In re El Paso Energy Corporation Pension Plan

Rebuttal Report of
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Expert Report of Findings

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Section I

Transition Benefits were Very Valuable to Older Employees

I have reviewed the Declaration of Claude Poulin dated April 15, 2008 in the El Paso Cash Balance litigation. Mr. Poulin makes a series of calculations about benefits provided under the Cash Balance pension plan. While he states no conclusions about the results of these calculations, the implication is that El Paso mistreated plan participants (particularly older participants) in the period from January 1, 1997 through present. I refute each of the specific claims made by Mr. Poulin in the next section of this report. I must start my rebuttal, however, by commenting on the value of the transition benefits delivered to older employees, and highlighting how El Paso treated plan participants more generously than required by law and better than most other employers at this time.

By 1996, El Paso Corporation was facing extreme financial difficulty, typical of their industry at that time. Management assessed their options, and decided that changes needed to be made to the generous final-pay defined benefit pension plan.

In my experience working with hundreds of pension plan sponsors in this decade, most employers facing this urgency froze their defined benefit plan and replaced it with a 401(k) plan. This contention is supported by the sharp decline in the number of defined benefit plans over the past 15 years. However, El Paso was committed to their plan and the benefits it provided, so they did not freeze their plan.

Once a decision was made not to freeze benefits, El Paso decided to prospectively convert their final pay plan to a less generous cash balance plan. They were again in good company making this decision, as I know of many plan sponsors who did the same. However, many of these other plan sponsors started the cash balance plan with limited or no transition benefits. Again, this was not the case with El Paso. In order to protect their employees,

particularly those close to early retirement eligibility, El Paso continued its prior final-pay formula for 5 years. In my broad experience, this is among the most generous transition provisions I have ever seen. Since early retirement eligibility was typically at age 55, this 5-year transition was a tremendous benefit to employees at or over age 50 at the time of conversion. El Paso offered this transition when it converted its plan at the beginning of 1997, and again when it merged Sonat into its plan in 2000 and Coastal in 2001.

How many employees benefited from this generous transition benefit? The following table shows the number of employees who were included in the cash balance conversions, the number of these employees who subsequently terminated during the transition periods, and the number of these employees who retired under the transition benefits:

Employees Terminating or Retiring During Transition Periods

Division	Total # of Employees	Total Terminating	Total Retiring*
Combined	6,037	3,139	557

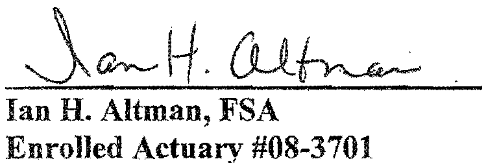
* - Retirees included in total terminating

As the table shows, the majority of pension plan participants terminated during the transition period, when they were fully covered by the transition benefits offered by El Paso. For this majority, they were in most cases substantially better off with the transition benefits than they would have been with just the cash balance formula, and they never experienced any wear-away. This is especially true for the 557 employees who achieved early retirement during the transition (by definition, these people were age 50 or over when transition began). Mr. Poulin's report provides clear demonstrations of the value of the early retirement benefits under the transition formula, which would have been denied many participants had the old formula not been extended for five years.

In conclusion, El Paso's approach to cash balance conversion, with a 5-year transition period, was of substantial benefit to thousands of older employees. Any implication that it disadvantaged large numbers of employees, or discriminated against older employees, is not supported by the cited facts.

Furthermore, there were several high level conclusions reached in my initial expert report, and by Michael Ward in his expert report, that Mr. Poulin has not addressed. My findings included the fact that the El Paso plan covered a high majority of participants over age 40 from 1998 through 2006, and a high majority of plan cost was directed to those over age 40. Mr. Ward demonstrated that even if accrued benefits payable at age 65 may have been frozen under the alleged wear-away, early retirement benefits (immediately payable, often as a lump sum) were increasing steadily, and most participants in this plan retire prior to age 65. Mr. Poulin did not offer any contrary analysis in his initial report.

My background and the terms of my engagement remain the same as in effect at the time my original expert report was issued.



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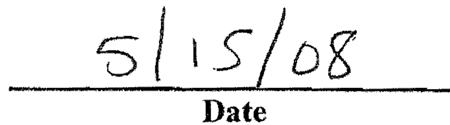
Enrolled Actuary #08-3701



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Section II

Refutation of Specific Contentions

Starting on page 6 of his report, Mr. Poulin raises a series of contentions about the El Paso Cash Balance Plan that are either irrelevant or erroneous. I address these contentions below.

Rates of Benefit Accrual Decrease with Age - Mr. Poulin presents an analysis claiming to demonstrate that the "rates of benefit accrual" decrease with age. To make this demonstration, he calculates the change in the age 65 accrued benefit for participants under the cash balance plan. The exhibits presented are the standard "Cooper-like" analysis that has been offered in several prior cash balance age discrimination cases.

