BEFORE THE WASHINGTON
UTILITIES AND TRANSPORTATION COMMISSION

WASHINGTON UTILITIES AND
TRANSPORTATION COMMISSION,
Complainant,

v.

PUGET SOUND PILOTS,
Respondent.

Docket TP-

TESTIMONY OF
BRUCE J. McNEIL
ON BEHALF OF PUGET SOUND PILOTS

JUNE 29, 2022
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I. IDENTIFICATION OF WITNESS

Q: Please state your name, business and business address.

Q: Does Exhibit BJM-02 summarize your educational background and professional experience as a pension law specialist?
A: Yes.

Q: During your 38 years of law practice, have you published books in the field of pension law?
II. PURPOSE OF TESTIMONY

Q: What is the purpose of your testimony?

A: I have been asked to provide a legal opinion regarding the enforceability of the Puget Sound Pilots ("PSP") pension plan and to provide an analysis of how to transition PSP's existing pay-as-you-go or farebox pension plan to a fully funded defined-benefit pension plan as ordered by the Washington Utilities and Transportation Commission.

A. Both Retirees and All Current PSP Pilots Have Legally Enforceable Rights to the Benefits Promised in the PSP Pension Plan.

Q: Were you asked by the Puget Sound Pilots to provide a legal opinion regarding whether PSP’s existing retirement program is a legally binding obligation owed by PSP both to current retirees and to all current working PSP pilots?

A: Yes.

Q: In performing that legal analysis, what documents did you review?

A: I reviewed the retirement plan document, which is titled “Amended Retirement Program of Puget Sound Pilots,” Exhibit BJM-03. I also reviewed the testimony of former PSP executive director and general counsel Walter Tabler detailing the history of the PSP pay-as-you-go or farebox pension plan.

Q: What is your opinion regarding the legal enforceability of the existing PSP pension plan?

A: In my opinion, there is no question that the existing pay-as-you-go Puget Sound Pilots pension plan is a binding legal obligation of PSP pursuant to the well developed body of law.
governing employee benefits in the United States, which includes the Employee Retirement
Income Security Act of 1974, as amended (“ERISA”). Section 402(a)(1) of ERISA provides
that an employee benefit plan shall be established and maintained pursuant to a written
instrument. The plan document is an agreement of the parties and may be governed by
general principles of federal common law, including the federal common law of contract.
The PSP pension plan should be governed by the terms of the plan document and the federal
common law of contract. Applying the federal common law of contract, the provisions in the
plan form a binding contractual agreement. The Third Circuit Court of Appeals has found
that breach of contract principles, applied as a matter of federal common law, govern
disputes arising out of plan documents. Kemmerer v. ICI Americas Inc., 70 F.3d 281 (3d Cir.
1995). Under these contract principles, “a unilateral contract which created vested rights in
those employees who accepted the offer it contained by continuing in the company’s
employment until retirement” is binding and enforceable. In re New Valley Corp., 89 F.3d
143, 150 (3d Cir. 1996). In other words, all existing retirees have legal rights enforceable
against PSP to the benefits each retiree earned under the PSP pension plan during that
retiree’s years of service as a state-licensed PSP maritime pilot. In addition, all pilots who are
currently members of the Puget Sound Pilots Association and who have signed the
documentation when each pilot is first licensed to accept and support the PSP pension plan
also have legal rights enforceable against PSP to the benefits each working pilot earns during
his or her years of service as a PSP pilot. Accordingly, the PSP pension plan and the rights
of the retirees and the pilots under the plan should be interpreted as a unilateral contract that
is binding and enforceable against PSP. The court in In re New Valley Corp. said that the
plan documents contained several specific and mandatory provisions promising benefits
which vested upon retirement, and declared that “the company’s claim to an unfettered right
to terminate in the face of specific grants of benefits ‘ha[d] no basis in contract law’ and was
‘more than minimally unfair.’” Id. at 151 (quoting Kemmerer v. ICI Americas Inc., 70 F.3d
281, 287 (3d Cir. 1995).

Q: Is there any room for argument or doubt about the legal opinion you have just
expressed?
A: No. Based on the clarity of the law on this issue, the abundantly clear terms of the
PSP pension plan and the fact that the plan has been administered for decades in compliance
with the clear terms of that plan, there is no question regarding the contractual enforceability
of the PSP pension plan on the part of both retirees and all currently licensed PSP pilots.

