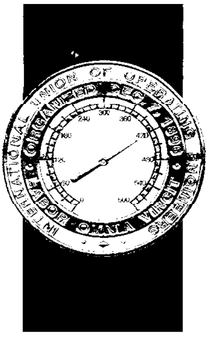


International Union of Operating Engineers

AFFILIATED WITH THE AMERICAN FEDERATION OF LABOR AND CONGRESS OF INDUSTRIAL ORGANIZATIONS

VINCENT J. GIBLIN
GENERAL PRESIDENT

CHRISTOPHER HANLEY
GENERAL SECRETARY-TREASURER

GENERAL VICE PRESIDENTS
WILLIAM C. WAGGONER
WILLIAM E. DUGAN
JAMES MCLAUGHLIN
BRIAN E. HICKEY
GARY KROEKER
JOHN M. HAMILTON
ALLAN B. DARR
KENNETH CAMPBELL
PATRICK L. SINK
WILLIAM K. DUFFY
GERALD ELLIS
JERRY KALMAR
PHILIP SCHLOOP
RUSSELL E. BURNS

TRUSTEES
MARK HOLLIDAY
CHAIRMAN
JOHN T. AHERN
MICHAEL GALLAGHER
RODGER KAMINSKA
KUBA BROWN

GENERAL COUNSEL
RICHARD GRIFFIN

May 8, 2007

VIA FACSIMILE AND REGULAR MAIL

Ms. Stephanie Weakley
Office of Procurement and Assistance Management
U.S. Department of Energy
1000 Independence Avenue, SW
Washington, DC 20585

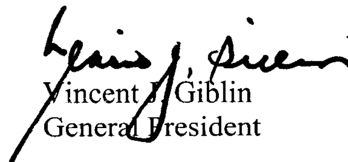
Re: Request for Public Comment on Department of Energy Contractor Employee Pension and Medical Benefits

Dear Ms. Weakley:

Enclosed are the comments of the International Union of Operating Engineers on the Department of Energy's proposed change in policy regarding contractor employee pension and medical benefits.

For the reasons discussed in these comments, we urge that the proposed policy be rescinded.

Sincerely,



Vincent J. Giblin
General President

VJG:fg

Enclosure

Comments of the International Union of Operating Engineers on Proposed DOE Notice 351.1 Contractor Employee Pension and Medical Benefits Policy

---

I. INTRODUCTION

In Notice 351.1 DOE has proposed a new policy on contractor employee pension and medical benefits. The new policy would change existing policy applying to some 200,000 employees and beneficiaries of DOE contractors, by limiting reimbursable benefit costs to those that are "market-based." Determining market-based costs for medical benefits is ill defined in the proposed policy and appears to add confusion, without demonstrable benefit, to the existing policy's standards for determining acceptable medical benefit costs.

With respect to pension benefits, however, the proposal makes an enormously significant change from existing policy. In spite of the fact that pension benefits make up less than 20% of DOE's unfunded benefit liabilities, the new policy proposes that, henceforth, market-based pension benefits for new hires will be limited only to those provided through defined contribution plans. That is, regardless of the comparative costs of the benefits provided through a defined benefit or a defined contribution plan, only those provided through a defined contribution regime will be reimbursed.

The Department's judgment that defined benefit pension plans are not to be considered market-based is contrary to the national pension policy embodied in the Pension Protection Act of 2006 (PPA), is based upon a flawed factual analysis, and will produce significant adverse economic consequences to the Department that have not been considered.

For all of these reasons, the proposed policy should be rescinded.

II. MEDICAL BENEFITS

DOE unquestionably has a responsibility to ensure that contractors develop employee benefit programs that facilitate achievement of objectives and business strategies in support of DOE missions in a cost-effective manner. To that end, DOE has already adopted policies set forth in DOE Order 350.1, Contractor Human Resources Management Programs, Chg. 1 (DOE O 350.1), which provide that the reasonableness and allowability of compensation, including medical benefit plans, must be determined in accordance with the cost principles in the DOE Acquisition Regulation and the Federal Acquisition Regulation. These cost principles include a requirement that contractors submit an evaluation of their medical benefit programs using a professionally recognized measure to compare their benefit programs to other organizations to assure that their

per capita cost per full-time employee or net benefit value is no more than five percent (5%) above the comparator for other organizations. Moreover, contractors are required to submit a corrective plan to achieve conformance with the range of acceptability when the cost is greater than five percent above the comparator for other organizations.

