Increasing Costs and Liabilities Projected for Contractors' Pensions and Postretirement Benefits may exceed budget requested for indirect program costs in FY 2009 and FY 2010.

The Department's liability for contractor employee pension and other post-retirement medical benefits stems from the evolution of Management & Operating (M&O) contracts during World War II, when the Atomic Energy Commission (AEC) entered into arrangements with private contractors comprised of industrial and academic organizations for the construction and operation of facilities necessary for the atomic energy program. M&O contracts contemplate long-term relationships where contractors handle day-to-day management and operation of the facilities, and the Government reimburses the contractors for virtually all costs and exercises broad oversight.

Work performed under M&O contracts had no commercial counterpart, required a stable, long-term workforce, and extensive on-the-job training at remote and often undesirable worksites; therefore, contractors provided benefits designed to recruit and retain employees for the long-term. This also drove a requirement for follow-on contractors to retain existing employees along with their pay and benefits. DOE still uses cost-reimbursement contracts to manage its facilities. Subject to specific allowability, allocability, and reasonableness requirements applicable to all government cost-reimbursement contracts, DOE continues to reimburse the costs of employee compensation and benefits -- including pension and postretirement benefits (PRB) -- for current and former employees.

Over the last several years, the annual cost of pension and other post-retirement benefits has increased significantly. Between FY 2001 and FY 2008, the amount that DOE reimbursed its contractors annually for these benefits rose from $263 million to $705 million – a 168 percent increase. In addition, DOE's liability for these benefits increased from $7.5 billion in FY 2001 to $12.3 billion in FY 2008. Furthermore, new Pension Protection Act (PPA)[1] requirements coupled with the recent market downturn in assets are expected to increase costs over the next 2 to 5 years. As a result, DOE faces a significant challenge in balancing its responsibility for mission funding and funding necessary to recruit and retain a highly skilled contractor workforce.

Most of the contractor pension plans will be valued on January 1, 2009 and then DOE will be able to determine the funding requirements. Preliminary indications are that at least 25 of the total of 47 defined benefit plans may require contributions greater than expected, and several of these plans will be less than 80% funded. DOE is evaluating contractor projections of anticipated pension contributions compared to FY 2009 budgeted pension contributions. Upon completion of this evaluation, DOE will be able to determine the impact on the FY 2009 budget.

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[1] The PPA requires that for plan years beginning after 12/31/07, plans must be funded at 100% of the present value of the benefit liability (it was 90% under the old rules.) Any funding shortfall must be amortized over 7 years versus up to 30 years under the old rules. At risk plans, those that are less than 80% funded, trigger benefit restrictions and more conservative assumptions. Severely underfunded plans, less than 60% funded, cause benefit accruals to cease.