UNITED PARCEL SERVICE INC
Form 10-Q
May 07, 2012
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United States
Securities and Exchange Commission
Washington, D.C. 20549

Form 10-Q
(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2012, or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission file number 001-15451

United Parcel Service, Inc.
(Exact name of registrant as specified in its charter)

Delaware	58-2480149
(State or Other Jurisdiction of Incorporation or Organization)	(IRS Employer Identification No.)
55 Glenlake Parkway, NE Atlanta, Georgia	30328
(Address of Principal Executive Offices)	(Zip Code)

(404) 828-6000
(Registrant's telephone number, including area code)

Former name, former address and former fiscal year, if changed since last report.

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes þ No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes þ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of "accelerated filer", "large accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. Check one: Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ (Do not check if a smaller reporting company) Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No þ

There were 233,763,372 Class A shares, and 725,732,912 Class B shares, with a par value of $0.01 per share, outstanding at April 20, 2012.

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PART I. FINANCIAL INFORMATION

Cautionary Statement About Forward-Looking Statements

This report includes certain “forward-looking statements” within the meaning of the Private Securities Litigation Reform Act of 1995. Statements in the future tense, and all statements accompanied by terms such as “believe,” “project,” “expect,” “estimate,” “assume,” “intend,” “anticipate,” “target,” “plan,” and variations thereof and similar terms are intended to forward-looking statements. We intend that all forward-looking statements we make will be subject to safe harbor protection of the federal securities laws pursuant to Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934.

Our disclosure and analysis in this report, in our Annual Report on Form 10-K for the year ended December 31, 2011 and in our other filings with the Securities and Exchange Commission contain some forward-looking statements regarding our intent, belief and current expectations about our strategic direction, prospects and future results. From time to time, we also provide forward-looking statements in other materials we release as well as oral forward-looking statements. Such statements give our current expectations or forecasts of future events; they do not relate strictly to historical or current facts. Management believes that these forward-looking statements are reasonable as and when made. However, caution should be taken not to place undue reliance on any such forward-looking statements because such statements speak only as of the date when made.

Forward-looking statements are subject to certain risks and uncertainties that could cause actual results to differ materially from our historical experience and our present expectations or anticipated results. These risks and uncertainties are described in Part I, “Item 1A. Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2011 and may also be described from time to time in our future reports filed with the Securities and Exchange Commission. You should consider the limitations on, and risks associated with, forward-looking statements and not unduly rely on the accuracy of predictions contained in such forward-looking statements. We do not undertake any obligation to update forward-looking statements to reflect events, circumstances, changes in expectations, or the occurrence of unanticipated events after the date of those statements.

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Item 1. Financial Statements
UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
March 31, 2012 (unaudited) and December 31, 2011
(In millions)

	March 31, 2012	December 31, 2011
ASSETS		
Current Assets:		
Cash and cash equivalents	$5,133	$3,034
Marketable securities	947	1,241
Accounts receivable, net	5,637	6,246
Deferred income tax assets	635	611
Other current assets	1,121	1,152
Total Current Assets	13,473	12,284
Property, Plant and Equipment, Net	17,614	17,621
Goodwill	2,177	2,101
Intangible Assets, Net	634	585
Non-Current Investments and Restricted Cash	304	303
Other Non-Current Assets	1,761	1,807
Total Assets	$35,963	$34,701
LIABILITIES AND SHAREOWNERS’ EQUITY		
Current Liabilities:		
Current maturities of long-term debt and commercial paper	$919	$33
Accounts payable	2,000	2,300
Accrued wages and withholdings	1,881	1,843
Self-insurance reserves	772	781
Income taxes payable	567	146
Other current liabilities	1,404	1,411
Total Current Liabilities	7,543	6,514
Long-Term Debt	11,079	11,095
Pension and Postretirement Benefit Obligations	5,465	5,505
Deferred Income Tax Liabilities	1,870	1,900
Self-Insurance Reserves	1,826	1,806
Other Non-Current Liabilities	681	773
Shareowners’ Equity:		
Class A common stock (236 and 240 shares issued in 2012 and 2011)	3	3
Class B common stock (725 and 725 shares issued in 2012 and 2011)	7	7
Additional paid-in capital	—	—
Retained earnings	10,433	10,128
Accumulated other comprehensive loss	(3,020)	(3,103)
Deferred compensation obligations	76	88
Less: Treasury stock (2 shares in 2012 and 2011)	(76)	(88)
Total Equity for Controlling Interests	7,423	7,035
Total Equity for Non-Controlling Interests	76	73
Total Shareowners’ Equity	7,499	7,108
Total Liabilities and Shareowners’ Equity	$35,963	$34,701

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED INCOME
(In millions, except per share amounts)
(unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Revenue	$13,136	$12,582
Operating Expenses:		
Compensation and benefits	6,835	6,562
Repairs and maintenance	302	315
Depreciation and amortization	459	441
Purchased transportation	1,717	1,648
Fuel	1,025	908
Other occupancy	237	261
Other expenses	992	975
Total Operating Expenses	11,567	11,110
Operating Profit	1,569	1,472
Other Income and (Expense):		
Investment income	6	11
Interest expense	(94)	(85)
Total Other Income and (Expense)	(88)	(74)
Income Before Income Taxes	1,481	1,398
Income Tax Expense	511	483
Net Income	$970	$915
Basic Earnings Per Share	$1.01	$0.92
Diluted Earnings Per Share	$1.00	$0.91

STATEMENTS OF CONSOLIDATED COMPREHENSIVE INCOME
(In millions)
(unaudited)

	Three Months Ended March 31, 2012	Three Months Ended March 31, 2011
Net income	$970	$915
Change in foreign currency translation adjustment, net of tax	91	125
Change in unrealized gain (loss) on marketable securities, net of tax	(1)	(4)
Change in unrealized gain (loss) on cash flow hedges, net of tax	(41)	(63)
Change in unrecognized pension and postretirement benefit costs, net of tax	34	55
Comprehensive income	$1,053	$1,028

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
STATEMENTS OF CONSOLIDATED CASH FLOWS
(In millions)
(unaudited)

	Three Months Ended March 31,	
	2012	2011
Cash Flows From Operating Activities:		
Net income	$970	$915
Adjustments to reconcile net income to net cash from operating activities:		
Depreciation and amortization	459	441
Pension and postretirement benefit expense	238	210
Pension and postretirement benefit contributions	(220)	(1,252)
Self-insurance reserves	11	(6)
Deferred taxes, credits and other	(92)	128
Stock compensation expense	162	120
Other (gains) losses	80	23
Changes in assets and liabilities, net of effect of acquisitions:		
Accounts receivable	585	312
Other current assets	(34)	137
Accounts payable	(276)	(81)
Accrued wages and withholdings	43	144
Other current liabilities	377	182
Other operating activities	(23)	8
Net cash from operating activities	2,280	1,281
Cash Flows From Investing Activities:		
Capital expenditures	(428)	(402)
Proceeds from disposals of property, plant and equipment	19	11
Purchases of marketable securities	(1,160)	(1,042)
Sales and maturities of marketable securities	1,462	1,141
Net decrease in finance receivables	24	26
Cash paid for business acquisitions	(100)	—
Other investing activities	(76)	(16)
Net cash used in investing activities	(259)	(282)
Cash Flows From Financing Activities:		
Net change in short-term debt	885	1,297
Proceeds from long-term borrowings	4	12
Repayments of long-term borrowings	—	(113)
Purchases of common stock	(547)	(505)
Issuances of common stock	131	104
Dividends	(534)	(503)
Other financing activities	112	(45)
Net cash provided by financing activities	51	247
Effect Of Exchange Rate Changes On Cash And Cash Equivalents	27	41
Net Increase In Cash And Cash Equivalents	2,099	1,287
Cash And Cash Equivalents:		
Beginning of period	3,034	3,370
End of period	$5,133	$4,657

