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ORIGINAL

Decision No. 89015 JUN 27 1978

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. 57629 (Filed October 13, 1977)
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 1004 (Filed December 20, 1977)
And Related Matters.	Case No. 5439, OSH 318 (Filed December 20, 1977) Case No. 5441, OSH 403 (Filed December 20, 1977)

Irving R. Segal and Roger L. Ramsey, Attorneys at Law, for United Parcel Service, Inc., applicant.
Norman I. Molaug, for J.C. Penney Company, Inc.; Jesse W. Syme, for Sears, Roebuck and Co.; Raymond E. Shull, for Western Traffic Conference; and Jack L. Bishop, for Sunset House; protestants.
Edward J. Marnell, for Adams Delivery Service, Inc.; Dunne, Phelps and Mills, by Marshall G. Berol, Attorney at Law, for themselves; Robert F. Schafer, for Duracell Products Company; Arthur D. Maruna and H. Hughes, for California Trucking Association; and Frank O. Spellman, for himself; interested parties.
Steven Weissman, Attorney at Law, and Robert Bouchet, for the Commission staff.

O P I N I O N

United Parcel Service, Inc. (UPS) seeks authority to increase certain of its rates for its common carrier parcel delivery service between points in California, as follows:

Movements Wholly Within Territories A, B, and C (Local Zones)	(Cents) Present Rate	Proposed Rate
Per Package	70	79
Per Pound	5.9	6.6

All Other Movements Within California	(Cents) Present Rate	Proposed Rate
Per Package	70	79
Per Pound		
Zone 2	6.4	7.1
Zone 3	8.2	9.2
Zone 4	10.6	11.9
Zone 5	12.9	14.5

The rate increases described above are designed to produce additional annual revenues of $13,056,698.

UPS also seeks to revise the method of disposing of fractions. The present tariff rule provides that in computing the charge for an individual package shipment fractions of less than one-half cent will be omitted and fractions one-half cent and greater will be increased to the next whole cent. UPS proposes that in computing such charge, fractions of one-tenth of a cent or greater will be increased to the next whole cent. The proposed method of disposing of fractions is that set forth in tariffs filed with the Interstate Commerce Commission (ICC) applicable to interstate traffic. The rule charge is estimated to produce an annual revenue increase of about $347,000. Because of the rates we authorize herein (see Finding 3) this issue is moot for purposes of this proceeding.

Public hearing in Application No. 57629 was held before Administrative Law Judge Mallory at San Francisco on January 5, 1978 at which UPS presented its evidence in support of the requested rate increase, and on February 22, 23, and 24, 1978 at which other parties, including the protestants and the Commission staff, presented evidence. The matter was submitted on March 22, 1978 upon receipt of comments from UPS on late-filed exhibits of the Commission staff.

Background - Revenue
And Expense Determinations

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 Los Angeles and San Francisco metropolitan areas as a contract carrier, and pickup and delivery of interstate shipments transported by United Parcel Service Company, an airfreight forwarder.[1/] 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.

1/ In Application No. 57776 filed December 29, 1977, UPS seeks to amend its common carrier certificate to cover delivery of packages from retail stores. Application No. 57776 alleges that the contract carrier service in question now consists of the delivery of package merchandise (also furniture merchandise in the case of two Los Angeles department stores, The May Co. and J. W. Robinson), between said stores, their branches and warehouses, and the premises of their customers, pursuant to individual written contracts entered into with each store served. UPS would continue to handle under its contract carrier permit the delivery of furniture and the interstore transfer of merchandise, as described above, under its contract carrier permit for the department stores whose contracts now provide for such service. That application was recently granted by the Commission.

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 intrastate 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 service.

UPS's 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.

The last general rate increase authorized to UPS was pursuant to Decision No. 87876 dated September 20, 1977 in Application No. 56871. 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 95.58 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 operations."

That decision requested the Commission staff 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.

UPS Showing

In preparing its presentation herein, UPS followed the methods described under the preceding heading and adopted the ratemaking adjustments found reasonable in prior proceedings.

