Fund and the Health and Welfare Fund. As previously reported, the Funds' Executive Director informed the Trustees at their March 24, 2009 Meeting that YRC has reported cash flow issues caused by the current decline in the general economy. As a result, YRC proposed an arrangement under which portions of its payment obligations to the Funds would be deferred for several months, and the Funds would be given liens or mortgages to secure the deferred obligations.

This issue was discussed further at the Trustees' May 12, 2009 Meeting, and later in May the Funds entered a Contribution Deferral Agreement ("Deferral Agreement") with YRC. Under the Deferral Agreement, the Pension Fund has agreed to defer payment of YRC's pension contribution obligations accrued during January, March, April and May of this year (the "Deferral Period," representing a deferral of contributions totaling approximately \$83 million). The Fund's financial consultant indicated that absent deferral of these contribution obligations, YRC would be in default of loan covenants with its banks; Staff reported that such a default would risk triggering an insolvency and liquidation of YRC, which would destroy any chance of rehabilitating the employer as a healthy contributor to the Funds.

Some 25 other multiemployer pension plans in which YRC participates have joined in the Deferral Agreement, but the Pension Fund is owed approximately 63% of the contributions deferred under the Agreement.²

Repayment of the Deferral Period contributions is secured under the Deferral Agreement by first lien collateral on approximately 150 real estate parcels owned by YRC, plus additional second lien collateral. The Pension Fund's Staff reported (1) that this was the maximum collateral package that could be obtained from YRC and its banks to support the Deferral Period contributions, and (2) that YRC's banks (who had a first lien on virtually all the company's assets) required the Pension Fund to agree to the Deferral Agreement as a condition for the banks' release of the collateral.

²As of May 15, 2009, YRC became current in its contribution obligations to the Health and Welfare Fund and it apparently intends to remain current in its payments to that Fund for the foreseeable future.

The Deferral Agreement requires repayment of the deferred contributions in 36 monthly installments commencing in January 2010. YRC is also scheduled to pay interest on the deferred contributions on a current basis and the Pension Fund's Staff has reported that the first interest payment to the Fund of \$338,271.64 was timely made by YRC on July 15. In addition, Staff has reported that YRC recently sold a small portion of the first lien collateral provided by the Deferral Agreement, and the Pension Fund received approximately \$3.7 million as its share of the net proceeds from this sale as a pre-payment under the Deferral Agreement.

However, the Pension Fund's Staff and financial consultants have reported that YRC is both unable and unwilling to meet its pension contribution payment obligations beyond the Deferral Period, i.e., contribution obligations accrued after May of this year. While some additional security can apparently be provided to cover YRC's June and July pension contribution accruals, Staff advised the Trustees that protection of the Pension Fund's interests cautions in favor of *terminating* the participation of YRC in the Pension Fund in order to stop the accrual of further pension obligations for which the company is not able to provide funding. Accordingly, at the Trustees' July 16 Meeting, the Board formalized action to terminate YRC's participation in the Pension Fund.

The Pension Fund's Staff has also reported that a few days before this formal action to terminate YRC at the July 16 Trustees' Meeting, representatives of YRC and the International Brotherhood of Teamsters reached an agreement to amend YRC's current labor agreement to eliminate the company's pension contribution obligation for the next 18 months, and to resume making those contributions in January 2011. (This agreement is being considered for ratification by the YRC bargaining unit members.) In light of YRC's intention to return to the Pension Fund as a participating employer at a later date, and upon a recommendation from Staff, the Trustees' decided at their July 16 Meeting that YRC's termination of participation in the Pension Fund should not at this time (and subject to certain conditions) be treated as a complete and permanent cessation of its obligation to contribute to the Pension Fund that would trigger withdrawal liability. For similar reasons, the Trustees resolved that YRC's termination of participation in the Pension Fund should not at this time be treated as a Rehabilitation Plan Withdrawal (see p. 4 above), which would reduce the pension benefits of the YRC participants.

Health and Welfare Fund
Financial Information
 (Dollars in thousands)

The Health and Welfare Fund's financial summary for the second quarter of 2009 is compared below with interim financial information for the same periods of 2008:

	<u>2nd Quarter Ended June 30,</u> <u>2009</u>	<u>2008</u>
Contributions	\$280,875	291,838
Benefits	256,224	253,171
TeamCare admin- istrative ex- penses	7,184	7,261
General and ad- ministrative expenses	<u>9,840</u>	<u>9,550</u>
Net operating income (loss)	7,627	21,856
Investment in- come (loss)	<u>48,027</u>	<u>(15,238)</u>
Increase (De- crease) in net assets	55,654	6,618
Net assets, end of period	<u><u>\$1,147,436</u></u>	<u><u>1,104,225</u></u>
Five-month average participants (FTEs)	88,673	95,189

For the six months ended June 30, 2009, the Health and Welfare Fund's net asset increase from operations (before investment income) was as follows:

- (a) (\$15,603) less contributions,

- (b) \$5,198 less benefits,
- (c) \$148 less TeamCare administrative fees, and
- (d) \$848 less general and administrative expenses.

Net investment income for the six months ended June 30, 2009 was \$34,137 more than for the same period last year. This increase resulted primarily from \$37,310 favorable change in realized/unrealized gain (loss) offset by \$3,195 less interest and dividend income.

During the six months ended June 30, 2009 and 2008, the Fund transferred \$46,445 and \$72,486, 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 June 30, 2009 shows the investment asset allocation as 74% fixed income and 26% equity.

This report also notes that the five month average number of Full-Time Equivalents (FTE) memberships decreased 6.8% from May 2008 to May 2009 (going from 95,189 to 88,673). During that period, the average number of retirees covered by the Health and Welfare Fund decreased by 10.6% (from 14,582 to 13,038).

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 second quarter of 2009 the following for professional services and expenses for the Independent Special Counsel:

April	\$ 0
May	\$ 0
June	\$442.75

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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: Ms. Carol A. De Deo (w/encl.) **Via UPS Next Day**
Mr. Michael A. Schloss (w/encl.) **Via UPS Next Day**
Mr. Thomas C. Nyhan