Decision No. 87876 SEP 20 1977

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. 56871 (Filed November 12, 1976)
In the Matter of the Investigation for the purpose of considering and determining minimum rates for transportation of any and all commodities statewide, including, but not limited to, those rates which are provided in Minimum Rate Tariff 2 and the revisions or reissues thereof.	Case No. 5432, OSH 946 (Filed February 1, 1977)
And Related Matters.	Case No. 5439, OSH 302 Case No. 5441, OSH 384 (Filed February 1, 1977)

(Appearances are shown in Decision No. 87283.)

FINAL OPINION

In Application No. 56871, United Parcel Service, Inc. (UPS) seeks authority to increase certain of its rates for common carrier parcel delivery service between points in California as follows:

Movements Wholly Within Local Drayage Area A, B, or C	Present Rates	Proposed Rates
Per Package	60¢	70¢
Per Pound	5	5.9

(Continued on next page)

All Other Movements Throughout California	Present Rates	Proposed Rates
Per Package	66¢	70¢
Per Pound		
Zone 2	6.0	6.4
Zone 3	7.7	8.2
Zone 4	9.9	10.6
Zone 5	12.1	12.9
Overall California Intrastate Revenue per Package	141.0¢	154.3¢
Percent Increase Sought		9.4%

The proposed rates are designed to produce additional annual revenues of $10,616,000.

Orders Setting Hearing in Cases Nos. 5432, 5439, and 5441 state as follows:

> "Various minimum rate tariffs published by the Commission contain provisions for the alternative application of common carrier rates which may be applied in lieu of the minimum rates when such common carrier rates produce a lower aggregate charge for the same transportation than results from the application of the minimum rates. Accordingly, hearings in the several minimum rate investigation cases should be held with the hearings in Application 56871 for the purpose of determining whether common carriers maintaining, under outstanding authorizations permitting the alternative use of common carrier rates, rates below the specific minimum rate levels otherwise applicable, should be authorized and directed to increase such rates to the level of the rates established by United Parcel Service, Inc. pursuant to decision in said Application 56871, or to the level of the specific minimum rates, whichever is lower."

The Orders Setting Hearing were consolidated for hearing with Application No. 56871.

Public hearing in the consolidated proceeding was held on February 24, 1977 at which evidence in support of the relief sought was presented by UPS. The Commission staff, not having completed its investigation, was not prepared to present its evidence. The matters were adjourned to May 17, 1977 for receipt of the staff evidence.

Because of the time lag between the filing of the application and date of the adjourned hearing, partial general relief was granted in the amount of the requested increase less two cents per package by Decision No. 87283 dated May 3, 1977. Based on an estimated volume of 80,000,000 packages in the 1977 test year used by UPS, the increased annual revenue granted by Decision No. 87283 is $9,016,000. The increase granted by Decision No. 87283 will be referred to hereinafter as the "interim increase".1/

The Commission concluded in Decision No. 87283 that 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 in order to maintain competitive relationships.

1/ Decision No. 87283 states:

"Interim rate relief has specific significance to the Commission and to the California Supreme Court. It should only be authorized in those instances wherein an applicant has established to the Commission's satisfaction that an emergency financial situation exists which requires granting rate relief pending any further showing. Here, such an emergency has not been established. However, applicant has made its initial case and that case has been tested by cross-examination. In the absence of persuasive objection, there is no reason why partial relief may not now be granted to applicant. Such partial general rate relief should be granted."

The minimum rates for parcel delivery service set forth in Item 265 of Minimum Rate Tariff 2 (MRT 2), Item 850 of Minimum Rate Tariff 1-B (MRT 1-B), Item 420 of Minimum Rate Tariff 9-B (MRT 9-B), and Item 425 of Minimum Rate Tariff 19 (MRT 19) were established to meet the rates published and maintained by UPS based on findings in prior decisions that UPS was the ratemaking carrier in the parcel delivery field. The rates in those tariff items historically were raised to the levels authorized to UPS in order to maintain parity with UPS rates. The parcel delivery rates in the above-named minimum rate tariff items are lower than the minimum charges otherwise applicable. The Commission has not raised the minimum parcel delivery rates to the levels authorized to UPS in Decision No. 87283. As no discussion for such action is contained in that decision, the parties were not made aware of the rationale underlying the Commission's determination that the minimum parcel rates should not be concurrently increased to the level granted to UPS.