See notes to unaudited consolidated financial statements.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS
NOTE 1. BASIS OF PRESENTATION
Principles of Consolidation
In our opinion, the accompanying interim, unaudited, consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information and with the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. These consolidated financial statements contain all adjustments (consisting of normal recurring accruals) necessary to present fairly our financial position as of March 31, 2012, our results of operations for the three months ended March 31, 2012 and 2011, and cash flows for the three months ended March 31, 2012 and 2011. The results reported in these consolidated financial statements should not be regarded as necessarily indicative of results that may be expected for the entire year. The interim consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2011.
For interim consolidated financial statement purposes, we provide for accruals under our various employee benefit plans and self-insurance reserves for each three month period based on one quarter of the estimated annual expense.
Certain prior year amounts have been reclassified to conform to the current year presentation. These reclassifications had no impact on our financial position or results of operations.
Fair Value of Financial Instruments
The carrying amount of our cash and cash equivalents, accounts receivable, finance receivables and accounts payable approximate fair value as of March 31, 2012. The fair value of our investment securities is disclosed in Note 4, our short and long-term debt in Note 8 and our derivative instruments in Note 13. We utilized Level 1 inputs in the fair value hierarchy of valuation techniques to determine the fair value of our cash and cash equivalents, and Level 2 inputs to determine the fair value of our accounts receivable, finance receivables and accounts payable.
Accounting Estimates
The preparation of the accompanying interim, unaudited, consolidated financial statements requires management to make estimates and judgments that affect the reported amounts of assets and liabilities and the disclosure of contingencies at the date of the consolidated financial statements as well as the reported amounts of revenues and expenses during the reporting period. Estimates have been prepared on the basis of the most current and best information and actual results could differ materially from those estimates.
Change in Accounting Methodology
As described in our Annual Report on Form 10-K for the year ended December 31, 2011, we elected to change our accounting methodologies for recognizing expense for our company-sponsored U.S. and international pension and other postretirement benefit plans. The impact of these changes in our accounting methodologies was reported through retrospective application of the new policies to all periods presented. Accordingly, all relevant information as of, and for the quarter ended, March 31, 2011 has been adjusted to reflect the application of the new policies.
NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS
Adoption of New Accounting Standards
In May 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standards Update to disclosure requirements for fair value measurement. These amendments, which became effective for us in the first quarter of 2012, result in a common definition of fair value and common measurement and disclosure requirements between U.S. GAAP and IFRS. Consequently, the amendments change some fair value measurement principles and disclosure requirements. The implementation of this amended accounting guidance had an immaterial impact on our consolidated financial position and results of operations.

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In June 2011, the FASB issued an Accounting Standards Update that increases the prominence of items reported in other comprehensive income in the financial statements. This update requires companies to present comprehensive income in a single statement below net income or in a separate statement of comprehensive income immediately following the income statement. This requirement became effective for us beginning with the first quarter of 2012, and we have included the required presentation in this Form 10-Q.

Other accounting pronouncements adopted during the periods covered by the consolidated financial statements had an immaterial impact on our consolidated financial position and results of operations.

Accounting Standards Issued But Not Yet Effective

Accounting pronouncements issued, but not effective until after March 31, 2012, are not expected to have a significant impact on our consolidated financial position or results of operations.

NOTE 3. STOCK-BASED COMPENSATION

We issue employee share-based awards under the UPS Incentive Compensation Plan, which permits the grant of nonqualified stock options, incentive stock options, stock appreciation rights, restricted stock, performance shares, performance units and management incentive awards to eligible employees. The primary compensation programs offered under the UPS Incentive Compensation Plan include the UPS Management Incentive Award program, the UPS Long-Term Incentive Performance Award program and the UPS Stock Option program. We also maintain an employee stock purchase plan which allows eligible employees to purchase shares of UPS class A common stock at a discount. Additionally, our matching contributions to the primary employee defined contribution plan are made in shares of UPS class A common stock.

Compensation Program Changes

Effective January 1, 2011, we modified certain components of our management compensation programs for future award grants, as follows:

- We eliminated our Long-Term Incentive program, and incorporated the value of the award into our Management Incentive Award program. The combined award is referred to as the “Management Incentive Award” program.
- Previously, the restricted stock units granted under the Management Incentive Award program were granted in the fourth quarter of each year, while the restricted performance units granted under the Long-Term Incentive program were granted in the second quarter of each year (restricted stock units and restricted performance units are referred to as “Restricted Units”). Prospectively, Restricted Units granted under the modified Management Incentive Award will generally be granted in the first quarter of each year.

Management Incentive Award

During the first quarter of 2012, we granted Restricted Units under the Management Incentive Award program to eligible management employees. Restricted Units under the Management Incentive Award program will generally vest over a five year period with approximately 20% of the award vesting on January 15th of each of the years following the grant date (except in the case of death, disability, or retirement, in which case immediate vesting occurs). The entire grant is expensed on a straight-line basis over the requisite service period. Based on the date that the eligible management population and performance targets were approved for the Management Incentive Award program, we determined the award measurement date to be February 6, 2012 and therefore the Restricted Units grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of $76.92 on that date.

Long-Term Incentive Performance Award

During the first quarter of 2012, we also granted target Restricted Units under the UPS Long-Term Incentive Performance Award program to eligible management employees. Of the total 2012 target award, 90% of the target award will be divided into three substantially equal tranches, one for each calendar year in the three-year award cycle from 2012 to 2014, using performance criteria targets established each year. For 2012, those targets consist of consolidated operating return on invested capital and growth in consolidated revenue. The remaining 10% of the total 2012 target award will be based upon our achievement of adjusted earnings per share in 2014 compared to a target established at the grant date.

The number of Restricted Units earned each year will be the target number adjusted for the percentage achievement of performance criteria targets for the year. The percentage of achievement used to determine the Restricted Units earned may be a percentage less than or more than 100% of the target Restricted Units for each tranche. Based on the date that the eligible management population and performance targets were approved for the 2012 performance tranches, we determined the award measurement date to be March 1, 2012; therefore the target Restricted Units grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of $76.89 on that date.