The existing policy adequately and appropriately assures that contractor medical benefit costs are consistent with the comparable private sector contractor costs.

III. PENSION BENEFITS

The proposed policy prohibiting defined benefit plan coverage for new employees should be rescinded for at least three reasons. First, it contravenes national pension policy. Second, it is based upon a flawed factual analysis. Third, it will create adverse economic consequences that have not been considered.

A. The Proposed Policy Contravenes National Pension Policy

Notice 351.1 was issued in April 2006. Since that time, however, Congress has acted to specifically address the funding volatility of defined benefit plans that formed the basis of Notice 351.1's future prohibition of defined benefit plans. Accordingly, Notice 351.1 is no longer necessary and contravenes the intention of Congress, and the President, that defined benefit plans be preserved and strengthened.

On August 17, 2006, President Bush signed into law the Pension Protection Act of 2006 with the following words:

> "Americans who spend a lifetime working hard should be confident that their pensions will be there when they retire. Last year I asked Congress to strengthen protections for the pensions of our workers. Members of both parties came together to pass a good bill that will improve our pension system.... And I'm really pleased to sign this bill into law."[1]

And the President's views were echoed by high Administration officials both during the consideration of the PPA and after its passage.[2]

---

[1] President George W. Bush Statement on Signing HR 4, the Pension Protection Act of 2006, August 17, 2006.

[2] For example:

- "As you know, President Bush has made retirement security one of the highest priorities of his second term. A critical component of his agenda is ensuring that the defined benefit pension system is viable and that the promises made to the workers enrolled in these plans are kept."

The PPA strengthens defined benefit plans through new funding rules which eliminate the funding volatility permitted by prior law. Prior law allowed employers to contribute little, if anything, to defined benefit plans during periods of strong investment returns, but then required large contributions when investment returns deteriorated.

It is precisely this pattern of funding that DOE portrays at page 5 of its April 2007 document, Department of Energy Contractor Employee Pension and Medical Benefits, which was distributed at stakeholder meetings. The chart at page 5 depicts the dramatic increase in annual contributions to contractor defined benefit plans from 2000 to 2006. The chart, however, captures only one-half of the volatility cycle. It reflects only the high contribution period, without taking into account the prior period of low contributions. As we will show, when a more representative time frame is analyzed, the cost of these plans has been modest.

The Department must recognize that the new funding rules of the PPA will preclude the type of funding volatility that gave rise to its concern with defined benefit plans. The PPA requires more rapid and current funding than previous law, requires market-to-market asset measurement and prohibits five-year actuarial smoothing of gains and losses. Each of these PPA mandates is intended to, and will, eliminate the unprecedented funding volatility of the early years of this decade.

Most importantly, when Congress and the President have specifically acted to strengthen and preserve defined benefit pension plans, the Department of Energy should not directly contravene that action by mandating that these plans be abandoned.[3]

Secretary of Labor Elaine L. Chao remarks on "Protecting the Retirement Security of America's Workers: The President's Plan for Reforming Private Defined Benefit Pension Plans," National Press Club, Washington DC, January 10, 2005.

- "[T]he primary goals of the Administration's proposal are to improve pension security for workers and retirees [and] to stabilize the defined benefit pension system…."

  Testimony of Ann L. Combs, Assistant Secretary for Employee Benefits Security, U.S. Department of Labor, before the Senate Finance Committee, March 1, 2005.

- "The Administration believes that defined benefit plans should remain a viable option for companies that want to provide guaranteed retirement benefits to their employees."

  Testimony of Bradley D. Belt, Executive Director, Pension Benefit Guaranty Corporation, before the Senate Budget Committee, June 15, 2005.