Further public hearing was held before Administrative Law Judge Mallory at San Francisco on May 17 and 18, 1977, and the matters were submitted. The evidence of the Commission staff was presented by witnesses appearing for its Finance Division and its Transportation Division. Rebuttal to the staff's presentation was presented by UPS. In a statement, California Trucking Association requested that the parcel delivery rates in MRTs 2, 1-B, 9-B, and 19 be increased to the level authorized to UPS in Application No. 56871. No evidence directed to that request was presented by any party to the proceeding.

<u>Background - Revenue and Expense Determinations</u>

UPS 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). 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.

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, Inc.

In arriving at the expenses for UPS's California intrastate common carrier operation, it is necessary to allocate joint operating expenses incurred in UPS's contract carrier operations and the pickup and delivery operations of its freight forwarder affiliate, as well as the expenses incurred by the common carrier service. 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.

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 is based on 4.5 percent of gross revenue. For ratemaking purposes, that percentage has been adjusted downward, to 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.

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 Decision No. 83217 dated July 30, 1974 in Application No. 54517.

As in prior proceedings, operating expenses are 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. Test year operating revenues are determined by adjusting historical year operating revenues to include on a full-year basis any increases granted to UPS that are not included in such historical operating revenues, or which are included only on a partial-year basis. UPS historically has experienced a year-to-year increase in its California intrastate traffic volume. In determining test year operating results, operating expenses and operating revenues under present and proposed rates are reduced to a per-package basis and the per-package revenues and expenses are expanded by the estimated increase in number of packages to be handled in order to determine test year operating results reflective of the estimated increased traffic volume.

Prior to this proceeding, the last rate increase authorized to UPS was pursuant to Decision No. 85186 dated December 2, 1975 in Application No. 55317. That decision found as follows:

> "6. Over the last six years, we have authorized UPS to increase its rates based on adopted results of operations which produce operating ratios (after taxes) ranging between 95.67 percent to 97.17 percent, and rates of return ranging from 8.92 percent to 12.0 percent.
>
> "7. We authorize as reasonable the operating ratio of 95.58 percent and the rate of return of 10.87 percent set forth in Adopted Results of Operations Table 6. Such allowance is reasonably within the range previously granted to UPS and will not produce excessive earnings for UPS's intrastate common carrier operation."

UPS's Showing

UPS's showing, as presented at the hearings held in February 1977 and set forth in Decision No. 87283, is repeated in part herein for the purpose of comparison with staff data.

Management fees reflected on UPS's books in the base year used in its presentation (year ended June 30, 1976) were based on 4.5 percent of gross revenue. For ratemaking purposes UPS substituted a value based on 2.51 percent of total operating expenses.

In other respects, UPS followed the methods found reasonable in prior proceedings, as more fully described under the proceeding heading, in determining its estimated test year operating results.

The following is UPS's estimated operating results for a test year ending December 31, 1977. Column 1 represents historic data for the year ended June 30, 1976 adjusted for increased revenues resulting from higher rates authorized on an interim basis and adjusted expenses reflecting increased wages and related payroll expense. Column 2 adjusts the data in Column 1 to show the increased revenues from the greater package volume expected in the test year and to show the estimated increases in nonpayroll expenses (excepting business service expense).

TABLE 1

UNITED PARCEL SERVICE, INC.

California Intrastate Common Carrier Operation
Income Statement
Projected for Twelve Months Commencing January 1, 1977
Showing Results of Interim Rate Increase (Column 1)
And the Effect of Estimated Increase in Volume (Column 2)

Item	(1) Projected Year Results On Base Year Volume Level (Note 1)	(2) Projected Year Results With Estimated Increase In Volume (Note 2)
Packages	72,203,495	80,000,000
Operating Revenue	$109,973,912	$121,848,000
Operating Expenses		
Payroll and Fringe Benefits	$ 77,409,738	$ 85,768,000
Non-Payroll	21,668,950	24,008,000
Depreciation Expense	2,445,450	2,445,450
Business Service Expense	2,548,256	2,816,758
Total Expense	$104,072,394	$115,038,208
Net Operating Revenues	$ 5,901,518	$ 6,809,792
Income Taxes		
State	$ 438,177	$ 519,922
Federal	1,412,888	1,809,622
Total Income Taxes	1,851,065	2,329,544
Net Income	$ 4,050,453	$ 4,480,248
Operating Ratio Before Income Taxes	94.63	94.41
Operating Ratio After Income Taxes	96.32	96.32

Note 1: Base year is the year ended June 30, 1976.