Nonqualified Stock Options

Historically, awards granted under the UPS Stock Option program were granted during the second quarter of each year to a limited group of eligible senior management employees. Stock option awards generally vest over a five year period with approximately 20% of the award vesting at each anniversary date of the grant (except in the case of death, disability, or retirement, in which case immediate vesting occurs). The options granted will expire ten years after the date of the grant. In the first quarter of 2012, we granted 0.2 million stock options at a weighted average grant price of $76.94. The weighted average fair value of our employee stock options granted, as determined by the Black-Scholes valuation model, was $14.88 for 2012, using the following assumptions:

	2012	
Expected life (in years)	7.5	
Risk-free interest rate	1.63	%
Expected volatility	25.06	%
Expected dividend yield	2.77	%

Compensation expense for share-based awards recognized in net income for the three months ended March 31, 2012 and 2011 was $162 and $120 million pre-tax, respectively.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
NOTES TO UNAUDITED CONSOLIDATED FINANCIAL STATEMENTS

NOTE 4. CASH AND INVESTMENTS

The following is a summary of marketable securities classified as available-for-sale as of March 31, 2012 and December 31, 2011 (in millions):

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
March 31, 2012				
Current marketable securities:				
U.S. government and agency debt securities	$216	$1	$(1)	$216
Mortgage and asset-backed debt securities	175	3	—	178
Corporate debt securities	382	4	—	386
U.S. state and local municipal debt securities	15	—	—	15
Other debt and equity securities	152	—	—	152
Total marketable securities	$940	$8	$(1)	$947

	Cost	Unrealized Gains	Unrealized Losses	Estimated Fair Value
December 31, 2011				
Current marketable securities:				
U.S. government and agency debt securities	$184	$3	$—	$187
Mortgage and asset-backed debt securities	188	4	(1)	191
Corporate debt securities	835	4	(2)	837
U.S. state and local municipal debt securities	15	—	—	15
Other debt and equity securities	10	1	—	11
Total marketable securities	$1,232	$12	$(3)	$1,241

Auction Rate Securities

During the first quarter 2011, we sold all remaining investments in auction rate securities, which had been classified as non-current marketable securities. These sales did not have a material impact on our statement of consolidated income.

Investment Other-Than-Temporary Impairments

We have concluded that no other-than-temporary impairment losses existed as of March 31, 2012. In making this determination, we considered the financial condition and prospects of the issuers, the magnitude of the losses compared with the investments' cost, the length of time the investments have been in an unrealized loss position, the probability that we will be unable to collect all amounts due according to the contractual terms of the securities, the credit rating of the securities and our ability and intent to hold these investments until the anticipated recovery in market value occurs.

Maturity Information

The amortized cost and estimated fair value of marketable securities at March 31, 2012, by contractual maturity, are shown below (in millions). Actual maturities may differ from contractual maturities because the issuers of the securities may have the right to prepay obligations without prepayment penalties.

	Cost	Estimated Fair Value
Due in one year or less	$385	$385
Due after one year through three years	252	253
Due after three years through five years	44	45
Due after five years	256	261
	937	944

Equity securities	3	3
	$940	$947

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Non-Current Investments and Restricted Cash
We had $286 million of restricted cash related to our self-insurance requirements, as of March 31, 2012 and December 31, 2011, which is reported in “Non-Current Investments and Restricted Cash” on the consolidated balance sheets.
At March 31, 2012 and December 31, 2011 we held an $18 and $17 million, respectively, investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan. This investment is classified as “Non-Current Investments and Restricted Cash” in the consolidated balance sheets with the quarterly change in investment value recognized in the statements of consolidated income.
Fair Value Measurements
Marketable securities utilizing Level 1 inputs include active exchange-traded equity securities and equity index funds, and most U.S. Government debt securities, as these securities all have quoted prices in active markets. Marketable securities utilizing Level 2 inputs include asset-backed securities, corporate bonds and municipal bonds. These securities are valued using market corroborated pricing, matrix pricing or other models that utilize observable inputs such as yield curves.
We maintain holdings in certain investment partnerships that are measured at fair value utilizing Level 3 inputs (classified as “other investments” in the tables below, and as “Other Non-Current Assets” in the consolidated balance sheets). These partnership holdings do not have quoted prices, nor can they be valued using inputs based on observable market data. These investments are valued internally using a discounted cash flow model based on each partnership’s financial statements and cash flow projections. The significant unobservable inputs used in the fair value measurement of the investment partnerships are state and federal tax credits provided by each partnership, tax benefits from investment losses and tax benefits on interest expense. Significant increases or decreases in any of these inputs in isolation would result in changes in the fair value measurement. Generally, a decrease in the assumption used for the state and federal tax credits is accompanied by a directionally similar change in value of the investment.
The following table presents information about our investments measured at fair value on a recurring basis as of March 31, 2012 and December 31, 2011, and indicates the fair value hierarchy of the valuation techniques utilized to determine such fair value (in millions):

	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
March 31, 2012				
Marketable Securities:				
U.S. government and agency debt securities	$216	$ —	$—	$216
Mortgage and asset-backed debt securities	—	178	—	178
Corporate debt securities	—	386	—	386
U.S. state and local municipal debt securities	—	15	—	15
Other debt and equity securities	—	152	—	152
Total marketable securities	216	731	—	947
Other investments	18	—	204	222
Total	$234	$ 731	$204	$1,169

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	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)	Balance
December 31, 2011				
Marketable Securities:				
U.S. government and agency debt securities	$187	$ —	$—	$187
Mortgage and asset-backed debt securities	—	191	—	191
Corporate debt securities	—	837	—	837
U.S. state and local municipal debt securities	—	15	—	15
Other debt and equity securities	—	11	—	11
Total marketable securities	187	1,054	—	1,241
Other investments	17	—	217	234
Total	$204	$ 1,054	$217	$1,475

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the three months ended March 31, 2012 and 2011 (in millions):

	Marketable Securities	Other Investments	Total
Balance on January 1, 2012	$—	$217	$217
Transfers into (out of) Level 3	—	—	—
Net realized and unrealized gains (losses):	—	—	—
Included in earnings (in investment income)	—	(13)	(13)
Included in accumulated other comprehensive income (pre-tax)	—	—	—
Purchases	—	—	—
Sales	—	—	—
Balance on March 31, 2012	$—	$204	$204
Balance on January 1, 2011	$138	$267	$405
Transfers into (out of) Level 3	—	—	—
Net realized and unrealized gains (losses):	—	—	—
Included in earnings (in investment income)	—	(13)	(13)
Included in accumulated other comprehensive income (pre-tax)	—	—	—
Purchases	—	—	—
Sales	(138)	—	(138)
Balance on March 31, 2011	$—	$254	$254

There were no transfers of investments between Level 1 and Level 2 during the three months ended March 31, 2012 and 2011.