There are several flaws in this approach. First and foremost, it is my understanding that the cash balance age discrimination claims have already been dismissed in this case. As such, the fact that the age 65 accrued benefit grows at a decreasing rate with age is not relevant. Second, Poulin equates "rate of benefit accrual" with the growth rate in the age 65 accrued benefit. However, these two items are not the same. Cash balance plans typically pay benefits out as lump sums, and the El Paso Plan is no exception. When the actual benefits payable (as a lump sum) are compared over advancing age, there is a clear pattern of increase (see Exhibit 1, which replicates one of Poulin's examples while focusing on the benefits actually payable).

Future Accruals are Substantially Reduced – Mr. Poulin presents figures supporting the claim that the rate of benefit accrual under the cash balance plan is significantly lower than under the prior plan formula. This point is not in dispute. El Paso needed to cut back on the generous retirement benefits it provided when it encountered financial difficulties, and did so by

converting to a cash balance plan. Sponsoring a pension plan in the U.S. is a purely voluntary exercise, and a sponsor generally has the right to modify, reduce or eliminate benefits prospectively at any time. Any implication that El Paso acted improperly by reducing future accruals when it changed its pension plan is erroneous.

Mr. Poulin continues his assertions about reduced benefit accruals by documenting that the cash balance plan provides less generous early retirement subsidies than did the prior defined benefit plans. Again, there is no dispute about this point. Subsidized early retirement factors are perhaps the single greatest reason why pension plan sponsors convert final-pay plans to cash balance plans. When it no longer serves the employer's interest to encourage early retirement, plan sponsors prospectively convert to "pure actuarial reductions" through implementing a cash balance plan. Given the wide differences in early retirement treatment highlighted by Mr. Poulin at the bottom of page 12, the importance and generosity of the 5-year transition, which was purely voluntary on El Paso's part, is highlighted.

Wear-Aways Often Last Over 10 Years – Mr. Poulin makes several assertions about the length of the wear-away period, during which the transition benefit exceeds the cash balance benefit and no additional age-65 accrual is realized. We have several issues with this analysis. First, Mr. Poulin commences his analysis after the 5-year transition has been realized. This is not the effective date of the plan change, which was amended 5 years earlier. Of course, had El Paso not chosen to extend the final-pay benefits for 5 years after the date of amendment, there would be no wear-away. Secondly, Mr. Poulin attributes the wear-away to the fact that El Paso chose not to apply the "A + B" approach to benefits, rather using a transition period and a "greater of A or B" approach. Note, had El Paso wanted to choose an "A + B" approach, they would have done so without any transition protection. Mr. Poulin is implying that El Paso should have provided a generous 5-year transition, and then gone to an A + B approach, which

would be equivalent to not making any changes to the plan for 5 years. Given the financial urgency faced by El Paso at this time, Mr. Poulin's suggestion is unreasonable. I have never experienced a plan sponsor who combined a transition period like El Paso's with an A + B approach in my near 30 years of practice. Finally, the heading of this section obscures the fact that for younger employees the projected wear-away period is much shorter than 10 years. Mr. Poulin's two examples of employees age 34 at the time of plan conversion show an expected wear-away of only 2 to 3 years.

Mr. Poulin goes on to highlight four reasons why he believes that the cash balance benefit is lower than it should be under the new plan formula. First, he cites the fact that the cash balance conversion did not reflect the value of early retirement subsidies. This point is not disputed; it was not a requirement to reflect early retirement subsidies and most cash balance conversions do not reflect such subsidies. Second, he cites the fact that the conversion balance reflects a pre-retirement mortality discount. This again is not refuted, was allowable, and was common practice. Third, he returns to the claim that the conversion balance did not reflect the 5-year transition benefit. As previously stated, I have never seen a cash balance conversion that contained a transition period and reflected that transition benefit in the initial balance conversion. Finally, he claims that the interest rate now being credited on the cash balance accounts is lower than the initial discounting rates. The rates used to establish the initial cash balances were appropriate measures at the time of conversion (Mr. Poulin does not dispute this). The fact that market rates have declined since conversion appears to be the source of his concern. Had market interest rates risen, participants would have come out ahead on the initial conversion – there was no inherent bias present at the conversion. Falling interest rates cannot be blamed on El Paso Corporation.

In this section, Mr. Poulin also notes that benefit accruals for employees like Mr. Tomlinson will resume at some point before they reach age 65. Mr. Poulin states, "The rate of benefit accrual at that time will be infinitely more than the zero accrual rate in the preceding 10 years." This type of analysis is generally found in claims about backloading violations in cash balance conversions. The analysis is not relevant in this case, however, as the backloading claims have already been dismissed.

Section 3

Methodology of Calculations

Mr. Poulin prepared a series of Exhibits to support the results of his report. This section offers specific comments on the methodology used to create these exhibits.

