

Decision No. 84537**ORIGINAL**

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. 55317
(Filed November 15, 1974;
amended March 28, 1975)

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

Case No. 5432, OSH 837
(Filed January 14, 1975)

And Related Matters.

Case No. 5439, OSH 241
Case No. 5441, OSH 330
(Filed January 14, 1975)

Irving R. Segal and Roger L. Ramsey, Attorneys at Law, for United Parcel Service, Inc., applicant.
William J. Jennings and Elmer Sjostrom, Attorneys at Law, Clyde T. Neary, John F. Specht, and A. L. Gielegem, for the Commission staff.

SECOND INTERIM OPINION

United Parcel Service, Inc. (UPS), a highway common carrier, seeks authority under Sections 454 and 491 of the Public Utilities Code to establish on less than statutory notice certain increased

rates applicable to its intrastate common carrier parcel delivery service between points in California.

Interim Decision No. 84012 dated January 21, 1975 authorized UPS to increase its rates as follows:

- (a) Amend Item 45 of Local Parcel Tariff Cal. P.U.C. No. 18 by establishing a charge of 75 cents for correction of wrong addresses.
- (b) Amend Item 80-A of said tariff by establishing a charge of 75 cents for each C.O.D. received for collection.
- (c) Amend Item 150-D of said tariff by establishing a rate per package of 55 cents.

The relief sought in the application as filed is shown in the margin.^{1/}

Public hearing was held before Commissioner Symons and Examiner Mallory on April 8 and 9, 1975, and the matter was continued to June 30, 1975. On March 28, 1975 UPS filed an amended application seeking additional relief. The amendment states that such filing was made upon receiving advice that the Commission staff would not be ready to proceed at the hearing beginning April 8, and would request adjournment to a later date. The test year used in the original filing was the year ended June 30, 1974. As indicated in

^{1/} Applicant originally sought authority to make the following tariff changes:

- a. Amend Item No. 45 of Local Parcel Tariff Cal. P.U.C. No. 18 by increasing the charge for correction of wrong addresses from 65 cents to 85 cents.
- b. Amend Item No. 80-A of Local Parcel Tariff Cal. P.U.C. No. 18 by increasing the charge for each C.O.D. received for collection from 65 cents to 85 cents.
- c. Amend Item No. 150-D of Local Parcel Tariff Cal. P.U.C. No. 18 by increasing the rate per package from 45 cents to 60 cents.

Decision No. 84012, the labor agreement covering UPS's drivers and helpers in Southern California was in negotiation. The amendment recites that the wage rates and fringe benefits contained in the offer made by UPS to the union were rejected and that a three-week strike ensued before final agreement was reached. That agreement contained higher wage rates than UPS's offer. The exhibits attached to the original application reflected the offer rather than wage rates included in the agreement. The amendment states that because of the higher wage rates for its Southern California employees than originally requested and because of delay in concluding this matter, the test year used by applicant was revised to show estimated operating results for the year ending June 30, 1976, and additional rate relief was sought.

The rate relief requested in the amendment is as follows:

1. Authorization for the balance of the relief sought in the original application and not granted in Decision No. 84012, that is:
 - (a) 5 cents per package.
 - (b) 10 cents for each C.O.D. handled.
 - (c) 10 cents for each address correction.
2. Authorization to increase the rate per pound to five cents for each territory or zone, except Zone 2.

Evidence in support of the requested rate relief was presented by the controller for the Pacific Region of United Parcel Service, Inc. The witness explained that United Parcel Service, Inc. operates in several states. In California, UPS conducts a specialized common carrier service for the transportation of small packages from other than retail stores (the service for which increased rates are sought herein). In addition, UPS conducts retail store delivery operations in the metropolitan areas of San Francisco and Los Angeles as a contract carrier, and pickup and delivery of interstate shipments transported by United Parcel Service Company, an airfreight forwarder.

Both UPS and United Parcel Service Company are wholly owned subsidiaries of United Parcel Service of America, Inc.

The witness testified that buildings and other plant facilities used by UPS in its operations are leased from subsidiaries of Service Plants Corporation which, in turn, is a subsidiary of United Parcel Service of America.

The witness testified that in arriving at the expenses for UPS's California intrastate common carrier operations, it is necessary to allocate joint operating expenses incurred in UPS's contract carrier operations and pickup and delivery operations for its freight forwarder affiliate, as well as the common carrier service. The witness stated that the methods of allocating operating expenses were the same as those used by it in prior proceedings. Operating rents for facilities leased by UPS from its affiliate were eliminated and so-called landlord or ownership costs were substituted therefor, in order to eliminate any element of profit in transactions between affiliates.

