May 1, 1989

Fred Smith
Chairman of the Board
Federal Express Corporation
P. O. Box 727
Memphis, Tennessee

Dear Fred:

I wish to respond to your April 24, and April 25, 1989, letters with specific attention to pay and benefit issues.

With regard to compensation, I must make the following points.

1) Even though our pay survey compares many parameters of our vocation, the interpretation and application of this information leaves much to be desired. Our crewmembers are well aware of this and emphasized it over and over again in meetings during our last management turnover. Once again, many promises to improve the pay review were made, but no substantial changes have been implemented.

2) Since our pay surveys compare annual yields and given our hourly rates, the only way we can maintain competitive wages with major air carriers is to earn an inordinate amount of credit hours. In fact, credit hour creep has been our only real hedge against inflation for quite some time. It is our crewmembers' apparent willingness to fly these hours which may account for your belief that the "appropriate compromise" to which you refer in your letter is in fact appropriate.

3) The nature of our business requires our crewmembers to perform their jobs under conditions which will undoubtedly take their toll in disability and life expectancy. If we continue to attempt to extract the hard time productivity increases you desire without reducing work days (TAFB), this problem will worsen.

4) Because there is virtually no input or impact from pilots (including Flight Management), our compensation system is, in fact, what Mr. Hogue referred to in the aforementioned meetings as one which first defines results and then designs a method to achieve those results.

I urge you to become more aware of the typical crewmember's feelings on these issues. Your attempt to "read" the crew force opinions via a few one on one meetings with individual crewmembers, while admirable, may in fact mislead you regarding prevalent viewpoints. If the FAB had been effective, it should have been the sounding board used to understand the crew force views on compensation. I also contend that survey feedback results have and will confirm that the pilot group is not in agreement with our compensation methodology or its results.

Your "red letter" discussion about the pension plan is, quite frankly, confusing to me. You appear to mix defined benefit and defined contribution values and attempt to assign money-purchase plan status to our variable (DPSP/PSP) plan. As we discussed in our meeting, the key to evaluating our plan's real worth centers around the assumptions made regarding the variable side of our combination plan. As an employee, I have yet to see details about our new DPSP plan (PSP). I am aware, however, that it is based on 10% of U.S. pre-tax profit margins and also subject to approval by the Board of Directors. This makes the new proposal "variable" and not a true money-purchase pension or "B" plan. Yes, our defined benefit is higher than those of typical airline combination plans, but their "B" plans are adjusted to account for this difference and typically pay 9%-11% of the crewmember's salary, rather than a portion of a portion of corporate earnings. In addition, their "B" plans are contractual agreements which tend to show stable contribution levels over time in successful companies. With regard to our DPSP, our Corporation, while successful, has not maintained consistent contribution levels. According to internal Company documents, a 10% defined benefit enhancement would be necessary to "mitigate the funding deficiencies in the DPSP over the past few years". While our defined benefit has been increased by this 10% number, the loss of COLA approximately offsets this gain and the gain from the change in social security offset, given reasonable assumptions for highly paid employees. In other words, we have not achieved the results promised in pilot meetings with regard to the "two step" proposals. As you will recall during those pilot meetings two years ago and in FAB meetings, the announced improvements included the 10% defined benefit enhancement (over 2 years), a resumption of cash DPSP contributions, and an ongoing COLA program.

You emphasize the "significant upside potential" of our proposed new profit sharing plan, but fail to point out the downside to this type of plan. A 5-year crewmember can examine his DPSP statement and realize that a profit sharing plan may not work as planned. Since our new proposal has no contractual floor, it may be presumptuous to assume 3% of pay (as per our recent handout) considering the past record with DPSP and the likely short term profit potential of our Company. As you indicated in our recent conversation, your defined contribution "enhancements" are prospective in nature. This means that pilots employed over the last five years will be unable to achieve replacement ratios which have been advertised by the Company. This, in effect, rewards new hires at the expense of pilots who have been employed more than one year prior to the June 1, 1989, plan implementation.