- "[With pension reform] we can look forward to steadily improving private DB pension funding, brighter prospects for the publicly-sponsored DB pension insurance fund, and a more secure future for American workers."

  Assistant Secretary of Treasury Mark J. Warshawsky's Remarks on Pension Funding and Accounting, European Institute's Sovereign Funds Roundtable, London, England, May 17, 2006.

[3] The desire of Congress and the President to strengthen and preserve defined benefit plans is consistent with the unanimous professional and academic agreement that these plans are far superior to defined contribution plans as vehicles for the delivery of real retirement security. See: M. Barton Waring and Laurence B. Siegel, "Don't Kill the Golden Goose! Saving Pension Plans," *Financial Analysts Journal,* Jan/Feb 2007, pp. 31-45, at www.cfapubs.org; Craig Copeland, "Retirement Plan Participation and Retirees' Perception of Their Standard of Living," *Employee Benefit Research Institute (EBRI) Issue Brief, No. 289,* Jan. 2006 at http://ssrn.com/abstract=876991; Ruth Helman,

B. The Proposed Policy Is Based Upon a Flawed Factual Analysis

1. The Time Frame Utilized Exaggerates the Cost of the Contractor Plans

In spite of public requests for additional contribution and funding information, DOE has relied only upon the data presented on the chart at page 5 of its document titled Department of Energy Contractor Employee Pension and Medical Benefits, April 2007. That chart provides contribution and funding data for only the seven-year period from 2000 through 2006.

The chart portrays a period of steadily rising contributions to contractor defined benefit plans, with unfunded liabilities that rose until 2005 but then began to fall.

The chart presents a severely distorted picture because it captures only the results of two unparalleled events in U.S. history that produced unprecedented shocks to the U.S. economy and defined benefit plan funding: the bursting of the technology bubble in 2000, followed by the terrorist attacks of September 11, 2001. The combination of those two events produced a five-year period from 2000 to 2005 with the worst combined stock and bond market returns since the period 1937 to 1942. Those shocks to the economy came after the extended bull markets of the 1980s and 1990s, during which time it is likely that DOE contractors, as permitted by prior law, made minimal contributions, if any, to their defined benefit plans.

While the Department has denied our request to provide contribution funding data for periods prior to 2000, at the April 17, 2007 stakeholder meeting attended by representatives of this organization, a DOE staff member advised that in 1996 the Department made no contributions whatsoever for contractor defined benefit plans. We have searched publicly available sources for additional DOE contribution data, and have found it for only two other years, 1998 and 1999. That data is found at page 100 of the Department of Energy FY 1999 Accountability Report, and discloses contributions of $52 million in 1998 and $61 million in 1999.

Adding the contribution data for 1996, 1998 and 1999 begins to put the Department's limited analysis in better perspective. As we show in the next section, adding these three years to the seven years depicted in DOE's chart, the aggregate cost of the contractor plans was approximately 3.78% of compensation. That cost is extremely modest by any standards, and far cheaper than the Federal Employees Retirement System (FERS) plan covering federal employees.

Craig Copeland and Jack VanDerhei, "Will More of Us Be Working Forever? The 2006 Retirement Confidence Survey," *EBRI Issue Brief, No. 292,* Apr. 2006 at http://ssrn.com/abstract=897751; Craig Copeland, "Individual Account Retirement Plans: An Analysis of the 2004 Survey of Consumer Finances," *EBRI Issue Brief, No. 293,* May 2006 at http://ssrn.com/abstract=900845; "The Value of Defined Benefit Plans," *American Academy of Actuaries Issue Brief,* Jul. 2006 at www.actuary.org; Jack VanDerhei, "Defined Benefit Plan Freezes: Who's Affected, How Much, and Replacing Lost Accruals," *EBRI Issue Brief, No. 291,* Mar. 2006 at http://ssrn.com/abstract=891170; Barton Waring, Laurence Siegel and Timothy Kohn, "Mind the Gap? Why DC Plans Underperform DB Plans, and How to Fix Them," (Barclays Global Investors) *The Investment Research Journal*, Jan. 2004, Vol. 7 Issue 1.