Note 2: Estimated intrastate volume for 12 months ending December 31, 1977.

The following table depicts the estimated rate of return under proposed interim rates using the data set forth in UPS's Exhibit 13:

TABLE 2

UNITED PARCEL SERVICE, INC.

California Intrastate Common Carrier Operation
Summary of Earnings
For Twelve Months Commencing January 1, 1977

Depreciated Value of Operating Properties (Exhibit 12)	$44,378,440
Provision for Working Cash	3,633,735
Rate Base	48,012,175
Net Income per Table 1 - Column 2	4,480,248
Rate of Return under Interim Rates	9.3%

The following table sets forth UPS's estimates of test year operating revenues and expenses under the full amount of the increases sought in Application No. 56871. (Exhibits 13 and 14.)

TABLE 3

United Parcel Service, Inc.

California Intrastate Common Carrier Operation
Income Statement
Projected for Twelve Months Commencing January 1, 1977
Showing Results of Proposed Rate Increase (Column 1)
And the Effect of Estimated Increase in Volume (Column 2)

	(1) Projected Year Results on Base Year Volume Level	(2) Projected Year Results With Estimated Increase in Volume
Packages	72,203,495	80,000,000
Operating Revenue	$111,417,982	$123,448,000
Operating Expenses		
Payroll and Fringe Benefits	77,409,738	85,768,000
Non-Payroll	21,668,950	24,008,000
Depreciation Expense	2,445,450	2,445,450
Business Service Expense	2,548,256	2,816,758
Total Expense	104,072,394	115,038,208
Net Operating Revenues	7,345,588	8,409 792
Income Taxes		
State	568,143	663,922
Federal	2,043,658	2,508,502
Total Income Taxes	2,611,801	3,172,424
Net Income	4,733,787	5,237,368
Operating Ratio before Income Taxes	93.41	93.19
Operating Ratio after Income Taxes	95.75	95.76
Rate Base (Table 2)	48,012,175	48,012,175
Rate of Return	9.9%	10.9%

(Continued)

TABLE 3
(Continued)

Note 1:

Packages: Estimated Intrastate Volume for 12 months ending December 31, 1977.

Revenue : Estimated Intrastate Volume multiplied by Average Revenue per package in Column 1 (80,000,000 x $1.5431).

Expense : Payroll and Fringes - Estimated Intrastate Volume multiplied by Average Payroll and Fringe Benefit Expense per package in Column 1 (80,000,000 x $1.0721).

Non-Payroll - Estimated Intrastate Volume multiplied by Average Non-Payroll Expense per package in Column 1 (80,000,000 x $.3001).

Depreciation Expense - Same amount as estimated for Projected Year Results in Column 1.

Business Service Expense - 2.51% of Payroll, Non-Payroll, and Depreciation Expense ($112,221,450 x 2.51%).

Finance Division Evidence

Exhibit 16 contains the report of the Commission's Finance Division study of applicant's operations.

The report states that the examination of the accounting and financial records of UPS and its affiliates included a review of UPS's methods and procedures, and the use of auditing techniques and tests of accounting records considered necessary. The report presents the results of the staff's examination of UPS's accounting records for the fiscal year ended June 30, 1976. The data contained in the books and records were adjusted to reflect ratemaking adjustments found proper in prior decisions. Rent for facilities leased from affiliates was deleted and ownership costs were substituted; depreciation for revenue plant and equipment was revised to reflect the service lives found reasonable in Decision No. 83217 dated July 30, 1974 in Application No. 54517, and business service expense was reduced from 4.5 percent to 2.57 percent of operating expense.[2]

2/ The above-described ratemaking adjustments were also made in UPS's test year estimates in Table 3.

Based on its current examination, the staff recommended that further adjustments be made.

The principal adjustments relate to business service expense and to depreciation expense for revenue equipment.

Business Service Expense

The parent company of UPS, United Parcel Service of America, Inc. (America), performs management functions on behalf of all subsidiaries. The expense for such services are recorded on the book of subsidiaries based on 4.5 percent of gross revenues. In past proceedings, that expense has been assigned to UPS, for ratemaking purposes, based on the relationship of UPS's total operating expenses (exclusive of business service expense) to the total operating expenses of all America's subsidiaries. On such basis, business service expense represents 2.51 percent of UPS's operating expense for the historical period.