The following are UPS's estimated operating results for a test year ending December 31, 1978. Column 1 represents historic data for the year ended December 31, 1976 adjusted for increased revenues resulting from higher rates authorized in prior proceedings 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, 1978
Showing Results of Proposed 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	74,605,313	82,000,000
Operating Revenue	$128,644,856	$141,392,600
Operating Expenses		
Payroll and Fringe Benefits	82,162,452	90,306,600
Nonpayroll	33,057,614	36,334,200
Depreciation Expense	2,638,001	2,638,001
Business Service Expense	2,816,806	3,089,763
Real Estate Accounting Expense	-	21,174
Total Expense	120,674,873	132,389,738
Net Operating Revenues	7,969,983	9,002,862
Income Taxes		
State	612,700	697,883
Federal	2,380,097	2,793,519
Total Income Taxes	2,992,797	3,491,402
Net Income	4,977,186	5,511,460
Operating Ratio Before Income Taxes	93.80%	93.63%
Operating Ratio After Income Taxes	96.13%	96.10%
Rate Base	50,834,114	50,834,114
Rate of Return	9.79%	10.84%

Note 1: Base year is the year ended December 31, 1976.

Note 2: Estimated intrastate volume for 12 months ending December 31, 1978.

UPS seeks no specific rate of return or operating ratio. It seeks the revenue increases set forth in Table 1 as a means of offsetting increased operating expenses, principally wages, that it will incur in 1978. UPS pointed out that its projections in Table 1 are based on the assumption that it would receive a rate increase effective at the beginning of the calendar year, and that to the extent that relief is delayed, it will not have the opportunity to earn the operating ratio and rate of return set forth in that exhibit.

Protestants' Evidence

The Western Traffic Conference (WTC) is an association of traffic managers representing 72 retail corporations on the Pacific Coast, of which 48 are in California. An officer of WTC and three representatives of member corporations testified in opposition to the amount of the rate increase sought by UPS.

The retailers ship large numbers of small parcels from suppliers and distribution centers to retail stores. For such traffic UPS competes primarily with the Parcel Post Division of the United States Post Office. UPS's Exhibit 5 compares its proposed rates with the rates for uninsured parcel post. The territorial limits of UPS's Zones 2 through 5 are identical with parcel post Zones 2 through 5.[2/] In the past UPS rates were slightly below parcel post rates. The comparison in Exhibit 5 indicates that its proposed rates are slightly higher than uninsured parcel post rates for all zones and shipment weights.

2/ No comparison is made in Exhibit 5 between UPS Territories A, B, and C rates and parcel post local zone rates or third class rates for 15 ounces or less because historically parcel post rates have been substantially lower than corresponding UPS rates.

The witness for J.C. Penney Company (Penney) testified that Penney has generally switched from parcel post to UPS because of UPS's superior service from its suppliers to its retail stores. Penney has approximately 500 suppliers in California that ship in quantities of 100 pounds or less. If UPS's rates exceed parcel post rates, Penney will evaluate whether to switch all or part of that traffic back to parcel post, or to seek alternatives to both UPS and parcel post, such as shipment consolidation through exempt forwarder operations. Evidence of a similar notice was introduced by Sears, Roebuck and Co. (Sears). Sears indicated that it attempts to have catalog customers pick up their merchandise at retail stores, rather than deliver it to the customer's home or business. Both Penney and Sears testified that they oppose UPS rate increases that exceed general inflation rates.

A representative of Sunset House testified that his company is a national mail order house. Sunset House uses UPS for deliveries to its California customers. Sunset House cannot pass on to its customers any additional increase; and because its average selling price per item is $2 or less, it cannot absorb any increase in UPS rates. If UPS rates exceed parcel post, Sunset House will shift all its business from UPS to parcel post.

The evidence of the foregoing witnesses is convincing that substantial diversion of important amounts of traffic would occur if UPS increases its rates for movements to Zones 2 through 5 above the current levels of parcel post rates for similar weights and distances.