NOTE 5. PROPERTY, PLANT AND EQUIPMENT

Property, plant and equipment as of March 31, 2012 and December 31, 2011 consist of the following (in millions):

	2012	2011
Vehicles	$5,954	$5,981
Aircraft (including aircraft under capitalized leases)	14,763	14,616
Land	1,110	1,114
Buildings	3,105	3,095
Building and leasehold improvements	2,985	2,943
Plant equipment	6,863	6,803
Technology equipment	1,642	1,593
Equipment under operating leases	89	93
Construction-in-progress	374	303
	36,885	36,541
Less: Accumulated depreciation and amortization	(19,271)	(18,920)
	$17,614	$17,621

NOTE 6. EMPLOYEE BENEFIT PLANS

Information about net periodic benefit cost for our company-sponsored pension and postretirement benefit plans is as follows for the three months ended March 31, 2012 and 2011 (in millions):

	U.S. Pension Benefits		U.S. Postretirement Medical Benefits		International Pension Benefits	
	2012	2011	2012	2011	2012	2011
Net Periodic Cost:						
Service cost	$249	$218	$22	$22	$15	$9
Interest cost	353	327	52	52	11	10
Expected return on assets	(492)	(489)	(4)	(4)	(12)	(11)
Amortization of:						
Transition obligation	—	—	—	—	—	—
Prior service cost	43	43	1	2	—	—
Other net (gain) loss	—	30	—	—	—	1
Actuarial (gain) loss	—	—	—	—	—	—
Net periodic benefit cost	$153	$129	$71	$72	$14	$9

During the first three months of 2012, we contributed $192 million and $28 million to our company-sponsored pension and postretirement medical benefit plans, respectively. We also expect to contribute $232 and $443 million over the remainder of the year to the pension and U.S. postretirement medical benefit plans, respectively.

As of December 31, 2011, we had approximately 245,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters ("Teamsters"). These agreements run through July 31, 2013. We have approximately 2,700 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association, which became amendable at the end of 2011. Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which runs through November 1, 2013. In addition, approximately 3,200 of our ground mechanics who are not employed under agreements with the Teamsters are employed under collective bargaining agreements with the International Association of Machinists and Aerospace Workers ("IAM"). Our agreement with the IAM runs through July 31, 2014.

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UNITED PARCEL SERVICE, INC. AND SUBSIDIARIES
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We contribute to a number of multiemployer defined benefit and health and welfare plans under terms of collective bargaining agreements that cover our union-represented employees. Our current collective bargaining agreements set forth the annual contribution increases allotted to the plans that we participate in, and we are in compliance with these contribution rates. These limitations will remain in effect throughout the terms of the existing collective bargaining agreements.

NOTE 7. GOODWILL AND INTANGIBLE ASSETS

The following table indicates the allocation of goodwill by reportable segment as of March 31, 2012 and December 31, 2011 (in millions):

	U.S. Domestic Package	International Package	Supply Chain & Freight	Consolidated
December 31, 2011 balance	$—	$361	$ 1,740	$2,101
Acquired	—	67	—	67
Currency / Other	—	4	5	9
March 31, 2012 balance	—	$432	$ 1,745	$2,177

The increase in goodwill in the International Package segment was due to the acquisition of Kiala S.A., a firm based in Brussels that provides e-commerce retailers a platform to offer delivery options to consumers. The purchase price allocation was not complete as of March 31, 2012 and therefore adjustments to the recorded amount of goodwill may occur in 2012 prior to the one year anniversary of the acquisition. The remaining increase in goodwill for both the International and Supply Chain & Freight segments was due to the impact of the weakening U.S. Dollar on the translation of non-U.S. Dollar goodwill balances.

The following is a summary of intangible assets as of March 31, 2012 and December 31, 2011 (in millions):

	Gross Carrying Amount	Accumulated Amortization	Net Carrying Value
March 31, 2012:			
Trademarks, licenses, patents, and other	$189	$(65)	$124
Customer lists	132	(70)	62
Franchise rights	111	(59)	52
Capitalized software	2,062	(1,666)	396
Total Intangible Assets, Net	$2,494	$(1,860)	$634
December 31, 2011:			
Trademarks, licenses, patents, and other	$146	$(54)	$92
Customer lists	120	(66)	54
Franchise rights	109	(58)	51
Capitalized software	2,014	(1,626)	388
Total Intangible Assets, Net	$2,389	$(1,804)	$585

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NOTE 8. DEBT AND FINANCING ARRANGEMENTS

The carrying value of our outstanding debt as of March 31, 2012 and December 31, 2011 consists of the following (in millions):

	Maturity	2012	2011
Commercial paper	2012	$885	$—
4.50% senior notes	2013	1,773	1,778
3.875% senior notes	2014	1,048	1,050
5.50% senior notes	2018	837	841
5.125% senior notes	2019	1,109	1,119
8.375% debentures	2020	498	504
3.125% senior notes	2021	1,629	1,641
8.375% debentures	2030	283	284
6.20% senior notes	2038	1,480	1,480
4.875% senior notes	2040	489	489
Floating rate senior notes	2049-2053	376	376
Facility notes and bonds	2015-2036	320	320
Pound Sterling notes	2031/2050	793	777
Capital lease obligations	2012-3004	476	469
Other debt	2022	2	—
Total Debt		11,998	11,128
Less: Current Maturities		(919)	(33)
Long-term Debt		$11,079	$11,095

Debt Classification

We have classified our 4.50% senior notes with a principal balance of $1.750 billion due in January 2013 as a long-term liability, based on our intent and ability to refinance the debt as of March 31, 2012.

Sources of Credit

We are authorized to borrow up to $10.0 billion under the U.S. commercial paper program we maintain. We had $885 million outstanding under this program as of March 31, 2012, with an average interest rate of 0.04%. As of March 31, 2012, we have classified the entire commercial paper balance as a current liability in our consolidated balance sheets.

We also maintain a European commercial paper program under which we are authorized to borrow up to €1.0 billion in a variety of currencies, however there were no amounts outstanding under this program as of March 31, 2012.

We maintain two credit agreements with a consortium of banks. One of these agreements provides revolving credit facilities of $1.5 billion, and expires on April 11, 2013. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to Citibank’s publicly announced base rate, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our 1-year credit default swap spread, subject to a minimum rate of 0.10% and a maximum rate of 0.75%. The applicable margin for advances bearing interest based on the base rate is 1.00% below the applicable margin for LIBOR advances (but not lower than 0.00%). We are also able to request advances under this facility based on competitive bids for the applicable interest rate. There were no amounts outstanding under this facility as of March 31, 2012.

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The second agreement provides revolving credit facilities of $1.0 billion, and expires on April 12, 2017. Generally, amounts outstanding under this facility bear interest at a periodic fixed rate equal to LIBOR for the applicable interest period and currency denomination, plus an applicable margin. Alternatively, a fluctuating rate of interest equal to Citibank's publicly announced base rate, plus an applicable margin, may be used at our discretion. In each case, the applicable margin for advances bearing interest based on LIBOR is a percentage determined by quotations from Markit Group Ltd. for our credit default swap spread, interpolated for a period from the date of determination of such credit default swap spread in connection with a new interest period until the latest maturity date of this facility then in effect (but not less than a period of one year). The applicable margin is subject to certain minimum rates and maximum rates based on our public debt ratings from Standard & Poor's Rating Service and Moody's Investors Service. The minimum applicable margin rates range from 0.100% to 0.375%, and the maximum applicable margin rates range from 0.750% to 1.250%. The applicable margin for advances bearing interest based on the base rate is 1.00% below the applicable margin for LIBOR advances (but not less than 0.00%). We are also able to request advances under this facility based on competitive bids. There were no amounts outstanding under this facility as of March 31, 2012.