The total business expense for the historical year ended June 30, 1976 was $40,595,168. Included in that amount were expenses incurred for the movement of America's headquarters from New York City to Greenwich, Connecticut, in the amount of $923,341. The staff report states that the benefits of this move will accrue to UPS for many years. The report recommends that the cost be amortized over a period of ten years, rather than be charged to current operating expenses. The staff adjustment to business service expense removed the charge to current expenses of $923,341 and substituted one-tenth of that amount ($92,334) as the amortized portion of that total amount to be charged to current expenses.

Also included in business service expenses are the start-up costs of initiating operations in the states of Montana, Utah, Idaho, Arizona, and Nevada in the amount of $3,434,001. A cadre of personnel from established districts was assigned to establish pickup and delivery routes and to train drivers, sorters, and office personnel in connection with the commencement of service within the newly certificated area. Start-up costs in the amount of $3,434,001 were excluded from business service expense for the reason that the staff witness concluded that the start-up costs are unrelated to UPS's California operations.

UPS rents its operating properties from an affiliated company. The accounting services related to the rental activity are separately identified in America's books of accounts. The staff excluded from business service expense accounting service charges of $235,065 and in lieu thereof, substituted in historical year operating expenses an amount of $33,403, representing an allocation of cost based on the number of rental units in California.

The staff also excluded from business service expense dues paid to non-qualifying organizations under Pacific Tel. & Tel. Co. (1964) 62 CPUC 775. In that decision the Commission found that donations and contributions to charitable, social, and community welfare organizations should be excluded from operating expenses and should be below-the-line charges borne by stockholders.

UPS challenged the accounting adjustments to business service expense related to headquarters moving expenses and start-up costs for its new mountain states operations. UPS did not dispute the adjustments regarding accounting service charges on properties rented from affiliates, or non-qualifying expenses for dues and donations.

Depreciation of Revenue Equipment

The staff financial examiner recommended that the service lives of automotive equipment adopted for ratemaking purposes in Decision No. 83217 in Application No. 54517 be reevaluated by extending such lives to the actual retirement ages of such equipment.

The Commission, in Decision No. 83217, adopted for ratemaking purposes a service life of 15 years for vans and 12 years for tractors and trailers, based on a study of a staff transportation engineer received as Exhibit 20 in Application No. 54517. The salvage value of each equipment class is 10 percent.

The staff financial witness analyzed the retirement ages of UPS's vans and tractor-trailer units in the three California districts for the years 1967 through 1976. That study showed that the weighted average retirement age for vans is 19.1 years and for tractor-trailer units is 16.9 years.

According to Exhibit 16, the service lives of revenue equipment are more dependent on management policies than on any other single factor. That is, the decision as to whether equipment is traded in every three years or every 20 years depends primarily on management decisions influenced by maintenance policies and to some degree by accidents that result in occasional early retirements. The staff accountant attempted to ascertain why, in view of the data on retirement ages, the company has used lives that are so much shorter than its actual experience. The explanation offered was that although the older equipment remains on the books, it is only used occasionally, in times of peak demand. To test this statement the staff accountant made a study of the percentage utilization of vans and tractors in the three California districts, by model year. The results of that study showed that the utilization of the older equipment is only slightly lower than new equipment. For example, tractors purchased in 1958 were used about 78 percent of the time as compared with tractors purchased in 1975, that were in use about 80 percent of the time.

Based on the analysis of these data, the witness recommended that the Commission adopt service lives of 19 years for vans and 17 years for tractors and trailers.

Annualized depreciation on vans as of the year ended June 30, 1976, using a 15-year life, would result in charges to operating expenses of $828,544. If the average service life for vans was extended to 19 years, annual depreciation charges would be reduced to $654,114. Annualized depreciation on tractors and trailers as of the year ended June 30, 1976, using a 12-year service life, would result in charges to operating expense of $789,179. If the average service life for tractors and trailers was extended to 17 years, annual depreciation charges would be reduced to $557,068.

Income Taxes - Interest Income

The staff accountant furnished to the staff engineer the data used in calculating test year income taxes including the amount of interest expense to be used as a deduction from pre-tax income. The record shows that interest income expected to be earned in the test year was not considered as a factor by the staff accountant. It is the contention of the staff that interest income is a non-operating item which should not be considered in determining the amount of federal or state income taxes for rate-making purposes. No reference to prior Commission decisions was furnished to support that contention.

Recommendations

No rate of return study was made by the Finance Division. No recommendation as to reasonable levels of earnings was furnished, nor did the financial examiner make any recommendation as to whether a further increase be granted.