The decision to seek increased rates rests with UPS. If UPS proposes rates, and we authorize them, that result in a diversion of traffic to parcel post, the economic brunt of such diversion will affect UPS. We assume that UPS management fully understands the consequence of rate increases on its business and has assessed the transportation market ramifications. We note that UPS traditionally competes by providing specialized and supposedly superior service to small parcel shippers. Even though proposed UPS rates may exceed some parcel post rates we assume UPS has considered elements of competition aside from purely economic impact.

A witness appearing for Duracell Products Company, a manufacturer of dry cell batteries, testified that no increases are sought in accessorial charges and that such charges do not appear to bear their full share of UPS's cost of service. The witness stated that if accessorial charges are increased, the increase in the proposed package and pound rates would be less. The witness asked that the Commission staff be directed in a future proceeding to determine fully allocated costs of service for the several accessorial services for which a separate charge is set forth in UPS's tariff[3/] and to recommend appropriate levels of charges related to costs of service.

Staff Presentation

The staff evidence was presented through a financial examiner, a transportation engineer, and a transportation rate expert. Both the finance and engineering witnesses presented evidence on depreciation of revenue equipment in response to the request contained in Decision No. 87876 that the staff prepare current studies and residual values of UPS automotive equipment.

The staff financial witness also presented recommendations concerning UPS's capital structure and rate of return, and with respect to business service expense.

3/ The accessorial services are correction of wrong address ($.85), COD ($.85), acknowledgment of delivery ($.20), and pickup services ($2 per week).

The staff engineer presented estimated jurisdictional results of operations by adjusting the data set forth in Table 1 to reflect (a) revised annual depreciation of revenue equipment and related rate base adjustments, (b) revised nonpayroll costs per package, (c) the level of business service expense recommended by the staff financial witness, and (d) computation of income taxes using the method recommended by the financial witness.

The staff rate expert presented recommended rate levels designed to produce additional revenues to yield the rate of return recommended by the staff financial witness.

Rate of Return

The staff rate of return witness in Exhibit 14 recommended that the Commission find as reasonable a rate of return of 9.99 percent. That recommendation is based on an average cost of long-term debt of 7.62 percent and a return on equity of 11.0 percent related to a hypothetical capital structure consisting of 30 percent debt and 70 percent equity.

Capital Structure

The staff witness recommended that UPS's revenue requirements be tested against a theoretical debt structure because the witness believed that UPS's parent (United Parcel Company of America) had acted imprudently in the past by its reliance almost wholly upon equity for its capital requirements. It is the opinion of the witness that historically debt financing by UPS has been at very favorable rates compared to the cost of equity capital and the cost of debt financing by other companies. The witness testified that prudent management would have made more use of less costly debt financing and that a reasonable capital structure for the purposes of this proceeding is 30 percent debt and 70 percent equity.

Cost of Debt

UPS presented rebuttal evidence to show that the cost of long-term debt comparisons made in the staff exhibit was erroneous because the entering dates of the debt agreements set forth in the staff study were incorrect. UPS's purpose was to show that, contrary to the conclusion in the staff report, UPS's parent did not obtain lower rates of interest than the trucking companies with which it was compared. UPS also presented Exhibit 40 to show that if UPS had borrowed the additional capital to increase its debt to 30 percent in today's market, the cost of that additional debt would raise the embedded cost of debt from 7.62 percent as used in the staff exhibit to 9.07 percent.

Return on Equity

The witness compared his recommended return on common equity of 11 percent with the average return on equity for the ten largest highway carriers filing financial reports with this Commission. That comparison is distorted by the large operating losses incurred by one carrier that produced a correspondingly large negative return on stockholders' equity. UPS presented rebuttal testimony to show that the largest publicly owned motor carriers whose stock is traded on national exchanges earned revenues which produced returns on equity between 20 and 26 percent. The ICC, in its last investigation of UPS's rate structure in which a return on equity was in issue (General Increase-January, 1976 United Parcel Service, I&S Docket No. M-28872, 245 ICC 353), found that a return on adjusted year-end equity of 16.5 percent and a corresponding operating ratio (before taxes) of 92 percent, were reasonable. The ICC order states (at page 270) "The 16.5 percent return on equity is not out of line with the returns enjoyed by other carriers." Purportedly, the comparisons made by UPS in its Exhibit 40 confirm that statement.