Debt Covenants

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of March 31, 2012 and for all prior periods, we have satisfied these financial covenants. These covenants limit the amount of secured indebtedness that we may incur, and limit the amount of attributable debt in sale-leaseback transactions, to 10% of net tangible assets. As of March 31, 2012, 10% of net tangible assets is equivalent to $2.561 billion, however we have no covered sale-leaseback transactions or secured indebtedness outstanding. Additionally, we are required to maintain a minimum net worth, as defined, of $5.0 billion on a quarterly basis. As of March 31, 2012, our net worth, as defined, was equivalent to $10.443 billion. We do not expect these covenants to have a material impact on our financial condition or liquidity.

Fair Value of Debt

Based on the borrowing rates currently available to the Company for long-term debt with similar terms and maturities, the fair value of long-term debt, including current maturities, is approximately $12.970 and $12.035 billion as of March 31, 2012 and December 31, 2011, respectively. We utilized Level 2 inputs in the fair value hierarchy of valuation techniques to determine the fair value of all of our debt instruments.

NOTE 9. LEGAL PROCEEDINGS AND CONTINGENCIES

We are involved in a number of judicial proceedings and other matters arising from the conduct of our business activities.

Although there can be no assurance as to the ultimate outcome, we have generally denied, or believe we have a meritorious defense and will deny, liability in all litigation pending against us, including the matters described below, and we intend to defend vigorously each case. We have accrued for legal claims when, and to the extent that, amounts associated with the claims become probable and can be reasonably estimated. The actual costs of resolving legal claims may be substantially higher or lower than the amounts accrued for those claims.

For those matters as to which we are not able to estimate a possible loss or range of loss, we are not able to determine whether the loss will have a material adverse effect on our business, financial condition or results of operations or liquidity. For matters in this category, we have indicated in the descriptions that follow the reasons that we are unable to estimate the possible loss or range of loss.

Judicial Proceedings

We are a defendant in a number of lawsuits filed in state and federal courts containing various class action allegations under state wage-and-hour laws. At this time, we do not believe that any loss associated with these matters, would have a material adverse effect on our financial condition, results of operations or liquidity.

UPS and our subsidiary Mail Boxes Etc., Inc. are defendants in two lawsuits about the rebranding or purchase of The UPS Store franchises-Morgate and Samica. We prevailed at the trial court level in both cases, and plaintiffs appealed.

•Morgate was filed in March 2003. The plaintiffs are 125 individual franchisees who did not rebrand and a certified class of all franchisees who did rebrand to The UPS Store. A bellwether trial for three individual plaintiffs was set for early 2010, but the trial court entered judgment against one of the three plaintiffs prior to trial, which was affirmed in January 2012. Plaintiffs have filed a petition for review with the California Supreme Court. The trial court also granted our motion for summary judgment against the members of the certified class, which was reversed in January 2012.

•Samica was filed in March 2006. The plaintiffs are 250 individual The UPS Store franchisees who either elected to rebrand or purchased new The UPS Store franchises. Summary judgment was granted in UPS's favor and affirmed on appeal in December 2011. Plaintiffs have indicated that they intend to file a petition for certiorari with the United States Supreme Court.

There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) three separate components of these cases were being appealed to federal and state courts following decisions favorable to UPS; and (2) it remains uncertain what evidence of damages, if any, plaintiffs will be able to present if any aspects of these cases proceed forward. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In AFMS LLC v. UPS and FedEx Corporation, a lawsuit filed in federal court in the Central District of California in August 2010, the plaintiff asserts that UPS and FedEx violated U.S. antitrust law by conspiring to refuse to negotiate with third party negotiators retained by shippers and by individually imposing policies that prevent shippers from using such negotiators. The Antitrust Division of the U.S. Department of Justice (“DOJ”) has informed us that it has opened a civil investigation of our policies and practices for dealing with third party negotiators. We are cooperating with this investigation. We deny any liability with respect to these matters and intend to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) we believe that we have a number of meritorious defenses; (2) discovery is ongoing; and (3) the DOJ investigation is ongoing. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

In Canada, three purported class-action cases were filed against us in British Columbia (2006); Ontario (2007) and Québec (2006). The cases each allege inadequate disclosure concerning the existence and cost of brokerage services provided by us under applicable provincial consumer protection legislation and infringement of interest restriction provisions under the Criminal Code of Canada. The British Columbia class-action was declared inappropriate for certification and dismissed by the trial judge. That decision was upheld by the British Columbia Court of Appeal in March 2010, which ended the case in our favor. The Ontario class action was certified in September 2011. Partial summary judgment was granted to us and the plaintiffs by the Ontario motions court. The complaint under the Criminal Code was dismissed. No appeal is being taken from that decision. The allegations of inadequate disclosure were granted and we are appealing that decision. The request to certify the case in Québec was heard in February 2012. We have denied all liability and are vigorously defending the two outstanding cases. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters, including (1) we are vigorously defending ourselves and believe that we have a number of meritorious legal defenses and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of these matters. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operation or liquidity.

Other Matters

In May and December 2007 and August 2008 we received and responded to grand jury subpoenas from the DOJ in the Northern District of California in connection with an investigation by the Drug Enforcement Administration. We also have responded to informal requests for information in connection with this investigation, which relates to transportation of packages on behalf of on-line pharmacies that may have operated illegally. We are cooperating with this investigation and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from this matter, including (1) we are vigorously defending ourselves and believe we have a number of meritorious legal defenses and (2) there are unresolved questions of law and fact that could be important to the ultimate resolution of this matter. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from this matter or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

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We received a grand jury subpoena from the Antitrust Division of the DOJ regarding the DOJ's investigation into certain pricing practices in the freight forwarding industry in December 2007.

In August 2010, competition authorities in Brazil opened an administrative proceeding to investigate alleged anticompetitive behavior in the freight forwarding industry. Approximately 45 freight forwarding companies and individuals are named in the proceeding, including UPS, UPS SCS Transportes (Brasil) S.A., and a former employee in Brazil. UPS will have an opportunity to respond to these allegations.

We are cooperating with each of these investigations, and intend to continue to vigorously defend ourselves. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including (1) we are vigorously defending each matter and believe that we have a number of meritorious legal defenses; (2) there are unresolved questions of law that could be of importance to the ultimate resolutions of these matters, including the calculation of any potential fine; and (3) there is uncertainty about the time period that is the subject of the investigations. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

On March 28, 2012, the European Commission ("Commission") announced a decision finding that 14 freight forwarders, including UPS, had infringed EU competition law. The Commission assessed a fine on UPS in the amount of €10 million. We are currently evaluating the decision and a potential appeal.