Evidence of Transportation Division

The Commission staff engineering witness presented Exhibits 17, 18, and 19, which contain development of operating revenues and expenses, income taxes, net income, and rate base for a test year ending December 31, 1977. Included in the staff engineer's report is a revision of the working cash study introduced in Exhibit 25 in Application No. 55317 (Decision No. 85186 of December 2, 1975) to bring the lead/lag analysis up to date.

Results of Operation Study

The staff engineer developed estimated test year operating results by revising data presented in Table 3 to reflect the following adjustments:

1. Business service expense calculated by the staff financial examiner was substituted for the business service expense allocation used in UPS exhibits.3/

2. Rate base data are revised to reflect the working cash allowance developed from the updating by the engineer of the lead/lag study of working cash introduced in the prior proceeding.

3. A projected package volume of 78,300,000 for the test year was substituted for the package volume of 80,000,000 estimated by UPS, as shown in Column 2 of Table 3.

4. Income tax calculations reflect the interest expense deductions furnished by the staff accountant.

The recommendation of the staff financial witness that service lives of equipment be extended was not adopted by the staff engineer and the test year operating results in Exhibits 17, 18, and 19 do not reflect that recommendation, but are based on the service lives found reasonable in prior decisions.

3/ The percentage used by the staff engineer in Exhibits 17, 18, and 19 was 2.22 percent; the amount recommended by the staff accountant in Exhibit 16 was 2.23 percent.

Exhibit 17 states that the staff's estimate of test year package volume was determined by applying the least-squares method to actual package volumes for recent years.

Test year revenues were determined by using the estimated revenue per package under proposed rates developed in UPS's Exhibit 14, and applying that factor to the package volume estimated by the staff. Estimated expenses were determined by applying UPS's estimates of per-package payroll and fringe benefits, and non-payroll expenses to the staff's estimated package volume.

The following table depicts the staff engineer's estimated operating results for a test year ending December 31, 1977, giving effect to the adjustments described above.

TABLE 4

Commission Staff Estimates of
United Parcel Service, Inc.
California Intrastate Common Carrier Operation
Projected for 12 Months Commending January 1, 1977

	Interim Rates		Proposed Rates	
No. of Packages	78,300,000		78,300,000	
Operating Revenue	$119,258,730		$120,824,730	
Avg. Revenue per Pkg.		$1.5231		$1.5431
Operating Expenses				
Payroll and Fringe Benefits	83,945,430		83,945,430	
Payroll and Fringe Benefits per Pkg.		1.0721		1.0721
Non-Payroll Expenses	23,497,830		23,497,830	
Non-Payroll Expenses per Pkg.		.3001		.3001
Depreciation	2,445,450		2,445,450	
Subtotal	109,888,710		109,888,710	
Business Service	2,439,530		2,439,530	
Total Expenses	112,328,240		112,328,240	
Net Operating Revenue	6,930,490		8,496,490	
Income Taxes				
California	509,027		649,967	
Federal	1,756,746		2,440,775	
Total	2,265,773		3,090,742	
Net Income	4,664,717		5,405,748	
Operating Ratio				
Before Income Taxes (percent)	94.19		92.97	
After Income Taxes (percent)	96.09		95.53	

The following table sets forth the staff engineer's estimate of rate base for year ending December 31, 1977 and his estimated rate of return under the assumptions set forth in the table.

TABLE 5

Commission Staff Estimate of
United Parcel Service, Inc.
California Intrastate Common Carrier Operations
12 Months Ending December 31, 1977
Rate of Return Comparison
(Staff Projected Package Volume)

	At Interim Rates	At Proposed Rates
Rate Base	$48,551,440	$48,551,440
Net Income (1)	4,537,362	5,278,394
Rate of Return (1)	9.35%	10.87%
Net Income (2)		5,405,748
Rate of Return (2)	9.61%	11.13%

(1) Calculations based on interest deduction in UPS exhibits introduced in the initial phase of this proceeding.

(2) Calculations based on interest developed by Finance Division for income tax computation.

Recommendation

The staff engineer made no recommendation concerning whether the full amount of the increase sought should be granted. Upon cross-examination, the staff engineer expressed the opinion that the rates of return set forth in Table 5 were within the parameters of rates of return authorized to UPS in prior proceedings, and that the rates of return under the sought rate level would not produce excessive earnings.