B. PSP’s Pay-As-You-Go Pension Plan Can Be Transitioned to a Funded
Defined Benefit Plan.

Q: Were you asked by the Puget Sound Pilots to evaluate the feasibility of
transitioning PSP’s existing pay-as-you-go pension plan to a fully funded defined
benefit plan?
A: Yes.

Q: Is it feasible for PSP to carry out the order of the Washington Utilities and
Transportation Commission (“UTC”) to develop a plan “to transition to a fully funded,
defined-benefit retirement plan and to implement full accrual accounting for retirement
depenses” and to do so in a manner that delivers the retirement benefits promised in the
PSP pension plan both to retirees and to existing working pilots?
A: Yes.

Q: Please explain.

A: Based upon my review of the available options, PSP could establish a multiple employer plan (“MEP”) that provides benefits substantially identical to the benefits provided to PSP retirees under the current unfunded pension plan. The U.S. Department of Labor recently issued final regulations interpreting the term “employer” for purposes of section 3(5) of ERISA which facilitates the adoption and administration of MEPs and thereby expands access to retirement plans for certain self-employed individuals. The final regulations permit certain working owners without employees to participate in a MEP sponsored by an employer group or an association. A PSP sponsored defined benefit MEP is a feasible option because, in my opinion, PSP meets the requirement to have sufficient common economic and representational interests to be a bona fide organization sponsoring an ERISA plan on behalf of its “working owner” members, each of which would be a “self-employed individual” receiving “earned income” as a licensed PSP pilot. The IRS said that a “self-employed individual” is usually a sole proprietor or a partner. An industry group or association like PSP that satisfies this “commonality” requirement could be treated as an “employer” under section 3(5) of ERISA and permit the industry trade group or association to sponsor a MEP for its membership under the control of its membership based upon the final regulations issued by the U.S. Department of Labor under section 3(5) of ERISA.

Section 401(c) of the Internal Revenue Code of 1986, as amended (the “Code”), provides rules for determining when a “self-employed individual” may be treated as an employee and eligible to participate in a tax-qualified retirement plan under section 401(a) of
the Code. Section 401(c) generally treats partners in a partnership and members of a limited
liability company (“LLC”) treated as a partnership as self-employed individuals for purposes
of participating in a tax-qualified plan described in section 401(a) of the Code. In my
opinion, a PSP-sponsored defined benefit MEP would satisfy the relevant tax-qualification
requirements applicable to the MEP and thus qualify for favorable tax treatment under
section 401(a) of the Code.

Q: To participate in the fully funded defined benefit MEP, would each PSP pilot
have to form an entity through which the pilot would provide his or her pilotage
services to PSP?
A: Yes, PSP would simply need to require each new pilot licensee to form the necessary
entity required under section 401(c), such as an LLC, to participate in the MEP. Considering
that 48 of the 50 currently licensed PSP pilots already use an entity through which they
provide their pilotage services to PSP, I am advised by PSP leadership that adding this
requirement will not be a significant issue.

Q: Did you examine other alternatives to the multiple employer plan approach that
you have just described?
A: Yes.

Q: Please describe your findings with respect to the availability of other
alternatives.
A: Pursuant to the applicable provisions of ERISA and the Code, the alternatives fall into two basic types of retirement plans: defined benefit plans that define the benefit to be paid to a plan participant (e.g., the product of years of service, final average salary, and an accrual factor would equal an annual retirement benefit), which would include the PSP sponsored defined benefit MEP, and defined contribution plans that define the contributions that are allocated to the accounts of each plan participant, which would include various types of 401(k) plans and various types of IRAs. In my opinion, none of the defined contribution plan options is feasible because none of these types of plans will allow sufficient levels of annual contributions to replicate the benefit levels promised in the unfunded PSP pension plan. With respect to a traditional 401(k) plan and a Simplified Employee Pension (“SEP”)-IRA plan, the maximum annual contributions that may be made by an employer and a participating employee are limited under section 415(c) of the Code to the lesser of: (i) 100% of the participant’s compensation, or (ii) a specified dollar amount, annually adjusted for cost-of-living increases, $61,000 for 2022, and $67,500 including catch-up contributions by employees who have attained age 50 or over. As to other types of IRAs, which include the Savings Incentive Match Plan for Employees, also referred to as a “SIMPLE IRA,” and the payroll deduction IRA, the annual plan contribution is limited to the lesser of: (i) 100% of compensation, or (ii) a specified dollar amount, annually adjusted for cost-of-living increases, $14,000 for 2022 for the SIMPLE IRA and $6,000 for the payroll deduction IRA.

