

ORIGINAL

Decision No. 78811

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application
of UNITED PARCEL SERVICE, INC.,
for authority to increase certain
of its rates for common carrier
parcel delivery service.

Application No. 52362
(Filed December 21, 1970)

In the Matter of the Investigation
into the rates, rules, regulations,
charges, allowances and practices
of all common carriers and highway
carriers relating to the transpor-
tation of any and all commodities
between and within all points and
places in the State of California
(including, but not limited to,
transportation of Minimum Rate
Tariff No. 2).

Case No. 5432 OSH 628
(Filed February 9, 1971)

And related matters.

Case No. 5439 OSH 141
Case No. 5441 OSH 222
(Filed February 9, 1971)

(Appearances are shown in Decision No. 78549.)

Additional Appearance:
George H. Morrison, for the Commission staff.

FINAL OPINION

United Parcel Service, Inc., (UPS) is a statewide highway common carrier of parcels (small packages). It also operates between California and other states. In this application it seeks to increase its wholesale parcel rates by 3 cents per package and one-half cent per pound. The Orders Setting Hearing in the captioned minimum rate proceedings were issued for the purpose of determining whether certain parcel rates presently maintained in the Commission's minimum

rate tariffs should be adjusted if the application herein is granted, the Commission having found that United Parcel Service, Inc. is the rate-making carrier with respect to the wholesale parcel delivery operations in question.

Public hearing was held before Examiner Mallory at San Francisco on February 25, March 31, April 1 and 2, 1971. Applicant's request for interim relief was submitted on February 25, 1971, and Decision No. 78549, dated April 13, 1971, authorized UPS to establish interim increases of two cents per package and one-half cent per pound in its wholesale parcel rates, pending determination of final rates based on the full record. Final submission of the proceeding was made on April 2, 1971.

Evidence was presented by applicant and the Commission staff. Exhibits 1 through 15, sponsored by applicant's controller for its Pacific Region, were received in evidence at the hearing on February 25, 1971. The data therein underlie the findings and conclusions in Decision No. 78549 (supra). Said witness presented additional Exhibits 16 through 21 on March 31, 1971, and rebuttal Exhibits 25 through 28 on April 2, 1971. A financial examiner from the Commission's Finance and Accounts Division sponsored Exhibit 22 containing historical results of operation, and certain rate-making adjustments to said historical operating results found appropriate in prior proceedings. Another financial examiner presented Exhibit 23 containing his study and recommendations concerning a reasonable rate of return for applicant's California intrastate wholesale parcel delivery operations. An engineer from the Commission's Transportation Division introduced Exhibit 24 containing his analyses and

recommendations with respect to working cash components of rate base and his estimates of operating results for a future year under the rates sought by applicant and under an alternative rate structure proposed by said witness.

The evidence adduced by petitioner and the Commission staff clearly indicates that operations for a future year at the interim rates authorized to UPS by Decision No. 77275, dated May 22, 1970 in Application No. 51871, prior to those granted herein on an interim basis, would result in operating losses for UPS's common carrier wholesale parcel delivery operations in California. The issues presented herein, therefore, involve the level of permanent increased rates which will provide reasonable earnings to UPS for its California common carrier wholesale parcel delivery operations in a future year. In order to make such determination, it is necessary to resolve the following issues:

1. Whether UPS's common carrier wholesale parcel delivery operations will continue to enjoy the year-to-year growth experienced in the past; and, if so, the amount that test-year revenue and expense estimates should be adjusted to reflect such growth.
2. The reasonable rate of return and operating ratio for UPS common carrier wholesale parcel delivery operations in a test year.
3. The reasonable amount of working cash which should be included in a test year rate base and, thus, earn a return.
4. Whether state franchise taxes (income taxes) should be determined on an "as paid" (unitary) basis or should be calculated as if UPS was a corporation having no interstate operations and no affiliated interests.