The witness testified that management fees covering expenses for legal, accounting, personnel, and other services incurred on behalf of all affiliates are charged to the affiliates. The charge on UPS's books for the management fee in the base year used in the exhibits developed for the amendment to the application (year ended June 30, 1974) was based on 4.5 percent of gross revenue. For rate-making purposes, the witness substituted a value based on 2.2 percent of total operating expenses. That percentage is the ratio that the total operating expenses for UPS's intrastate common carrier services bear to total operating expenses of all subsidiaries of the parent corporation to which a charge is made for management services. In the base and test year operating results developed by the witness, the depreciation expense for revenue equipment and plant equipment is adjusted on a remaining-life basis to reflect the service lives for

such equipment found reasonable for ratemaking purposes in the last proceeding involving UPS rates (Decision No. 83217 dated July 30, 1974 in Application No. 54517).

The witness adjusted base year operating revenues to reflect the increases resulting from Decisions Nos. 83217 and 84012, and prior decisions on a full-year basis. Operating expenses were adjusted to show on a full-year basis the additional costs that would have been incurred for wage and fringe benefits which became effective in the test year and before. Related adjustments were made in management expense and regulatory fees.

The following table summarizes applicant's estimate of operating results for a test year ending June 30, 1976 developed by adjusting revenues and expenses for the base year ended June 30, 1974 in the manner described above:

TABLE 1

UNITED PARCEL SERVICE, INC.

CALIFORNIA INTRASTATE COMMON CARRIER OPERATION

Income Statement
Projected for Year Ending June 30, 1976
To Show Increased Expenses
And Proposed Rate Increase
(Exhibit 15)

| | <u>At Interim Rates</u> | <u>At Rates Proposed in Amended Application</u> |
|------------------------|-----------------------------|---|
| Revenues | \$83,261,406 | \$89,270,175 |
| Operating Expenses | 81,536,390 | 81,556,399 |
| Income Taxes | 244,818 | 3,399,697 |
| Net Income | 1,480,198 | 4,314,079 |
| <u>Operating Ratio</u> | | |
| Before Income Taxes | 97.92% | 91.36% |
| After Income Taxes | 98.22% | 95.17% |

The witness testified that the projection in Table 1 (above) does not give effect to increases in nonpayroll operating expenses, nor does it reflect the increased level of traffic expected to be achieved by UPS in the test year. The following table sets forth the data in Table 1 adjusted to give effect to an estimated increase of 9.54 percent in nonpayroll expenses and a 9 percent increase in traffic in the test year over the base year and related increases in depreciation expenses and management fees:

TABLE 2

UNITED PARCEL SERVICE, INC.

CALIFORNIA INTRASTATE COMMON CARRIER OPERATION

Income Statement

Projected for 12 Months Commencing July 1, 1975
 Adjusted to Show Results of Proposed Rate Increase
 And the Effect of Assumed Increase in
 Volume, And Increase in Nonpayroll Expense (Excluding
 Business Service Fee)

(Exhibit 16)

| | (1) Table 2 Column 2 | (2) Projection (Note 1) |
|-------------------------------------|----------------------------|-------------------------------|
| Packages | 68,655,732 | 76,000,000 |
| Operating Revenue | \$89,270,175 | \$98,822,800 |
| <u>Operating Expenses</u> | | |
| Payroll and Fringe Benefits | \$63,476,499 | \$70,269,600 |
| Nonpayroll expense | 14,984,324 | 18,171,600 |
| Depreciation Expense | 893,280 | 988,760 |
| Business Service Expense | <u>1,745,790</u> | <u>1,967,459</u> |
| Total Expense | \$81,099,893 | \$91,397,419 |
| Net Operating Revenues | \$8,170,282 | \$7,425,381 |
| <u>Income Taxes</u> | | |
| State | \$ 695,568 | \$ 627,255 |
| Federal | <u>2,944,616</u> | <u>2,613,071</u> |
| Total Income Taxes | \$3,640,184 | \$3,240,326 |
| Net Income | \$4,530,098 | \$4,185,055 |
| Operating Ratio Before Income Taxes | 90.85% | 92.49% |
| Operating Ratio After Income Taxes | 94.93% | 95.77% |

(Continued)

TABLE 2
(Continued)

Note 1:

Packages - Assumed intrastate volume for 12 months ending June 30, 1976.

Revenue - Assumed intrastate volume times Column 1 average revenue per package.

Expense - Payroll and Fringes - Assumed intrastate volume times Column 1 average payroll and fringe benefit expense per package.

Nonpayroll Expense - Reflects result of increasing Column 1 expense per package by 9.54% based on average increase in intrastate nonpayroll expense per package over last 4-year period, and multiplying by 76 million packages.

Depreciation Expense - Assumed intrastate volume times Column 1 average depreciation expense per package.

Business Service Expense - 2.20% of payroll, nonpayroll, and depreciation expense.