Applicant's Rebuttal Testimony

Interest Deduction - Income Taxes

Applicant disputes the amount of the interest deduction for income tax calculation developed by the staff. The amount of the interest deduction from net operating expenses used in the staff's test year income tax calculation is $299,829. Of that amount, approximately two-thirds represent interest on short-term debt (so-called revolving credit account).4/ Applicant presented Exhibit 20, which contains its estimates of the interest expense which America will incur in 1977. Exhibit 20 shows that short-term debt (revolving credit) would fluctuate from a high of $45,000,000 in January to a low of nothing in December 1977; and that America's total interest on short-term debt for the year would be $808,046, and on long-term debt would be $223,894, for a total of $1,031,940. The intra-California portion of 1977 interest expense is shown to be $104,410 in Exhibit 22. UPS contends that if interest expense is to be reflected in income tax calculations, interest income also should be included. Exhibit 21 shows that substantial interest income has been earned in recent years from short-term cash investments; Exhibit 22 shows that the estimated interest income allocatable to 1977 California intrastate operations is $106,000. The money management policies of America were described

4/ The staff witness calculated test year debt expense for America of $3,144,965 of which $2,207,500 is interest expense on a revolving credit in the amount of $35,000,000. A portion of America's debt expense was allocated to UPS's intra-California operations in the same ratio that rate base items for such operations bear to total assets.

for the record which permit America to substantially reduce its borrowing requirements over a short period and to make short-term cash investments.

Business Service Expense

UPS does not dispute the staff adjustments to business service expense which eliminate real estate accounting costs and dues to non-qualifying organizations.

UPS disputes staff adjustments relating to the move of America's headquarters to Greenwich, and to the elimination of the start-up costs of UPS's new mountain states operations.

Exhibit 23 shows that business privilege tax savings resulting from the relocation was $1,519,208, comparing the year 1974 (New York City) with the year 1976 (Greenwich). That one-year tax saving exceeds the total moving costs of $923,341. UPS contends, in the alternative, that moving costs should be expensed in the period in which they occurred, but if the staff's contention is accepted, moving costs should be amortized over a shorter period than that recommended by the staff.

UPS presented testimony designed to show that the opening of the new mountain states territory directly benefits its California intrastate operations by generating additional traffic to or from California which produces economies of scale. The additional territory added to UPS's interstate operations permits it to serve all of the contiguous 48 states. Assertedly, the fact that shippers can reach all points in the 48 states should generate additional package volume that would tend to reduce unit costs. UPS contends that because the additional traffic volume in question will tend to reduce handling costs in California, that the costs of opening the mountain states territory should not be excluded from business service expense or, at least, should be treated the same as headquarters moving expenses and be amortized over a period of years.

Service Lives of Equipment

UPS contends that the study made by the staff accountant gives consideration only to the retirement ages of equipment, and that no study was made of other factors, including salvage values. In Exhibit 26, UPS presented data to show that there is a precipitous drop in usage of vans after the 23-year period analyzed in Chart C of staff Exhibit 16.

Issues

The issues raised by the staff in its presentation are the following:

1. The proper business service expense for inclusion in test year operating expenses.
   (a) Should the full amount of headquarters moving expenses be included, or should such expenses be amortized? If amortized, what period should be used?
   (b) Should start-up costs for newly certificated mountain states operations be included? If included, should such expenses be amortized, and what period should be used?
2. Should service lives of motor vehicle equipment be lengthened, as proposed by the staff accountant?
3. What is the appropriate interest expense deduction for computation of income taxes?
4. Should the reduced package volume estimated by the staff engineer be substituted for the test year volume estimated by UPS?
5. Should rate base be adjusted to reflect the staff's updated working cash allowance?

Discussion

Business Service Expenses

The staff recommends that headquarters moving expense be amortized over a ten-year period. UPS contends that the full amount of such expense should be included, inasmuch as the move produced an immediate reduction in expenses greater than the costs of the move. The moving costs are non-recurring expenses which will produce an effect on operating expenses for several future years. Therefore, the expenses should not be reflected in operating expenses in the period in which they were incurred, but should be spread over a reasonable period. (See San Diego Pipe Line Co. et al. (1971) 71 CPUC 832.) The staff selected a ten-year period. In our view that period is reasonable. The staff adjustment will be adopted.

The start-up costs for UPS's newly certificated mountain states operations do not appear to have a direct beneficial effect on California intrastate operations; therefore those costs should not be included in business service expenses. The staff adjustment is reasonable and will be adopted.