In January 2008, a class action complaint was filed in the United States District Court for the Eastern District of New York alleging price-fixing activities relating to the provision of freight forwarding services. UPS was not named in this case. In July 2009, the plaintiffs filed a first amended complaint naming numerous global freight forwarders as defendants. UPS and UPS Supply Chain Solutions are among the 60 defendants named in the amended complaint. We intend to vigorously defend ourselves in this case. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from these matters including: (1) the magistrate judge recommended that the district court grant our motion to dismiss, with leave to amend, and the scope of the plaintiffs' claims is therefore unclear; (2) the scope and size of the proposed class is ill-defined; (3) there are significant legal questions about the adequacy and standing of the putative class representatives; and (4) we believe that we have a number of meritorious legal defenses. Accordingly, at this time, we are not able to estimate a possible loss or range of loss that may result from these matters or to determine whether such loss, if any, would have a material adverse effect on our financial condition, results of operations or liquidity.

We are a defendant in various other lawsuits that arose in the normal course of business. We do not believe that the eventual resolution of these other lawsuits (either individually or in the aggregate), including any reasonably possible losses in excess of current accruals, will have a material adverse effect on our financial condition, results of operations or liquidity.

NOTE 10. SHAREOWNERS' EQUITY

Capital Stock, Additional Paid-In Capital and Retained Earnings

We maintain two classes of common stock, which are distinguished from each other primarily by their respective voting rights. Class A shares are entitled to 10 votes per share, whereas class B shares are entitled to one vote per share. Class A shares are primarily held by UPS employees and retirees, and these shares are fully convertible into class B shares at any time. Class B shares are publicly traded on the New York Stock Exchange under the symbol “UPS.” Class A and B shares both have a $0.01 par value, and as of March 31, 2012, there were 4.6 billion class A shares and 5.6 billion class B shares authorized to be issued. Additionally, there are 200 million preferred shares, with a $0.01 par value, authorized to be issued; as of March 31, 2012, no preferred shares had been issued.

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The following is a rollforward of our common stock, additional paid-in capital and retained earnings accounts for the three months ended March 31, 2012 and 2011 (in millions, except per share amounts):

	2012		2011	
	Shares	Dollars	Shares	Dollars
Class A Common Stock				
Balance at beginning of period	240	$3	258	$3
Common stock purchases	(2)	—	(2)	—
Stock award plans	2	—	1	—
Common stock issuances	1	—	1	—
Conversions of class A to class B common stock	(5)	—	(6)	—
Class A shares issued at end of period	236	$3	252	$3
Class B Common Stock				
Balance at beginning of period	725	$7	735	$7
Common stock purchases	(5)	—	(5)	—
Conversions of class A to class B common stock	5	—	6	—
Class B shares issued at end of period	725	$7	736	$7
Additional Paid-In Capital				
Balance at beginning of period		$—		$—
Stock award plans		210		143
Common stock purchases		(428)		(176)
Common stock issuances		63		58
Option premiums received (paid)		155		(25)
Balance at end of period		$—		$—
Retained Earnings				
Balance at beginning of period		$10,128		$10,604
Net income		970		915
Dividends ($0.57 and $0.52 per share)		(551)		(518)
Common stock purchases		(114)		(325)
Balance at end of period		$10,433		$10,676

From time to time, we enter into share repurchase programs with large financial institutions to assist in our buyback of company stock. These programs allow us to repurchase our shares at a price below the weighted average UPS share price for a given period. During the first quarter of 2012, we entered into an accelerated share repurchase program, which allowed us to repurchase $350 million of shares (4.6 million shares). The program was completed in March 2012.

In total, we repurchased a total of 7.1 million shares of class A and class B common stock for $542 million during the three months ended March 31, 2012, and 6.8 million shares for $501 million for the three months ended March 31, 2011. On May 3, 2012, the Board of Directors approved a new share repurchase authorization of $5.0 billion, which replaces an authorization previously announced in 2008. The new share repurchase authorization has no expiration date.

In order to lower the average cost of acquiring shares in our ongoing share repurchase program, we periodically enter into structured repurchase agreements involving the use of capped call options for the purchase of UPS class B shares. We pay a fixed sum of cash upon execution of each agreement in exchange for the right to receive either a pre-determined amount of cash or stock. Upon expiration of each agreement, if the closing market price of our common stock is above the pre-determined price, we will have our initial investment returned with a premium in either cash or shares (at our election). If the closing market price of our common stock is at or below the pre-determined price, we will receive the number of shares specified in the agreement. During the three months ended March 31, 2012, we did not pay premiums on options for the purchase of shares. However, we received $155 million in premiums for options that were entered into during 2011 that expired during this quarter. During the three months ended March 31, 2011, we paid $25 million in premiums on options for the purchase of shares, and had not received any premiums in excess of our initial investment.

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Accumulated Other Comprehensive Income (Loss)

We experience activity in AOCI for unrealized holding gains and losses on available-for-sale securities, foreign currency translation adjustments, unrealized gains and losses from derivatives that qualify as hedges of cash flows and unrecognized pension and postretirement benefit costs. The activity in AOCI for the three months ended March 31, 2012 and 2011 is as follows (in millions):

	2012	2011
Foreign currency translation gain (loss):		
Balance at beginning of period	$(160)	$(68)
Aggregate adjustment for the period (net of tax effect of $(11) and $(9))	91	125
Balance at end of period	(69)	57
Unrealized gain (loss) on marketable securities, net of tax:		
Balance at beginning of period	6	12
Current period changes in fair value (net of tax effect of $0, and $2)	1	4
Reclassification to earnings (net of tax effect of $(1) and $(4))	(2)	(8)
Balance at end of period	5	8
Unrealized gain (loss) on cash flow hedges, net of tax:		
Balance at beginning of period	(204)	(239)
Current period changes in fair value (net of tax effect of $(25) and $(32))	(42)	(53)
Reclassification to earnings (net of tax effect of $0 and $(6))	1	(10)
Balance at end of period	(245)	(302)
Unrecognized pension and postretirement benefit costs, net of tax:		
Balance at beginning of period	(2,745)	(2,340)
Reclassification to earnings (net of tax effect of $16 and $29)	28	47
Adjustment for Early Retirement Reinsurance Program (net of tax effect of $4 and $4)	6	8
Balance at end of period	(2,711)	(2,285)
Accumulated other comprehensive income (loss) at end of period	$(3,020)	$(2,522)

Deferred Compensation Obligations and Treasury Stock

Activity in the deferred compensation program for the three months ended March 31, 2012 and 2011 is as follows (in millions):

	2012		2011	
	Shares	Dollars	Shares	Dollars
Deferred Compensation Obligations:				
Balance at beginning of period		$88		$103
Reinvested dividends		1		1
Benefit payments		(13)		(19)
Balance at end of period		$76		$85
Treasury Stock:				
Balance at beginning of period	(2)	$(88)	(2)	$(103)
Reinvested dividends	—	(1)	—	(1)
Benefit payments	—	13	—	19
Balance at end of period	(2)	$(76)	(2)	$(85)

Noncontrolling Interests:

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments. The noncontrolling interests on our consolidated balance sheets primarily relate to a joint venture in Dubai that operates in the Middle East, Turkey and portions of the Central Asia region. The activity related to our noncontrolling interests is presented below for the three months ended March 31, 2012 and 2011 (in millions):

	2012	2011
Noncontrolling Interests:		
Balance at beginning of period	$73	$68
Acquired noncontrolling interests	3	2
Dividends attributable to noncontrolling interests	—	—
Net income attributable to noncontrolling interests	—	—
Balance at end of period	$76	$70

NOTE 11. SEGMENT INFORMATION

We report our operations in three segments: U.S. Domestic Package operations, International Package operations and Supply Chain & Freight operations. Package operations represent our most significant business and are broken down into regional operations around the world. Regional operations managers are responsible for both domestic and export operations within their geographic area.