As Godwins states in their conclusions, "The relative value of the Federal Express plan does not compare favorably with other major airline pilot plans in the industry. However, if the DPSP plan had been continued on an ongoing basis (at the assumed contribution rate of 5% of compensation), then the value of the Federal Express plan would have been within the range of other pilot pension plans in the industry. One is lead (sic) to conclude that the suspension of contributions to the Deferred Profit Sharing Plan resulted in the Federal Express plan becoming significantly less valuable than other pension plans in the industry."

In your April 24, letter you indicate three problems with Godwins' study. I wish to respond to your statements point by point.

1) It is important to note that the mathematical error made by Godwins had little impact on the content of their report, an approximate 2% error in Final Average Earnings (FAE) in the value of our old plan. The error does not alter the truth in the Godwins conclusion previously quoted. In addition, it must be understood that this error and its resultant impact was caught by Godwins and presented to you at the time you received the report. As you well know, our Benefits Department's recent "Retirement Plan Summary" missed the fact that United and American have excellent "B" plans as part of pension benefits. United's "B" plan was missed totally, resulting in a 31% FAE undervaluation, and American's "B" plan, while recognized, was undervalued by 30.5% of FAE. This is an error which is not understandable, but does underscore our need for airline experienced professional benefits specialists.

   The discussions in the rest of Point 1) can be resolved between the actuaries, but I am most concerned about the overall relative value of our pension plan, rather than engaging in a debate over whether our new plan is better than the old in specific areas.

2) I am in total agreement with this point. It should be pointed out, however, that if you used the existing Northwest plan the industry FAE average in their report changes from 67.0% to 63.5%. This compares to an approximate FAE average of 50% for the new Federal Express plan using the same assumption.

3) I have already addressed most of your statements mentioned here in earlier discussions. Allow me to highlight my points about the new Profit Sharing Plan:

   a) The Profit Sharing Plan is "variable" and discretionary, not a true money-purchase "B" plan.

   b) It is based on a portion of a portion of corporate profits.

   c) There is no downside protection or contractual floor.

d) DPSP also had an "outstanding opportunity" to provide for an excellent retirement program.

e) It is prospective and does not address the five year gap in DPSP funding. Some form of refunding must be made to adjust for past DPSP funding deficiencies.

The real issue here is that once we achieve and maintain an airline standard plan, future requirements for any refunding will vaporize. Any pilots retiring from this point on deserve a fair portion of an airline standard retirement plan based on their years of service.

I would urge some caution regarding the assumption that our plans are superior to the Flying Tiger programs. In the initial report, Godwins used Medinger and Associates wage inflation assumptions (6.5%/year) in evaluating relative plan values, which are the same wage inflation figures Mr. Priddy used when the Company presented the new pension plan to us. As you know, wage inflation assumptions have no effect on FAE values but could have an enormous impact on the Flying Tiger Career Average Earnings (CAE) formula. Those wage assumptions referred to earlier tend to undervalue the Flying Tiger programs. In later work, when Godwins applied wage assumptions that more closely reflected what had actually occurred at Federal Express, the Flying Tiger programs began to look quite different. This is why it is important that the actuaries work out these issues.

I would like to say that it is obvious that the complexity of these programs requires professional expertise. The representatives of the Federal Express pilots (the FAB) have for many, many years indicated a lack of understanding by our Benefits Department regarding pilot specific issues. We had been promised an airline benefit specialist and/or outside consulting assistance for a long time before we were finally able to obtain assistance from Godwins. If we had hired professionals years ago, we would have been far ahead of the problems we now face.

As a fellow pilot, you must understand my inherent need for facts and my general lack of trust until it is earned. I have not survived over twenty years in aviation, including combat, on a basis of a non-inquiring mind. In addition, when I sense weakness or doubt, I must investigate until I can fully evaluate the situation. It is impossible for me and my fellow crewmembers to turn off these essential aviator qualities when we leave the cockpit. This is why we continually probe and inquire. For pilots, the Benefits Department can only quell the consequence of these qualities with demonstrated facts. Federal Express should not want it any other way.

Respectfully,

Donald L. Engebretsen
Captain