Based on the foregoing, the percentage factor for business service expense for inclusion in test year results of operations is 2.23 percent.

Service Lives of Automotive Equipment

The staff accountant's study presents sufficient data to show that the service lives of automotive equipment may be understated. However, that study contains no corresponding analyses of salvage values of equipment, and did not give consideration to other economic data ordinarily evaluated in an engineering study. We will request our staff to prepare a new study of the service lives of automotive equipment for presentation in the next proceeding involving UPS rates.

Computation of Income Taxes

UPS, in its exhibits, uses a lesser interest deduction than the staff for computation of income tax expense. Rebuttal Exhibits 20, 21, and 22 show that the California intrastate portion of the interest expense UPS expects to incur in the test year is $104,410, rather than the figure of $299,829 used by the staff.

Interest income is a result of investments from short-term cash investments. It must be concluded that the cash used in making these investments was excess and not necessary to ordinary operations. Therefore, interest income, in this case, should not be a part of a computation of income taxes for California intrastate operations.

Test Year Package Volume

The record shows that staff estimates of package volume were projected from historical data on a mathematical basis, and no consideration was given to other factors. UPS showed that it expects added intrastate volume (as well as interstate volume) to result from additional operative rights which fill out its 48 states operation. It appears that UPS has analyzed data affecting traffic volume in addition to the historical data relied upon by the staff. UPS's estimate of package volume for the test year appears reasonable and should be utilized.

Working Cash Allowance

Both UPS and the staff developed lead/lag studies for determination of working cash requirements. The staff brought up to date its study produced for the most recent UPS rate proceeding, which was adopted for the purposes of that proceeding. The working cash allowance for inclusion in rate base as set forth in the staff study will be reasonable for the purpose of this proceeding.

Adopted Results of Operations

Based on the foregoing discussion the test year results of operations which we find reasonable and adopt for the purposes of this proceeding are the following:

TABLE 6

United Parcel Service, Inc.
Adopted Results of Operations
Under Interim and Proposed Rates
For A Test Year Ending
December 31, 1977

	Interim Rates	Proposed Rates
Packages	80,000,000	80,000,000
Operating Revenues	$121,848,000	$123,448,000
Operating Expenses		
Payroll and Fringe Benefits	85,768,000	85,768.000
Non-Payroll Expenses	24,008,000	24,008,000
Depreciation Expense	2,445,450	2,445,450
Business Service Expense	2,502,538	2,502,538
Total Expenses	114,723,988	114,723,988
Net Operating Revenue	7,124,012	8,724,012
Income Taxes		
California	544,030	688,030
Federal	1,921,640	2,615,020
Total Taxes	2,465,670	3,303,050
Net Income	4,658,342	5,420,692
Rate Base	48,551,440	48,551,440
Rate of Return	9.59%	11.17%
Operating Ratios		
Before Taxes	94.2%	92.9%
After Taxes	96.2%	95.6%

Reasonableness of Earnings

Permanent increases in rates were granted to UPS in the following proceedings. Both rate of return and operating ratio (after taxes) were considered in determining the reasonableness of the increases authorized.

Decision No.	Application No.	Test Year Ended	Rate of Return	Operating Ratio (After Taxes)
75692	50760	2/28/70	12.00%	95.67%
78711	52362	2/28/72	9.05	97.17
82581	53615	12/31/73	9.85	96.91
83217	54517	12/31/74	8.92	96.71
85186	55317	6/30/76	10.86	95.58

The rate of return of 11.11 percent resulting from the proposed rates falls within the range of rates of return resulting from rate increases approved in prior decisions. America's capital structure consists almost entirely of equity, as shown in the following data derived from applicant's Exhibit 22:

TABLE 7

United Parcel Service of America, Inc. and Subsidiaries Capital Structure for Year Ended December 31, 1977

	Amount (+000)	Percent
Shareholder's Equity	$478,739	96.25
Debt	18,635	3.75
Total Capital	497,374	100.00

Based on the above capital structure and a cost of debt of 4.52 percent, a rate of return of 11.11 percent produces a return on equity of about 12 percent, which is reasonable for the type of operations conducted by UPS.