Growth of Operations

The dissenting opinion of Commissioner Fred P. Morrissey to Decision No. 75692^{1/} reads in part as follows:

"The end result of the action of my colleagues... may be justified but one could never determine this from the record. The review and investigation of the Commission staff was most superficial and the whole procedure is violative of well-established principles of transportation and utility rate making and regulation. For example, a cursory investigation shows that the number of parcels handled is increasing at the rate of about two and a half to three million a year. At average revenue of 80¢ per parcel (data easily derived from the record), the procedure used thus ignores over two to three millions of dollars of additional revenue that can reasonably be expected in the current year. What expenses, if any, might be associated with this additional revenue is impossible to determine from the facts provided."

The record shows that information concerning growth was requested of UPS by the Commission staff. The record also indicates that such information must be obtained by special counts to separate California intrastate traffic from other traffic. The only information currently available is that set forth in Exhibit 21. Said exhibit shows that UPS's package volume for its intrastate common carrier service increased by 0.9 percent in 1970 over 1969. The record also shows that package volume in the first three months of 1971 approximated that for the same period in 1970. Thus, we find, based on the most recent facts available, that applicant's package volume has leveled off; therefore, no adjustment is required in test-year revenues and expenses to give effect to increased volume of traffic.

^{1/} Decision No. 75692, dated May 20, 1969, in Application No. 50760.

Rate of Return and Operating Ratio

The staff financial examiner testifying with respect to rate of return and operating ratio recommended that, based on his analyses, a rate of return of 11 percent on the rate base set forth in the staff engineer's study and an operating ratio of about 96.5 percent would be reasonable for UPS's common carrier wholesale parcel delivery operations for a future year. The witness testified that an 11 percent rate of return would produce a corresponding return on equity of 12.5 percent.^{2/}

The report in Exhibit 23 shows that, in connection with rate increases authorized to UPS in the past, the following operating ratios and rates of return were found not to be unreasonable:

	<u>Operating Ratio</u> <u>(After Taxes)</u>	<u>Rate of</u> <u>Return</u>
Decision No. 62344, 7/25/61	95.1 %	10.4%
Decision No. 72241, 4/4/67	95.49%	11.0%
Decision No. 74488, 8/6/68	95.49%	11.1%
Decision No. 75692, 5/20/69	95.67%	12.0%
Recommended herein by staff	96.5 %	11.0%

Exhibit 23 also contains the following statement: "It appears that the company's sought increase will have the effect of bringing the rate of return level up to or slightly higher than previously authorized by the Commission in previous rate proceedings. There also appears to be no specific reason why...the rate of return authorized has varied between 10.4% and 12.0% in past years."

^{2/} The witness assumed the following capital structure and an average cost of debt of 5.23 percent:

Debt:	\$ 3,348,208
Equity:	12,411,630
Total:	<u>\$15,759,838</u>

The report in Exhibit 23 further states: "The inherent risks of doing business, as far as I can determine, have not changed to any significant degree in the last ten years."

It appears from the foregoing that in the prior proceedings greater consideration was given to operating ratio (after taxes) than to rate of return; that operating ratio was held constant (as nearly as possible); and that the adopted rate of return was related to the operating ratio found reasonable in each proceeding.

The determination of a reasonable rate of return for a single utility company is a complex matter, but careful study of capital markets, inherent risks, capital structures and growth patterns, etc., permit an informed judgment. It is customary to include in a rate-of-return study a comparison of earnings of companies engaged in furnishing services similar to that rendered to the public and having similar risks by the applicant utility. It is also customary to present a range of rates of return which the staff believes sets the maximum and minimum reasonable returns for the utility. The foregoing types of information were not included in the staff rate-of-return study. The staff study compares only the earnings of UPS's parent company and of UPS's total operations. The earnings of the parent company and for UPS's total operations have consistently been higher than the returns authorized in prior proceedings or recommended herein for UPS's common carrier operations. It may be noted that UPS's continuous growth in patronage appears to have leveled off. Also, the staff witness concedes that business risks for applicant are no different from prior proceedings. The staff rate-of-return study turns upon itself, as it presents no data except that relating to UPS or its parent. It is not possible to determine from the staff study whether the 11 percent rate of return recommended therein is a maximum or minimum reasonable rate of return for UPS's intrastate common carrier operations.