Q: What about the defined benefit plan category? Is there a feasible option for PSP other than the MEP?
A: In my opinion, no. Although a high-earning independent contractor can create an individual defined benefit plan to match the benefits promised in the unfunded PSP pension plan, there is significant cost and risk associated with such an individualized defined benefit plan. The extra costs include the annual reports that are required to be filed with the U.S. Department of Labor, the IRS, and the Pension Benefit Guaranty Corporation (“PBGC”), an annual actuarial analysis, compliance with the funding requirements and professional asset management. The major risks are associated with the requirement for consistent annual contributions to the plan which, if not made, have severe consequences. If a sole proprietor is not able to make the required contributions to the defined benefit pension plan as determined by an actuary, the sole proprietor may be subject to penalties for failing to satisfy the funding requirements under sections 412 and 430 of the Code. Section 4971(a) imposes a 10% excise tax on an unpaid minimum contribution, and section 4971(b) imposes a 100% excise tax if there is no correction. Additionally, under section 430, the plan could impose a lien on the property and rights to property of the sole proprietor that is enforced by the PBGC. The PBGC could also involuntarily terminate the plan and impose liens on the sole proprietor’s assets to fund the underfunded liability. Considering the dangerous character of a PSP pilot’s job, commuting to and from work on pilot ladders often in challenging conditions, the risks of being unable to meet the annual contribution requirements for an individualized defined benefit plan are significant.

Q: Comparing the defined benefit MEP to the individualized defined benefit plan per pilot, are there significant savings with respect to annual reporting, actuarial and investment costs?
A: Yes, very much so. In my opinion, the defined benefit MEP would be one plan for all of the participating pilots. PSP would file only one annual report with the IRS, the Department of Labor and the PBGC, perform the actuarial analysis for one plan in a single report, satisfy the funding requirements under sections 412 and 430 of the Code for one plan, and enjoy considerable investment management savings with a single defined benefit MEP compared to the individualized defined benefit plan approach for each pilot.

Q: In order to make the transition from PSP’s existing unfunded pay-as-you-go pension plan to the fully funded ERISA-compliant tax-qualified MEP pension plan, what steps are necessary?

A: In my opinion, there are four steps. First, the defined benefit multiple employer plan would need to be drafted by my firm and approved by the PSP Board of Directors. Second, on behalf of PSP, I would seek a favorable determination letter from the IRS confirming that the PSP defined benefit multiple employer plan is a tax-qualified plan under section 401(a) of the Code sponsored by the PSP and composed of all of the PSP pilots providing their pilotage services through an entity such as an LLC. Based upon my discussions this year with representatives of the IRS and the Department of Labor who would be involved in responding to our request for an IRS determination letter and the determination of the status of PSP as the sponsor of the MEP under section 3(5) of ERISA, and my expertise in the governing law under the Code and ERISA, I am confident that a favorable determination letter approving the tax-qualified status of a PSP sponsored MEP would be issued. Third, I would seek an Advisory Opinion from the Department of Labor regarding the status of the
PSP as a plan sponsor under section 3(5) of ERISA. Fourth, PSP would need to appoint 
trustees for the MEP and select an actuary and an investment advisor.

Q: Assuming that the UTC issued a final order in early 2023 approving and funding 
the transition to the funded PSP MEP, would it be feasible to accomplish the four steps 
you have just described in time to accomplish the transition from the pay-as-you-go 
pension plan to the funded defined benefit plan as of January 1, 2024?
A: Yes, in my opinion, we would need no more than 12 months, maybe less, to 
accomplish the transition of the PSP pay-as-you-go pension plan to the funded MEP.

Q: Do you have an estimate of the cost of performing this transition to the PSP 
MEP?
A: The filing fee to seek an IRS favorable determination letter is $2,700. The cost to 
draft the defined benefit MEP and apply to the IRS for a determination letter, seek an 
Advisory Opinion from the Department of Labor on the status of PSP as an employer under 
3(5) of ERISA, and work with PSP leadership to implement the MEP by January 1, 2024, 
would be approximately $55,000.

III. CONCLUSION

Q: Does this conclude your testimony?
A: Yes.