The witness presented the following development of operating properties as of December 31, 1975, representing the midpoint in the rate year for the purpose of developing an average or midyear rate base:

TABLE 3

UNITED PARCEL SERVICE, INC.

CALIFORNIA INTRASTATE COMMON CARRIER OPERATION

List of Operating Properties
As of December 31, 1975 (See Note A)
(Exhibit 17)

| | <u>Cost</u> | <u>Depreciation</u> | <u>Book Value</u> |
|------------------------------------|----------------|---------------------|-------------------|
| Land and Structures | \$16,041,062 | \$ 1,907,207 | \$14,133,855 |
| Revenue Equipment | 19,798,718 | 8,586,391 | 11,212,327 |
| Plant Equipment | 15,465,363 | 5,430,914 | 10,034,449 |
| Improvements to Leasehold Property | 4,425,904 | 476,068 | 3,949,836 |
| Materials and Supplies | <u>422,428</u> | <u>-</u> | <u>422,428</u> |
| | \$56,153,475 | \$16,400,580 | \$39,752,895 |

Note A: Facilities leased from related companies included on an "as-owned" basis. Depreciation computed on a remaining-life basis, using depreciation lives found reasonable in Decision No. 83217.

The witness also developed in Exhibit 19 a working cash analysis for its intrastate operation for the year ended June 30, 1974 using the methods described in the Standard Practice U-16-Determination of Working Cash Allowance, promulgated by the Commission's Utilities

Division.^{2/} Exhibit 18, summarized in Table 4 below, sets forth applicant's estimated rate of return in the test year under rates proposed in the amended application:

TABLE 4

UNITED PARCEL SERVICE, INC.

CALIFORNIA INTRASTATE COMMON CARRIER OPERATION

Summary of Earnings
For 12 Months Commencing July 1, 1975

| | |
|---|------------------|
| Depreciated Value of Operating Properties (Table 3) | \$39,752,895 |
| Provision for Working Cash (Exhibit 19) | <u>2,558,883</u> |
| Rate Base | \$42,311,778 |
| Net Income Per Column 2 of Table 2 (above) | \$ 4,185,055 |
| Rate of Return | 9.9% |

The witness testified that the above rate of return is below a maximum reasonable rate of return.

As heretofore indicated, the Commission staff studies were not available at the time of hearing. The staff advised that its studies could not be ready for presentation before June 23, 1975. UPS objected to a postponement of the hearing for that length of time because any further rate relief justified herein could not become effective until well into the test year used by applicant, and because the need for additional relief is urgent. In the circumstances, the staff recognized that some provision for further relief would be appropriate pending further hearing. The staff stated that its analysis indicated that a rate increase designed to

^{2/} The working cash requirement developed in this manner is \$2,558,883. This compares with the working cash allowance of \$3,868,210 set forth in the adopted results of operations in Table 7 of Decision No. 83217.

produce additional revenues of \$2,700,000 would not be unreasonable. The staff recommended that if such relief is granted it be obtained by raising the package rates by 4 cents per package. UPS stated that it preferred an early hearing to any further interim relief; however, if the hearing dates are not advanced, interim relief should be accorded through the granting of the balance of relief sought in the original application.

Discussion

Applicant has presented its case in chief and cross-examination has been conducted. At this time we do not know whether the staff studies, when completed, will produce results which are materially different from applicant's estimates. Applicant has used all ratemaking adjustments and allocations found reasonable in prior Commission orders. A new working cash study was made by applicant in accordance with suggestions in Decision No. 83217. The Commission recognizes that applicant's operations are labor intensive (rather than capital intensive) inasmuch as wages, fringe benefits, and payroll taxes comprise about 75 percent of total operating expenses. Under union contracts with its employees, applicant has experienced wage increases under its Southern California agreement retroactive to November 1, 1974, and will experience a labor cost increase under its Northern California contract on July 1, 1975. The wage contracts provide for yearly increases in wage rates in stated amounts plus cost of living increases which are scaled to the Cost of Living Index prepared by the United States Department of Labor. The current Southern California hourly wage (including fringe benefits) is \$9.965 compared with the corresponding wage of \$8.682 effective in the prior year. On July 1, 1975 the Northern California hourly wage (including fringe benefits) will be \$10.062 compared with the current wage of \$9.424.

Based on applicant's showing the following would be the test year operating results if the balance of the rate increases originally sought is authorized:

TABLE 5

UNITED PARCEL SERVICE, INC.