Based on our conclusions concerning the primacy of operating ratio over rate of return in prior proceedings, that risks have not materially changed and that the company's growth in California has appeared to level off, we reach the ultimate finding that a rate of return within the range heretofore granted to UPS of 10.4 to 12.0 percent will be reasonable herein.

Working Cash

The working cash figure used by applicant was developed by taking 1/12 of test period operating expenses exclusive of the depreciation component of such expense total, modified to conform to the prior decisions' acceptance of a portion of such amount as appropriate for rate-making purposes.

A working cash study was undertaken by the Commission staff engineer. One of the components of working cash used in said study is the minimum bank deposits required to be maintained in order to avoid bank service charges. The record shows that the staff witness failed to give consideration to average float (funds deposited by UPS but not yet collected by the bank) and reserves, which cannot be used by the bank. If these factors are considered, working cash requirement developed by the staff exceeds that claimed by applicant. For the purpose of this proceeding we will adopt applicant's working cash estimate.

State Franchise Taxes

The financial examiner that presented a study of UPS's historical revenue and expenses and adjustments thereto found reasonable in prior proceedings, also recommended that California franchise taxes (corporate income taxes) be computed at the

statutory rate applicable to businesses conducting operations entirely within the state borders. Said method would result in lesser amounts than the allocated portion of taxes incurred by UPS. The statute provides for a three-factor formula called the unitary method for the computation of franchise taxes on businesses which operate in California and in other states.^{3/} Said unitary method must be applied as a matter of law to corporations such as United Parcel Service, Inc.^{4/} This Commission has used a different state franchise tax computation for rate-making purposes than would be incurred by a utility under the unitary method, in order to more nearly relate the amount of such taxes to estimated income from purely intrastate sources.^{5/}

The Commission, in the decision cited in the footnote, stated, "We reaffirm the principle that it is necessary to determine each time the matter comes before the Commission whether or not the payment by respondent of California taxes under then-existing conditions does in fact burden California ratepayers with additional

^{3/} The three allocation factors are: Revenues, property (plant) and wages.

^{4/} Edison California Stores v. McColgan, 30 C. 2d 472.

^{5/} Investigation of The Pacific Telephone and Telegraph Company, Decision No. 76726, dated January 27, 1970, in Case No. 8858, states: "...an adjustment of respondent's tax was required in order to relieve California ratepayers of the burden of assuming taxes on American Telephone and Telegraph's holding company functions..." [Decision No. 67369, 62 Cal. P.U.C. 779, 869 (1964) and Decision No. 74917 (unreported) mimeo page 12.]

tax expense over and above that which would result from payment by respondent of such taxes on a separate return basis." That decision further states that in the proceeding before it the savings in the utility's revenue requirements on the intrastate portion of its business resulting from the filing of a consolidated federal income tax return more than offset the increased state franchise taxes assessed on the unitary basis as opposed to a separate state return.

Applying the principles enunciated in Decision No. 76726, we must first determine whether the unitary method "burdens California ratepayers". In such determination we must apply federal income taxes and state franchise taxes on the same basis; that is, on a "consolidated-return" basis or a "separate-company" basis. Federal income taxes are actually paid on the consolidated return filed by UPS's parent company, while state franchise taxes are actually paid based on the entire 37-state operations of UPS.

The staff accountant recommended that income taxes be computed on the net income from applicant's California intrastate common carrier operations, adjusted to reflect the intrastate portion of: (a) The additional depreciation allowable for taxing purposes over that accrued on the books of applicant and (b) interest expense on the California properties leased by UPS from its affiliate. (Operating expenses were adjusted to substitute ownership costs for lease costs.) The nominal rates of 7 percent for state franchise taxes and 48 percent (plus surcharge) for federal income taxes were applied to said net income.