Issues in OSH Proceedings

Interim Decision No. 87283 authorized and directed common carriers to raise their competitive rates to the level authorized to UPS therein, but did not raise the corresponding minimum rates for parcel delivery service in the local San Francisco Bay Area, Metropolitan Los Angeles and Metropolitan San Diego drayage areas. Although that action was unexplained in the order, the purpose was to afford local drayage area carriers flexibility in their rates for parcel delivery service. It was expected that should permit carriers operating in the local drayage areas have found that the existing minimum rates were too low, the carriers would have appeared to request that the parcel rates in the drayage areas be raised. No such representations were made at the hearing. It appears, and we conclude, that an immediate raise in the local drayage parcel delivery rates is not necessary. Therefore, we will allow the minimum drayage rates for parcel delivery service to remain at their present levels. In the event that any carrier operating under such rates believes that the existing minimum rates are too low, that carrier may petition to raise the minimum rates to the levels granted to UPS herein.

Findings

1. Interim Decision No. 87283 in this proceeding authorized UPS to increase its rates, pending completion of staff studies and their receipt in evidence.

2. Relief not heretofore accorded to UPS in the interim Decision No. 87283 would permit it to further increase its rate per package by 2 cents. The estimated annual increase from such proposal is $1,600,000.

3. The studies undertaken by the Commission staff have been completed and were received in evidence at the hearing held on May 17 and 18, 1977.

4. As set forth in Tables 1 and 3 above, UPS's test estimates indicate that its intrastate common carrier operations would result in net operating revenues (after taxes) of $4,480,248, an operating ratio (after taxes) of 96.32 percent, and a rate of return of 10.9 percent.

5. As set forth in Table 4 above, staff's test year estimates indicate that under the full amount of rate increase sought herein, UPS's California intrastate common carrier operations would result in net operating revenues (after taxes) of $5,405,748, an operating ratio (after taxes) of 95.53 percent, and a rate of return on rate base of 11.13 percent.

6. Over the last six years, we have authorized UPS to increase its rates based on adopted results of operations which produce operating ratios (after taxes) ranging between 95.58 percent to 97.17 percent, and rates of return ranging from 8.92 percent to 12.0 percent.

7. We authorize as reasonable the operating ratio of 95.6 percent and the rate of return of 11.11 percent set forth in the adopted results of operations in Table 6. Such an allowance is reasonably within the range previously granted to UPS and will not produce excessive earnings for UPS's intrastate common carrier operation.

8. The balance of the rate increase sought in the application and not heretofore granted in the interim order will be reasonable and is justified. That amount is two-cents per package, which produces additional annual income of $1,600,000.

Conclusions

1. The balance of the rate increase sought herein should be granted, as provided in the order which follows.

2. Common carriers now maintaining parcel delivery rates comparable to the rates of UPS 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.

3. Minimum Rate Tariffs 1-B, 2, 9-B, and 19 should not be amended to reflect the increased wholesale parcel delivery rates authorized herein.

4. The Commission staff is requested to prepare current studies of the service lives and residual values of automotive equipment used by UPS in its intrastate common carrier operations for presentation in the next proceeding in which UPS seeks to increase its common carrier rates.

5. There is an immediate need for the rate relief ordered herein, and this order should be effective the date hereof.

FINAL ORDER

IT IS ORDERED that:

1. United Parcel Service, Inc. is authorized to establish the increased rates and charges as proposed in Application No. 56871.

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

4. The rates established by United Parcel Service, Inc., pursuant to Ordering Paragraph 1 hereof, shall not be further increased by the amounts authorized to common carriers by Decision No. 87048 in Case No. 5432, Petition No. 945, or supplemental decision(s) issued concurrently therewith.

5. While the drayage area rates in the Commission's minimum rate tariffs are not being increased by this order, common carriers are authorized to increase their rates to the level authorized applicant in Ordering Paragraph 1 hereof. 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 directed to increase such rates to the level of the rates authorized in Ordering Paragraph 1 hereof. Tariff publications authorized and required to be made by common carriers as a result of this ordering paragraph 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 thirty days after the effective date of the tariff publications made pursuant to the authority granted in Ordering Paragraph 1.

6. Common carriers, in establishing and maintaining the rates authorized thereinabove, are hereby authorized to depart from the provisions of Section 461.5 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 the long- and short-haul departures and to this order.

7. The proceedings in Case No. 5432 (OSH 946), Case No. 5439 (OSH 302), and Case No. 5441 (OSH 384) are terminated and those proceedings are closed.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 20th day of SEPTEMBER, 1977.

Robert Batinovich
President

William Symons, Jr.

Vernon L. Sturgeon

Richard D. Gravelle

Commissioners

I dissent. I am not persuaded that the applicant has established the need for a rate increase

Claire T. Dedrick