Estimated Revenues, Expenses, and Rate of
Return for a Test Year Ending June 30, 1976
At Rates Sought in Original Application

| | <u>Traffic Volume In Base Year*</u> | <u>Traffic Volume Estimated for Test Year</u> |
|-------------------------------|---|---|
| Packages | 68,655,732 | 76,000,000 |
| Operating Revenue | \$86,989,706 | \$96,292,000 |
| <u>Operating Expenses</u> | | |
| Payroll and Fringe Benefits | \$63,476,499 | \$70,269,700 |
| Nonpayroll Expense | 14,977,488 | 18,164,000 |
| Depreciation Expense | 893,280 | 988,760 |
| Business Service Expense | <u>1,745,640</u> | <u>1,967,294</u> |
| Total Expense | \$81,092,907 | \$91,389,754 |
| Net Operating Revenues | \$5,896,799 | \$4,902,246 |
| <u>Income Taxes</u> | | |
| State | \$ 501,228 | \$ 416,691 |
| Federal | <u>2,104,273</u> | <u>1,749,366</u> |
| Total Income Taxes | \$2,605,501 | \$2,166,057 |
| Net Income | \$3,291,298 | \$2,736,189 |
| Operating Ratio (After Taxes) | 96.2% | 97.2% |

* Basic year ended June 30, 1974.

Based on the rate base components set forth in Table 4 (above) the estimated rate of return on the net income in Column 2 of Table 5 (above) is 5.12 percent.

Findings

1. Applicant was last authorized on a permanent basis to increase its rates and charges for its California intrastate common carrier package service pursuant to Decision No. 83217 dated July 30, 1974 in Application No. 54517. That decision was based on estimated operating revenues, expenses (including taxes and depreciation), rate base, rate of return, and operating ratio under the rates authorized therein for a test year ended December 31, 1974.
2. Application No. 55317 was filed by UPS on November 15, 1974.
3. Ex parte Decision No. 84012 dated January 21, 1975 authorized interim increases in rates estimated to result in an annual revenue increase of \$7,161,086 pending hearing.
4. On March 28, 1975 amendment was made to Application No. 55317 seeking additional rate increases.
5. Public hearing was held on April 8 and 9, 1975 at which evidence in support of the application was presented by UPS.
6. At the hearing the Commission staff indicated that it planned to make detailed studies of applicant's books and records, and of its operating practices. The staff indicated that its studies would not be ready for presentation until June 23, 1975.
7. Applicant objected to the delay in submission of the proceeding, urging that it required rate relief on or before the onset of the test year used in projecting its revenue requirements. That test year begins July 1, 1975.
8. The Commission staff indicated that increased revenues in the approximate amount of increased wages estimated to amount to \$2,700,000 would be appropriate pending submission of this proceeding. The staff recommended that such increase be achieved by raising package charges by 4 cents.

9. Applicant requested that if an offset is granted pending receipt of staff evidence, the balance of the request in the original application be granted in order to simplify explanation of the adjustment to its 45,000 shippers in California. Such adjustment would produce approximately \$3,728,000 in added revenue.

10. Table 5 sets forth estimated test year operating results reflecting the granting of the balance of the rate increase sought in the original application. Those operating results indicate that under the increased traffic volume expected in the test year, UPS's California intrastate common carrier operations would experience an operating ratio (after taxes) of 97.2 percent and a rate of return of 5.12 percent. Such operating ratio and rate of return would not produce excessive earnings.

11. Further increases in rates to the level sought in the original application are justified pending final decision herein.

Conclusions

1. A further offset increase in rates should be granted as found reasonable above. The increase should be made effective July 1, 1975.

2. The application, as amended, should be scheduled for further hearing as indicated in the Commission's Daily Calendar.

3. Minimum Rate Tariffs 1-B, 2, 9-B, and 19 should be amended by separate order to reflect the increased wholesale parcel delivery rates authorized herein, and common carriers now maintaining parcel delivery rates comparable to the rates of applicant but otherwise lower than the established minimum rates should be authorized and directed to increase such rates to the level of the rates authorized to UPS herein in order to maintain competitive relationships.

SECOND INTERIM ORDER

IT IS ORDERED that:

1. United Parcel Service, Inc. is authorized to establish the following increased rates and charges in its Local Parcel Tariff Cal. P.U.C. No. 18:

- (a) Amend Item No. 45-A by increasing the charge for correction of wrong addresses to 85 cents.
- (b) Amend Item No. 80-B by increasing the charge for each C.O.D. received for collection to 85 cents.
- (c) Amend Item 150-E by increasing the charge per package to 60 cents.

2. Tariff publications authorized to be made as a result of the order herein may be made effective not earlier than July 1, 1975 on not less than five days' notice to the Commission and to the public.

3. The authority granted herein shall expire unless exercised within ninety days after the date hereof.

The effective date of this order shall be June 26, 1975.

Dated at San Francisco, California, this 10th day of JUNE, 1975.

Vernon L. Sturgeon
President
William Symons
Edward H. H. H.
Edward H. H. H.
Edward H. H. H.
Commissioners