U.S. Domestic Package

Domestic Package operations include the time-definite delivery of letters, documents and packages throughout the United States.

International Package

International Package operations include delivery to more than 220 countries and territories worldwide, including shipments wholly outside the United States, as well as shipments with either origin or distribution outside the United States. Our International Package reporting segment includes the operations of our Europe, Asia and Americas operating segments.

Supply Chain & Freight

Supply Chain & Freight includes our forwarding operations, logistics operations, UPS Freight and other aggregated business units. Our forwarding and logistics business provides services in more than 195 countries and territories worldwide, and includes supply chain design and management, freight distribution, customs brokerage, mail and consulting services. UPS Freight offers a variety of less-than-truckload (“LTL”) and truckload (“TL”) services to customers in North America. Other aggregated business units within this segment include Mail Boxes Etc., Inc. (the franchisor of Mail Boxes Etc. and The UPS Store) and UPS Capital.

In evaluating financial performance, we focus on operating profit as a segment’s measure of profit or loss. Operating profit is before investment income, interest expense and income taxes. The accounting policies of the reportable segments are the same as those described in the summary of accounting policies included in the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2011, with certain expenses allocated between the segments using activity-based costing methods. Unallocated assets are comprised primarily of cash, marketable securities and investments in limited partnerships.

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Segment information for the three months ended March 31, 2012 and 2011 is as follows (in millions):

	Three Months Ended March 31,	
	2012	2011
Revenue:		
U.S. Domestic Package	$8,004	$7,543
International Package	2,966	2,900
Supply Chain & Freight	2,166	2,139
Consolidated	$13,136	$12,582
Operating Profit:		
U.S. Domestic Package	$995	$880
International Package	408	453
Supply Chain & Freight	166	139
Consolidated	$1,569	$1,472

NOTE 12. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the three months ended March 31, 2012 and 2011 (in millions, except per share amounts):

	Three Months Ended March 31,	
	2012	2011
Numerator:		
Net income attributable to common shareowners	$970	$915
Denominator:		
Weighted average shares	959	988
Deferred compensation obligations	2	2
Vested portion of restricted shares	1	2
Denominator for basic earnings per share	962	992
Effect of dilutive securities:		
Restricted performance units	4	3
Restricted stock units	5	6
Stock option plans	1	1
Denominator for diluted earnings per share	972	1,002
Basic earnings per share	$1.01	$0.92
Diluted earnings per share	$1.00	$0.91

Diluted earnings per share for the three months ended March 31, 2012 and 2011 exclude the effect of 2.6 and 5.0 million shares of common stock, respectively, that may be issued upon the exercise of employee stock options, because such effect would be antidilutive.

NOTE 13. DERIVATIVE INSTRUMENTS AND RISK MANAGEMENT

Risk Management Policies

We are exposed to market risk, primarily related to foreign exchange rates, commodity prices and interest rates. These exposures are actively monitored by management. To manage the volatility relating to certain of these exposures, we enter into a variety of derivative financial instruments. Our objective is to reduce, where it is deemed appropriate to do so, fluctuations in earnings and cash flows associated with changes in foreign currency rates, commodity prices and interest rates. It is our policy and practice to use derivative financial instruments only to the extent necessary to manage exposures. As we use price sensitive instruments to hedge a certain portion of our existing and anticipated transactions, we expect that any loss in value for those instruments generally would be offset by increases in the value of those hedged transactions. We do not hold or issue derivative financial instruments for trading or speculative purposes.

Credit Risk Management

The forward contracts, swaps and options discussed below contain an element of risk that the counterparties may be unable to meet the terms of the agreements. However, we minimize such risk exposures for these instruments by limiting the counterparties to banks and financial institutions that meet established credit guidelines, and monitoring counterparty credit risk to prevent concentrations of credit risk with any single counterparty.

We have agreements with substantially all of our active counterparties containing early termination rights and/or bilateral collateral provisions whereby cash is required whenever the net fair value of derivatives associated with those counterparties exceed specific thresholds. Events such as a credit rating downgrade (depending on the ultimate rating level) would typically require an increase in the amount of collateral required of the counterparty and/or allow us to take additional protective measures such as early termination of trades. At March 31, 2012, we held cash collateral of $56 million under these agreements.

In connection with the agreements described above, we could also be required to provide additional collateral or terminate transactions with certain counterparties in the event of a downgrade of our debt rating. The amount of additional collateral is a fixed incremental amount. At March 31, 2012, the aggregate fair value of the instruments covered by these contractual features that were in a net liability position was $11 million. The Company has never been required to post any collateral as a result of these contractual features.

We have not historically incurred, and do not expect to incur in the future, any losses as a result of counterparty default.

Accounting Policy for Derivative Instruments

We recognize all derivative instruments as assets or liabilities in the consolidated balance sheets at fair value. The accounting for changes in the fair value of a derivative instrument depends on whether it has been designated and qualifies as part of a hedging relationship and, further, on the type of hedging relationship. For those derivative instruments that are designated and qualify as hedging instruments, a company must designate the derivative, based upon the exposure being hedged, as a cash flow hedge, a fair value hedge or a hedge of a net investment in a foreign operation.

A cash flow hedge refers to hedging the exposure to variability in expected future cash flows that is attributable to a particular risk. For derivative instruments that are designated and qualify as a cash flow hedge, the effective portion of the gain or loss on the derivative instrument is reported as a component of AOCI, and reclassified into earnings in the same period during which the hedged transaction affects earnings. The remaining gain or loss on the derivative instrument in excess of the cumulative change in the present value of future cash flows of the hedged item, or hedge components excluded from the assessment of effectiveness, are recognized in the statements of consolidated income during the current period.

A fair value hedge refers to hedging the exposure to changes in the fair value of an existing asset or liability on the consolidated balance sheets that is attributable to a particular risk. For derivative instruments that are designated and qualify as a fair value hedge, the gain or loss on the derivative instrument is recognized in the statements of consolidated income during the current period, as well as the offsetting gain or loss on the hedged item.