Discussion

The following table compares the components of the rate of return recommended by the staff (Table 12 of Exhibit 14) with adjustments that appear from the data supplied in UPS's rebuttal exhibits.

TABLE 2

Capital Components	Capital Ratio	Staff[(a)] Cost Factors	Staff[(a)] Weighted Cost	UPS[(b)(c)] Cost Factors	UPS[(b)(c)] Weighted Cost
Long-Term Debt	30%	7.62%	2.29%	9.07%	2.72%
Common Equity	70%	11.00%	7.70%	16.50%	11.55%
Total	100%		9.99%		14.27%

(a) Exhibit 14 - Table 12

(b) Debt Cost - Exhibit 40

(c) Equity Return - 353 ICC 245, 270

It may be seen that substitution of the return on equity found reasonable by the ICC and current debt costs in the staff's capital structure produce a rate of return of 14.27 percent.

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%
78811	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
87876	56871	12/31/77	11.17	95.61

In the computation underlying the recommended rate of return, the staff has incorrectly measured the cost of debt capital. If the rate of return calculation of the staff, based on its assumed capitalization of 30 percent debt and 70 percent equity, is revised to reflect an appropriate cost component for long-term debt of 9.07 percent and a return on equity of 13 percent, the resultant rate of return is 11.82 percent.

~~In proceedings before this Commission involving major gas, electric, and water utilities, it has been customary for our staff to recommend a range of rates of return which would provide reasonable earnings to the utility. In this proceeding, only a single rate of return was recommended.~~

For purposes of this proceeding, we find that UPS should have rates established to produce a post-tax operating ratio of 95.92 percent which results in a rate of return of 11.1 percent. (See Table 3.)

Depreciation of Revenue Equipment

The service lives adopted for ratemaking purposes in prior Commission orders are 15 years for vans and 12 years for tractor-trailer units. The adopted salvage value for each class of equipment is 10 percent.

The staff financial witness concluded, based on his study in Exhibit 13, that the actual service life for a package van is 19 years and for a tractor-trailer unit is 17 years, and that the appropriate related salvage ratios are 14 percent for vans and 10 percent for tractor-trailer units. Exhibit 13 examines the times at which motor vehicles are retired from service during the five-year period 1972 through 1976. The average age at retirement for vans was 19.19 years and for tractor-trailers was 17.09 years. In the opinion of the staff financial witness, the actual retirement age of automotive equipment is the best indicator of the actual service life of such equipment and, thus, should be the base on which depreciation expense is calculated for ratemaking purposes. Exhibit 13 also contains five-year average salvage ratios at the time of retirement of the equipment. The exhibit states that analysis of the recorded data reveals no clear-cut pattern in early years, but that at retirement ages of 19 years or more the pattern shows a salvage ratio at retirement of approximately 14 percent for vans and 10 percent for tractor-trailers.

The staff accountant recommended that depreciation expense and depreciation revenues be adjusted for ratemaking purposes to reflect his recommended service lives and salvage values of automotive equipment.

Based on his study in Exhibits 26, 27, and 28 the staff engineer recommended that the present service lives of 15 years for vans and 12 years for tractor-trailer units be retained. Exhibit 28 shows that as of October 1977, UPS operated 3,140 gas trucks, 267 diesel and gas tractors, 1,525 trailers, and 402 dollies. Their respective fleet ages were 10.09 years, 8.69 years, 7.28 years, and 8.42 years. The composite fleet age was 9.09 years.

Exhibit 26 states that the reserve ratio test developed by the Internal Revenue Service (IRS) does not warrant extension of service lives for van equipment. That test was developed to demonstrate whether the actual fleet retirement and replacement practices followed by the taxpayer are consistent with the service lives used for tax purposes. The ratio developed by the witness indicated to him that the current ratemaking depreciation schedule is consistent with actual practice. While information on how IRS treats depreciation, and tests the reasonableness of such expense, is informative, it may or may not provide a useful basis for our ratemaking determination. In this instance, as discussed below, we are not convinced that the IRS reserve ratio test approach is reasonable or reflective of actual conditions for this carrier.