Mr. Poulin's Exhibit D is intended to display how the rate of benefit accrual changes under the Cash Balance Plan as participants age. However, as previously mentioned, this chart displays the change in the accrued benefit at age 65, which is not the same as the rate of benefit accrual. Cash balance plans, like El Paso's, typically pay lump sum benefits. We have therefore prepared Exhibit 1, which utilizes the exact facts as Mr. Poulin's Exhibit D, but displays the growth in the lump sum as the employee ages.

The results of Exhibit 1 show that the growth in lump sum value does not decline with age. On the contrary, the lump sum growth increases as the participant ages. This demonstrates two things: 1) the underlying cash balance plan is not age discriminatory, and 2) Mr. Poulin's core argument falls apart if we separate the growth in the accrued benefit at age 65 from the rate of benefit accrual.

Mr. Poulin's Exhibit F shows projections of how long the wear-away period lasts for certain employees, as measured from the date at which the transition period ends. As previously mentioned, this is not the date of the plan change (which was 5 years earlier), it is merely the date at which the alleged wear-away period looks most extreme. Further, Mr. Poulin acknowledges that the results of the projections in Exhibit F are very sensitive to assumptions. I

note that Exhibit F utilizes a 4.0% interest credit projection, even though the current rate is 4.2%, and the rate has exceeded 4.0% for the last 3 years. If we use the actual interest crediting rates for projection purposes, I estimate that Mr. Poulin's model indicates a wear-away period for Mr. Tomlinson that is roughly one full year less than his 11 to 12 year projection. If we assume that the interest credit rate rises to 5.0% (interest rates are beginning to rise as commodity prices climb), the projected wear-away period is shortened by closer to two years, and if rates return to the initial level of 6.5%, the projected wear-away period could be reduced by several years. This sensitivity analysis produces two conclusions: Mr. Poulin's analysis is overstating results based on current conditions, and the results of this analysis are very sensitive to small changes in assumptions.

Finally, to assess damages, Mr. Poulin has accumulated the cash balance credits that would have been received were it not for the wear-away due to the continuation of prior formula benefits under the transition period. This methodology is flawed. Damages are typically taken as a measure of benefits lost due to a particular change or event. In this case, however, Mr. Poulin is counting as damages cash balance credits that would have been received except for the fact that the benefit was already received by the participant under the transition benefit. Since the only way that the cash balance credits would not be received is if the participant has already received the benefit under continuation of a prior formula, it is not appropriate to count that money in a tally of damages.

Exhibit 1

Revised Demonstration of Rate of Benefit Accrual

El Paso Cash Balance Plan
Rate of Benefit Accrual - Measured as a Lump Sum

Age 1	Salary 2	Pay Credit 3	Int Credit 4	Cash Bal 3 +4 + Prior	Increase Cash Bal	Increase as % of Sal
45	$ 54,900	$ 3,294	$ -	$ 3,294	$ 3,294	6.0%
46	$ 57,096	$ 3,997	$ 132	$ 7,422	$ 4,128	7.2%
47	$ 59,380	$ 4,157	$ 297	$ 11,876	$ 4,453	7.5%
48	$ 61,755	$ 4,323	$ 475	$ 16,674	$ 4,798	7.8%
49	$ 64,225	$ 4,496	$ 667	$ 21,837	$ 5,163	8.0%
50	$ 66,794	$ 4,676	$ 873	$ 27,386	$ 5,549	8.3%
51	$ 69,466	$ 4,863	$ 1,095	$ 33,344	$ 5,958	8.6%
52	$ 72,245	$ 5,057	$ 1,334	$ 39,735	$ 6,391	8.8%
53	$ 75,134	$ 5,259	$ 1,589	$ 46,583	$ 6,849	9.1%
54	$ 78,140	$ 5,470	$ 1,863	$ 53,916	$ 7,333	9.4%
55	$ 81,265	$ 5,689	$ 2,157	$ 61,762	$ 7,845	9.7%
56	$ 84,516	$ 5,916	$ 2,470	$ 70,148	$ 8,387	9.9%
57	$ 87,897	$ 6,153	$ 2,806	$ 79,107	$ 8,959	10.2%
58	$ 91,413	$ 6,399	$ 3,164	$ 88,670	$ 9,563	10.5%
59	$ 95,069	$ 6,655	$ 3,547	$ 98,872	$ 10,202	10.7%
60	$ 98,872	$ 6,921	$ 3,955	$ 109,748	$ 10,876	11.0%
61	$ 102,827	$ 7,198	$ 4,390	$ 121,335	$ 11,588	11.3%
62	$ 106,940	$ 7,486	$ 4,853	$ 133,675	$ 12,339	11.5%
63	$ 111,217	$ 7,785	$ 5,347	$ 146,807	$ 13,132	11.8%
64	$ 115,666	$ 8,097	$ 5,872	$ 160,776	$ 13,969	12.1%
65	$ 120,293	$ 8,420	$ 6,431	$ 175,627	$ 14,852	12.3%