But more significantly, the pattern of low contributions until 2002, followed by five years of steadily rising contributions, confirms that these plans behaved as expected under the prior funding rules, and can be expected to return to low contribution levels in the near future. The increasing contributions from 2002 to 2006 reflected the incremental recognition of the investment losses these plans suffered in the early decade. The law prior to the PPA permitted the application of an actuarial technique known as five-year smoothing. This technique permitted plans to recognize prior year investment losses in one-fifth increments in each succeeding year.

The U.S. markets are now recovering, and with that recovery a host of recent surveys has shown that defined benefit plan funding is recovering likewise.[4] Accordingly, it can be expected that the costs of these plans will rise for one or two more years (as the smoothing cycle is completed) and then begin to drop. The Department should already have, or be able to easily obtain, contribution projections for each of the contractor defined benefit plans. Certainly, the Department should not take sweeping action against these plans without knowing what contributions are projected for the coming years.

By utilizing only the 2000 to 2006 snapshot, the Department has mistakenly concluded that the defined benefit sky is falling. It is not.

2. Contractor Defined Benefit Plans Provide Superior Benefits to Those of Federal Employees, At One-Third of the Cost

The April 2007 DOE document, Department of Energy Contractor Employee Pension and Medical Benefits, contains the following statement at page 3:

> "On average, the retirement benefits received by DOE contractor employees are higher than the benefits earned by federal employees."

While we have no access to information concerning the relative value of the benefits provided by contractor defined benefit plans, we can calculate their relative cost from the available contribution data for the period 1996 to 2006 (with the exception of 1997 for which none is available to us). Utilizing that contribution data, together with U.S. Department of Labor wage data, we can conclude that the average annual cost of these contractor plans was 3.78% of compensation.

---

[4] See: "Corporate Pensions Had Strong Year, Study Says," *The Washington Post,* 12 Apr. 2007, p. D2; Theo Francis, "Pension Plans Take Healthy Turn," *The Wall Street Journal,* 23 Jan. 2007; Emily Newman, "Funding Levels Back in Black, Says UBS," *Pensions & Investments,* 22 Jan. 2007; "DB Funding Landscape Starts to Shine in 2006," Towers Perrin at http://www.plansponsor.com/pi_type10/_?RECORD_ID=36300; "A Return to Better Funding for Pensions in 2006," Watson Wyatt Worldwide at http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=16988; "Expected Improvement in the Funded Position of Multiemployer Pension Plans," The Segal Company, Winter 2007, pp. 1-4 at http://segalco.com/taft/pub-taft.cfm?ID=725.

This 3.78% figure is calculated as follows. Taking the 2000 to 2006 contribution data presented at page 5 of Department of Energy Contractor Employee Pension and Medical Benefits, and adding the previously referenced contribution data for 1996, 1998 and 1999, for these 10 years the average annual DOE contribution was $153.4 million. The Department has advised that these plans cover 100,000 active employees. Accordingly, the average cost per employee was $1,534 annually. While compensation figures have not been provided by the Department, we think it reasonable to assume that, on average, the contractor work force received compensation equivalent to the national average for all workers. The U.S. Department of Labor's National Compensation Survey, August 2006, reported that the national average hourly compensation rate at June 2005 was $18.52 for all workers. Adjusting that rate forward using the Department of Labor, Bureau of Labor Statistics cost survey data, the average hourly compensation rate at December 31, 2006 was $19.49. For a 2,080-hour year, that rate produces an average annual compensation of $40,539. The average annual contractor defined benefit plan cost of $1,534 per employee represents 3.78% of the average annual employee compensation of $40,539.

This 3.78% of compensation cost is not only modest in absolute terms, it is only about one-third of what DOE itself pays for its employees' participation in the Federal Employees Retirement System (FERS). Since 1983 all federal employees have been covered by Social Security as well as a defined benefit plan and a defined contribution plan. The defined benefit plan is FERS. A recent study by the Congressional Research Service found that federal agencies contribute 11% of payroll to FERS.[5]

If these contractor defined benefit plans are providing benefits superior to those of DOE employees at one-third of the cost, the Department is receiving a bargain to be preserved, not abandoned. And if there is any inequity in this situation, it is in the cost of federal benefits, not the cost of contractor benefits.