The following analysis set forth in Exhibit 26 led the engineer to conclude that the present service life of 12 years for tractor-trailers should not be changed.

<u>Composite Summary (1972-1976)</u>

1.	Tractors, Trailers, and Dollies	175 Retired
2.	Vehicle Years	2,065
3.	Retirement Age (L2 ÷ L1)	11.80 years

In determining his proposed revisions in salvage ratios, the engineer considered the costs associated with preparing the retired vehicles for sale. The staff engineer agreed that adjustments to his salvage value data were in order based on rebuttal testimony presented by UPS. The staff's late-filed Exhibit 34 contains net salvage values for package vans based on data supplied by UPS in its Exhibit 29. The staff engineer adjusted the tire costs in Exhibit 29 based on the use of smaller tires for trailers and dollies than for tractors. The effect of the adjustments is to reduce the net salvage value to 10.96

percent on tractor-trailer units and 10.17 percent for vans. A figure of 10 percent was used by the engineer for salvage values for both types of equipment. The resultant Transportation Division recommendation is identical to that previously adopted by the Commission as reasonable.

In the last UPS rate decision (Decision No. 87876), we directed staff to prepare a study on service lives and salvage values for service equipment for the next rate proceeding.

The Transportation Division's study agreed with the Finance Division's study only on the actual average retirement age of vans. The difference between the two divisions' studies for tractors, trailers, and dollies results primarily because the Transportation Division engineer included in his study the effect of an extraordinary 1975 sale of equipment by UPS to a large retail store. A review of Exhibit 26, page 3, and testimony shows that the 1975 sale was extraordinary. Therefore, we are of the opinion that the engineer's study should not be adopted. UPS supported the engineer's study, with the exception of salvage values.

We are of the opinion that the staff financial examiner's study more accurately reflects actual retirements. However, we will not adopt the exact service lives proposed by the Finance Division because there was no allowance made for the frequency and extent of use for the various vintages of fleet equipment. We find that after carefully reviewing the evidence it is reasonable, to more accurately reflect actual conditions, to adopt the following service lives:

Vans	17 years
Tractors, Trailers, and Dollies	15 years

The staff engineer's study of salvage values, as modified by the staff after UPS rebuttal evidence, is reasonable and will be adopted. The extraordinary 1975 sale of equipment did not distort the salvage value study, as it could have the service lives study.

Nonpayroll Expense Per Package

Traditionally, nonpayroll expense is calculated by determining the average nonpayroll expense per package for the test year and multiplying that number by the estimated number of total package shipments.

UPS developed its estimate of nonpayroll expense[4/] on a per package basis by calculating the average percent increase in that expense per package over its five-year period 1972 through 1976. UPS's estimate based on that averaging methodology is a 13.79 percent increase per year, or 44.31¢ per package (equating to $36.3 million for the test year). UPS shows in Exhibit 7 that the yearly increase in nonpayroll expense per package has been as follows:[5/]

1972 to 1973	9.95%	increase
1973 to 1974	15.52%	"
1974 to 1975	9.32%	"
1975 to 1976	20.35%	"

4/ Nonpayroll operating expense includes: operating supplies, general supplies, operating taxes and licenses, insurance, communications and utilities, and building and office rents. It excludes pension and retirement expense, depreciation, and business service fee.

5/ In its rebuttal showing, UPS indicated the increase from 1976 to 1977 was 10.51 percent.

The staff estimated the average percent increase per package by determining the expected inflation rate (using various economic indicators) that would be in effect at the end of the test period (and arrived at 6.9 percent); then staff weighed the anticipated increase in inflation at the end of the test period to arrive at an average percentage per package increase during the test period of 3.35 percent.

Thus, we are faced with UPS's estimated percent increase of 13.72 percent and staff's of 3.35 percent. The estimate of UPS is based on clearly fluctuating results from past years. Also we are not convinced that the methodology employed by UPS is reliable for rate-setting purposes. UPS projected the increase from 1976 to 1977 to be 13.79 percent. It was brought out in testimony (UPS rebuttal Exhibit 32) that the actual increase was only 10.51 percent.