The unitary method of computing state franchise taxes, as set forth in applicant's studies, provides a greater tax burden than

under the staff method. There would be no offsetting reduction in federal taxes stemming from the filing of a consolidated return. Therefore, we find the unitary method would cast a burden on California intrastate users of UPS's services, and the tax method advocated by the staff will be reasonable in determining test-year operating results.

Test-year Operating Results

The test-year operating results, set forth in the staff's Exhibit 24, adjusted to include in the rate base figure the amount of working cash found reasonable above, are as follows:

TABLE 1

ESTIMATED RESULTS OF OPERATIONS
UNITED PARCEL SERVICE, INC.
CALIFORNIA INTRASTATE CERTIFICATED COMMON CARRIER OPERATION
PROJECTED FOR TWELVE MONTHS COMMENCING JANUARY 1, 1971
AT RATES PROPOSED BY APPLICANT

Operating Revenues	\$51,726,453
Operating Expenses	\$48,521,483
Net Operating Revenue	\$ 3,204,970
<u>Income Taxes</u>	
State	\$ 168,623
Federal	\$ 1,075,344
Total	\$ 1,243,967
Net Revenue After Taxes	\$ 1,961,003
Oper. Exp. After Taxes	\$49,765,450
Oper. Ratio Before Taxes	93.80%
Oper. Ratio After Taxes	96.21%
<u>Value of Oper. Properties</u>	
Depreciated Properties	\$13,692,109
Working Cash	\$ 2,463,788
Rate Base	\$16,155,897
Rate of Return	12.14%

The staff witness proposed an alternate rate structure in order to bring applicant's test-year rate of return in line with that recommended by the staff financial witness of 11 percent.

Applicant's witness also presented exhibits showing the results of operations for a test covering the twelve-month period beginning April 1, 1971, in order that the known wage increases will be reflected in operating expenses for a full year. Applicant argued that the latter test-year more nearly reflects operating conditions which will be encountered by it during the effectiveness of the rates authorized as a result of this decision. Adjustment of the staff operating results in Table 1 to reflect the operating results which will be incurred for the twelve-month period beginning April 1, 1971 (\$49,330,988, Exhibit 19) and the corresponding rate base for such period (\$16,198,133, Exhibit 20), the net operating income would be \$1,465,697, the rate of return would be 9.05 percent and the operating ratio after taxes would be 97.1 percent.

Findings and Conclusions:

1. The last permanent increase proceeding involving applicant's intrastate common carrier wholesale parcel delivery rates culminated in Decision No. 75692, dated May 20, 1969. Said decision found that an operating ratio after income taxes of 95.67 percent and a rate of return of 12.0 percent under proposed rates were reasonable for said carrier. Said operating results are based on April 1, 1969, cost levels.

2. Since the issuance of Decision No. 75692, applicant has incurred increases in operating expenses, principally wage costs.

3. Applicant has been granted interim rate increases to offset labor costs in Decision No. 77275, dated May 22, 1970, in Application No. 51871, and in Decision No. 78549, dated April 14, 1971, in this proceeding. Applicant's operations for the year commencing January 1, 1971, at the level of interim rates granted in Decision No. 77275 would result in a loss.

4. For the purposes of determining a permanent level of rates in this proceeding, the operating results set forth in Table 1, as modified in the accompanying text providing an operating ratio after income taxes of 97.17 percent and a rate of return of 9.05 percent under proposed rates, reasonably represent the results of operation by applicant for a rate-year commencing April 1, 1971, under applicant's proposed rates.

5. No shipper opposed the granting of the authority sought by applicant.

6. The increases resulting from the establishment of proposed rates of 39 cents per package and the per pound rates granted on an interim basis are justified.

7. In proceedings in Cases Nos. 5432, 5435, 5439, and 5441, the Commission has heretofore found that for certain types of wholesale parcel delivery service, applicant is the rate-making carrier for the purpose of establishing minimum rates, and has included in certain minimum rate tariffs rates for wholesale parcel delivery on the same level as those maintained by United Parcel Service, Inc., as a highway common carrier.