3. The Contractor Defined Benefit Plans Are Currently 97% Funded, Will Soon Be Fully Funded, and Will Remain So

The chart at page 5 of DOE's April 2007 document, Department of Energy Contractor Employee Pension and Medical Benefits, reflects accrued unfunded liabilities of $2.2 billion in 2006. That number, while large in absolute terms has meaning only in relative terms.

An analysis of DOE's Consolidated Financial Statements for 2006 (CFS), which is posted on DOE's website, permits the funded status of these contractor plans to be placed in context. At page 177, the CFS presents a reconciliation of the funded status of the plans. That reconciliation discloses the plans had an Accumulated Benefit Obligation (ABO) of $24.923 billion, and plan assets of $24.108 billion. This is a shortfall of $815 million or 3% of the ABO. Accordingly, the plans are 97% funded on ABO.

[5] Retirement Benefits For Members of Congress, CRS Report For Congress, Congressional Research Service, February, 2007, p. 6.

The $2.2 billion unfunded liability figure also appears on the same page of the CFS. However, that is a shortfall not on the ABO, but on the ABO plus a $3.684 billion liability attributable to the effect of future compensation increases. For purposes of calculating current funded status, the ABO is the appropriate liability measure.

A 97% funded ratio presents no reason for alarm, especially when it is clear that defined benefit plans are recovering strongly from the adverse investment experience of the early decade. As referenced in footnote 4 herein, a range of recent studies have shown steadily improving defined benefit plan funding.

And, most significantly, Congress has acted through the PPA to assure that, once fully funded, these plans will not again be subject to the funding volatility which gave rise to DOE's concern.

C. The Department Has Failed to Consider Adverse Economic Consequences of the Proposed Policy

It appears that the Department has ignored or failed to consider potentially severe adverse financial consequences that would flow from its mandate that contractors abandon their defined benefit plans. These consequences would drive costs higher not lower. There are common adverse consequences for single and multiemployer plans, as well as additional adverse consequences for multiemployer plans.

1. Single and Multiemployer Plans

It is an actuarial fact that when a defined benefit plan is deprived of new entrants, the cost of funding the benefits of the remaining participants rises. This is because the cost to fund equivalent benefits increases with age and years of service.

Accordingly, the proposed policy will require funding of defined contribution benefits for new employees, while the funding costs for incumbent employee defined benefits will continue to rise without the moderating offset of new entrants.[6]

2. Additional Multiemployer Plan Consequences

The Pension Protection Act did not change the withdrawal liability provisions of prior law. Those provisions require that employers who withdraw from participation in multiemployer plans immediately commence the payment of their proportional share of any unfunded vested benefit liabilities in the plan at the time. This obligation arises for both complete and partial withdrawals.

---

[6] And the Department has completely failed to consider the comparative costs of new defined contribution plans, to those of the existing defined benefit plans. For instance, the Thrift Savings Plan, the defined contribution plan covering federal employees, provides for employer contributions of 5% of compensation. That cost is one-third greater than the 3.78% of compensation paid to maintain the existing defined benefit plans.

While the determination and calculation of complete and partial withdrawals are based upon the extent of the employer's participation and the size of each plan, there appears to have been no consideration whatsoever by DOE of the withdrawal liability consequences that would flow from its mandate that contractors immediately commence withdrawing from any multiemployer plans in which they participate. Nor does it appear that the Department has evaluated the extent of its responsibility for withdrawal liability payments made by contractors complying with the new policy.

IV. SUMMARY

The Department has declared a new market-based standard for the reimbursement of contractor employee pension and medical benefits. With respect to medical benefits, this standard appears to add only confusion to the previous standards. With respect to pension benefits, the standard makes an explicit choice of defined contribution plans over defined benefit plans. This choice is contrary to national pension policy, is based upon a flawed factual analysis, and fails to consider substantial adverse consequences.

Based upon the foregoing, Notice 351.1 should be rescinded.