A net investment hedge refers to the use of cross currency swaps, forward contracts or foreign currency denominated debt to hedge portions of our net investments in foreign operations. For hedges that meet the effectiveness requirements, the net gains or losses attributable to changes in spot exchange rates are recorded in the cumulative translation adjustment within other AOCI. The remainder of the change in value of such instruments is recorded in earnings.

Types of Hedges

Commodity Risk Management

Currently, the fuel surcharges that we apply to our domestic and international package and LTL services are the primary means of reducing the risk of adverse fuel price changes on our business. We periodically enter into option contracts on energy commodity products to manage the price risk associated with forecasted transactions involving refined fuels, principally jet-A, diesel and unleaded gasoline. The objective of the hedges is to reduce the variability of cash flows, due to changing fuel prices, associated with the forecasted transactions involving those products. We have designated and account for these contracts as cash flow hedges of the underlying forecasted transactions involving these fuel products and, therefore, the resulting gains and losses from these hedges are recognized as a component of fuel expense or revenue when the underlying transactions occur.

Foreign Currency Risk Management

To protect against the reduction in value of forecasted foreign currency cash flows from our international package business, we maintain a foreign currency cash flow hedging program. Our most significant foreign currency exposures relate to the Euro, the British Pound Sterling and the Canadian Dollar. We hedge portions of our forecasted revenue denominated in foreign currencies with option contracts. We have designated and account for these contracts as cash flow hedges of anticipated foreign currency denominated revenue and, therefore, the resulting gains and losses from these hedges are recognized as a component of international package revenue when the underlying sales transactions occur.

We also hedge portions of our anticipated cash settlements of intercompany transactions subject to foreign currency remeasurement using foreign currency forward contracts. We have designated and account for these contracts as cash flow hedges of forecasted foreign currency denominated transactions, and therefore the resulting gains and losses from these hedges are recognized as a component of other operating expense when the underlying transactions are subject to currency remeasurement.

We have foreign currency denominated debt obligations and capital lease obligations associated with our aircraft. For some of these debt obligations and leases, we hedge the foreign currency denominated contractual payments using cross-currency interest rate swaps, which effectively convert the foreign currency denominated contractual payments into U.S. Dollar denominated payments. We have designated and account for these swaps as cash flow hedges of the forecasted contractual payments and, therefore, the resulting gains and losses from these hedges are recognized in the statements of consolidated income when the currency remeasurement gains and losses on the underlying debt obligations and leases are incurred.

Interest Rate Risk Management

Our indebtedness under our various financing arrangements creates interest rate risk. We use a combination of derivative instruments, including interest rate swaps and cross-currency interest rate swaps, as part of our program to manage the fixed and floating interest rate mix of our total debt portfolio and related overall cost of borrowing. The notional amount, interest payment date and maturity date of the swaps match the terms of the associated debt being hedged. Interest rate swaps allow us to maintain a target range of floating rate debt within our capital structure.

We have designated and account for the majority of our interest rate swaps that convert fixed rate interest payments into floating rate interest payments as hedges of the fair value of the associated debt instruments. Therefore, the gains and losses resulting from fair value adjustments to the interest rate swaps and fair value adjustments to the associated debt instruments are recorded to interest expense in the period in which the gains and losses occur. We have designated and account for interest rate swaps that convert floating rate interest payments into fixed rate interest payments as cash flow hedges of the forecasted payment obligations. The gains and losses resulting from fair value adjustments to the interest rate swaps are recorded to AOCI.

We periodically hedge the forecasted fixed-coupon interest payments associated with anticipated debt offerings, using forward starting interest rate swaps, interest rate locks or similar derivatives. These agreements effectively lock a portion of our interest rate exposure between the time the agreement is entered into and the date when the debt offering is completed, thereby mitigating the impact of interest rate changes on future interest expense. These derivatives are settled commensurate with the issuance of the debt, and any gain or loss upon settlement is amortized as an adjustment to the effective interest yield on the debt.

Outstanding Positions

As of March 31, 2012 and December 31, 2011, the notional amounts of our outstanding derivative positions were as follows (in millions):

	March 31, 2012		December 31, 2011	
Currency hedges:				
Euro	€	2,337	€	1,685
British Pound Sterling	£	876	£	870
Canadian Dollar	C$	474	C$	318
Interest rate hedges:				
Fixed to Floating Interest Rate Swaps	$	6,424	$	6,424
Floating to Fixed Interest Rate Swaps	$	789	$	791
Interest Rate Basis Swaps	$	2,500	$	—
Forward Starting Swaps	$	500	$	—

As of March 31, 2012, we had no outstanding commodity hedge positions. The maximum term over which we are hedging exposures to the variability of cash flow is 39 years.

Balance Sheet Recognition and Fair Value Measurements

The following table indicates the location on the consolidated balance sheets in which our derivative assets and liabilities have been recognized, the fair value hierarchy level applicable to each derivative type and the related fair values of those derivatives (in millions). The table is segregated between those derivative instruments that qualify and are designated as hedging instruments and those that are not, as well as by type of contract and whether the derivative is in an asset or liability position.

Asset Derivatives	Balance Sheet Location	Fair Value Hierarchy Level	March 31, 2012	December 31, 2011
Derivatives designated as hedges:				
Foreign exchange contracts	Other current assets	Level 2	$85	$164
Foreign exchange contracts	Other non-current assets	Level 2	23	—
Interest rate contracts	Other non-current assets	Level 2	365	401
Derivatives not designated as hedges:				
Foreign exchange contracts	Other current assets	Level 2	—	2
Interest rate contracts	Other non-current assets	Level 2	70	82
Total Asset Derivatives			$543	$649

Liability Derivatives	Balance Sheet Location	Fair Value Hierarchy Level	March 31, 2012	December 31, 2011
Derivatives designated as hedges:				
Interest rate contracts	Other current liabilities	Level 2	$9	$—
Foreign exchange contracts	Other non-current liabilities	Level 2	143	185
Interest rate contracts	Other non-current liabilities	Level 2	12	13
Derivatives not designated as hedges:				
Interest rate contracts	Other non-current liabilities	Level 2	2	10
Total Liability Derivatives			$166	$208

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Our foreign currency, interest rate and energy derivatives are largely comprised of over-the-counter derivatives, which are primarily valued using pricing models that rely on market observable inputs such as yield curves, currency exchange rates and commodity forward prices, and therefore are classified as Level 2.

Income Statement Recognition

The following table indicates the amount and location in the statements of consolidated income for the three months ended March 31, 2012 and 2011 in which derivative gains and losses, as well as the related amounts reclassified from AOCI, have been recognized for those derivatives designated as cash flow hedges (in millions):

Derivative Instruments in Cash Flow Hedging Relationships	2012 Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	2011 Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion)	Location of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	2012 Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)	2011 Amount of Gain (Loss) Reclassified from Accumulated OCI into Income (Effective Portion)
Interest rate contracts	$(8)	$—	Interest Expense	$ (5)	$ (5)
Foreign exchange contracts	41	18	Interest Expense	16	34
Foreign exchange contracts	(5)	—	Other Operati		