We are also of the opinion that the staff's estimate of an annual 6.9 percent increase is too low. We find that it is reasonable to adopt 11 percent as an estimate of increase for this expense from 1977 to year-end 1978.

Both staff and UPS applied the average annual increase to the test period on a six-month basis, which amounts to weighting the effect of an expected end-of-test year expense. The ratemaking treatment is reasonable. We calculate test period nonpayroll expense per package to be 42.47¢ (actual 1977 expense of 40.26¢) plus 2.21¢ (5.5 percent increase), totaling 42.47¢. Nonpayroll expense for the test period totals $34,825,400 (82,000,000 x $0.4247).

Business Service Expense
And Revenue Adjustment

UPS concurs in the staff's adjustment to business service expense and the adjustment to revenues of $346,973 resulting from the proposed method of disposing of fractions.

Federal and State Income Taxes

The staff financial witness proposed that the interest deduction that would result from its imputed capital structure be used in computing test-year federal and state income taxes. UPS asks that we compute state franchise and federal income taxes for the projected year based on actual debt and interest expense.

It has been our consistent policy in ratemaking to provide for state franchise and federal income taxes on a basis that reflects as closely as we can determine the taxes that will actually be paid by the utility. For this reason we will ignore the hypothetical interest deductions that result from the staff proposal and compute test-year income taxes using the interest expense that will be incurred by UPS.

In recent decisions setting fares for airlines (PSA and Air California), we authorized fares that would generate a determined pre-tax operating ratio. We are interested in pursuing the question of whether that procedure might be appropriate for other types of transportation utilities. During the course of the next UPS rate-setting proceeding, we expect staff and UPS to present testimony of the desirability, or undesirability of using pre-tax operating ratios for setting rates.

The following table sets forth the adopted operating revenues, operating expense including income taxes, and rate base for a projected 1978 test year under present rates, proposed rates, and the rates we adopt based on test period package volumes.

TABLE 3

Test Period Results of Operations for
Intrastate Common Carrier Parcel Delivery Service[6]

Item	Present Rates (with rule change)	UPS Proposed Rates (with rule change)	Rates Adopted
Packages	82,000,000	82,000,000	82,000,000
Operating Revenues	$137,226,119	$141,748,748	$138,630,337
Operating Expenses (adjusted)			
Payroll and fringe benefits	$ 90,306,600	$ 90,306,600	$ 90,306,600
Nonpayroll	34,825,400	34,825,400	34,825,400
Depreciation	2,449,590	2,449,590	2,449,590
Business Service	2,845,096	2,845,096	2,845,096
Real Estate Accounting	21,174	21,174	21,174
Total Operating Expense	$130,447,833	$130,447,833	$130,447,833
Net Operating Revenue	$ 6,778,286	$ 11,300,915	$ 8,182,504
Income Taxes			
Federal and State Taxes	$ 1,779,651	$ 4,149,957	$ 2,519,393
Net Income (after taxes)	$ 4,998,635	$ 7,150,958	$ 5,663,111
Operating Ratio (after taxes)	96.36%	94.96%	95.92%
Rate of Return (Rate Base of $51,009,758)	9.8 %	14%	11.1 %

Additional Gross Revenue Required over present rates to produce an operating ratio of 95.92% is $1,404,218.

6/ Based on adopted test year volumes as follows:

	Packages	Poundage
Local	31,812,600	331,776,802
Zone 2	31,894,591	333,640,972
Zone 3	5,657,396	59,154,692
Zone 4	12,626,652	132,214,483
Zone 5	Ø	114,953
Total	82,000,000	

We are authorizing UPS to file rates that will give UPS the opportunity to realize a post-tax operating ratio of 95.9 percent. This results in a gross revenue increase of $1,404,218. The rates we authorize UPS to file are as follows in Column "C":

Rates in Cents

	A Present	B Proposed	C Adopted
Package	70	79	77
Local (per pound)	5.9	6.6	6.5
Zone 2	6.4	7.1	7.0
Zone 3	8.2	9.2	9.0
Zone 4	10.6	11.9	11.5
Zone 5	12.9	14.5	14.0

The rates we adopt and authorize for UPS will produce the necessary gross revenue requirement of $138,630,337 as follows:7/