8. The just, reasonable and nondiscriminatory minimum rate for wholesale parcel delivery service is, and for the future will be, the per package and per pound rates authorized herein to United Parcel Service, Inc.

9. The relationship between applicant's rates and said rates of other common carrier rates should be continued and maintained. (See Decision No. 72918, dated August 15, 1967, in Case No. 5432.)

Conclusions

We conclude that:

1. United Parcel Service, Inc., should be authorized to establish the rates proposed herein, on five days' notice.

2. Minimum Rate Tariffs 1-B, 2, 9-B and 19 should be amended by separate order to reflect the wholesale parcel delivery rates authorized to United Parcel Service, Inc., herein.

3. Common carriers now maintaining, under outstanding authorizations permitting the alternative use of common carrier rates, parcel delivery rates comparable to the rates of United Parcel Service, Inc., but otherwise below the minimum rates established by the Commission, should be authorized and directed to increase such rates, to the level of the increased rates of United Parcel Service, Inc., authorized herein, or to the level of the minimum rates specified and established in the minimum rate tariffs, whichever is the lower.

4. Common carriers should be authorized to continue to depart from the long- and short-haul provisions of Section 460 of the Public Utilities Code to the extent necessary to establish the rate increases provided for in the preceding paragraphs.

FINAL ORDER

IT IS ORDERED that:

1. United Parcel Service, Inc., is authorized to establish the following increased rates and charges:

Amend Item No. 120-E of Local Parcel Tariff P.U.C. No. 17 by canceling paragraphs (a) and (b) of said Item and substituting therefor the following paragraphs:

- (a) The rate for packages moving wholly within Territory A, wholly within Territory B, or wholly within territory C, as described in Item 25, shall be 39 cents per package plus 3 1/2 cents for each pound or fraction thereof of its weight.
- (b) The rates for all packages, except packages covered by paragraph (a) above, shall be 39 cents per package plus the following rates for each pound or fraction thereof of its weight.

<u>Zone</u>	<u>Rate Per Pound or Fraction Thereof</u>
2	4 1/2 ¢
3	5 1/2 ¢
4	7 1/2 ¢
5	9 1/2 ¢

(To determine the applicable zone between any two California points, consult governing publication referred to in Item 10 hereof.)

2. Tariff publications authorized to be made as a result of the order herein may be made effective not earlier than five days after the effective date hereof on not less than five days' notice to the Commission and to the public.

3. The authority hereinabove granted shall expire unless exercised within ninety days after the effective date of this order.

4. Common carriers maintaining, under outstanding authorizations permitting the alternative use of common carrier rates, parcel delivery rates comparable to the rates maintained by United Parcel Service, Inc., but otherwise less than the minimum rates established by the Commission applicable thereto, are authorized and directed to increase such rates to the level of the rates authorized in paragraph 1 hereof, or to the level of the minimum rates specified and established in the Commission's minimum rate tariffs whichever is the lower. Tariff publications authorized and required to be made by common carriers as a result of the order herein may be made effective not earlier than the fifth day after the effective date of this order, on not less than five days' notice to the Commission and to the public, and shall be made effective not later than July 31, 1971.

5. Common carriers, in establishing and maintaining the rates authorized hereinabove, are hereby authorized to depart from the provisions of Section 460 of the Public Utilities Code to the extent necessary to adjust long- and short-haul departures now maintained

under outstanding authorizations; such outstanding authorizations are hereby modified only to the extent necessary to comply with this order; and schedules containing the rates published under this authority shall make reference to the prior orders authorizing long- and short-haul departures and to this order.

The effective date of this order shall be ten days after the date hereof.

Dated at San Francisco, California, this 27th
day of JUNE, 1971.

[Signature]
Chairman
William J. Hyman
[Signature]
Vernon L. Stinson
[Signature]
Commissioners