	Present Rates	Proposed Rates	Adopted Rates
Accessorial Revenue	$ 9,803,100	$ 9,803,100	$ 9,803,100
Package and poundage revenue	117,208,102	131,558,201	128,605,041
Rule Change Revenue	265,688	346,973	(not adopted)
Effect of Rounding fractions8/	28,921	40,474	222,196
Gross Operating Revenue	137,226,119	141,748,748	138,630,337

7/ Based on estimated test year volumes as follows:

	Packages	Poundage
Local	31,812,600	333,776,802
Zone 2	31,894,591	333,640,972
Zone 3	5,657,396	59,154,692
Zone 4	12,626,652	132,214,483
Zone 5	Ø	114,953
Total	82,000,000	

8/ Revenue effect of rounding rate fractions of one-half cent or more to one cent. The rates authorized will result in more upward rounding than the existing or proposed rates. The rates adopted renders the UPS proposed rounding rule change unnecessary at this time.

Findings

1. UPS seeks an annual increase in revenues totaling $13,403,671 for California intrastate common carrier operations.

2. As set forth in Table 1 above, UPS's test year estimates indicate that its intrastate common carrier operations would result in net operating revenues (after taxes) of $5,511,460, an operating ratio (after taxes) of 96.10 percent, and a rate of return of 10.84 percent.

3. As set forth in late-filed Exhibit 34, staff's test year estimates indicate that under the rate increase sought herein UPS's California intrastate common carrier operations would result in net operating revenues (after taxes) of $7,384,125, an operating ratio (after taxes) of 94.79 percent, and a rate of return on rate base of 14.52 percent.

4. It is reasonable to authorize rates for UPS that will provide the utility with an opportunity to earn an after-tax operating ratio of 95.9 percent.

5. It is reasonable to adopt 42.47¢ per package as an estimate of nonpayroll expense for the test period.

6. It is reasonable for purposes of calculating depreciation expense to use 17 years as the service life for vans and 15 years for tractors, trailers, and dollies.

7. Table 3 reflects the adopted results of operations which we find to be reasonable. That table shows that for UPS to realize an operating ratio of 95.92 percent for the test period an increase of rates in the amount of $1,404,218 is required.

8. To generate the gross operating revenue required for UPS to realize an operating ratio of 95.9 percent it is reasonable to allow UPS to file the following rates:

	(Cents)
Package	77
Local	6.5
Zone 2	7.0
Zone 3	9.0
Zone 4	11.5
Zone 5	14.0

Those authorized rates will generate revenues of $138,630,337 for the test period ($1,404,218 more than existing rates).

Conclusions

1. UPS should be authorized to increase its package rates for movements wholly within Territories A, B, and C and to increase its rates for movements to Zones 2 through 5 to levels set forth in Finding 8.

2. The Commission staff is requested to prepare studies of the fully allocated costs of providing the accessorial services of correction of wrong address, collect on delivery, acknowledgment of delivery, and weekly pickup service, for presentation in the next proceeding in which UPS seeks a general rate increase.

3. Common carriers now maintaining parcel delivery rates comparable to the rates of UPS's 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.

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

O R D E R

IT IS ORDERED that:

1. United Parcel Service Inc. is authorized to establish the increased package rates for movements wholly within Territories A, B, and C, of 77 cents per package and 6.5 cents per pound.

2. United Parcel Service, Inc. is authorized to establish increased package rates for movements to Zones 2 through 5 to the following levels:

Zone 2	7.0 cents
Zone 3	9.0 cents
Zone 4	11.5 cents
Zone 5	14.0 cents

3. 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.

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

5. 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 and 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 Paragraphs 1 and 2 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 effective date of the tariff publications authorized by Ordering Paragraph 3, 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 Paragraphs 1 and 2.

6. 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 the long- and short-haul departures and to this order.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 27th day of JUNE, 1978.

William Symons Jr.
President

Vernon L. Sturgeon

Richard D. Gravelle

Claire T. Dedrick

Commissioners

Commissioner Robert Batinovich, being necessarily absent, did not participate in the disposition of this proceeding.