UNITED PARCEL SERVICE INC
Form 10-Q
August 07, 2015


United States
Securities and Exchange Commission
Washington, D.C. 20549

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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 June 30, 2015, 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

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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)

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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 197,740,294 Class A shares, and 698,448,250 Class B shares, with a par value of $0.01 per share, outstanding at July 27, 2015.

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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, 2014 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 include, but are not limited to: general economic conditions, both in the U.S. and internationally; significant competition on a local, regional, national, and international basis; changes in our relationships with our significant customers; the existing complex and stringent regulation in the U.S. and internationally, changes to which can impact our business; increased security requirements that may increase our costs of operations and reduce operating efficiencies; legal, regulatory or market responses to global climate change; negotiation and ratification of labor contracts; strikes, work stoppages and slowdowns by our employees; the effects of changing prices of energy, including gasoline, diesel and jet fuel, and interruptions in supplies of these commodities; changes in exchange rates or interest rates; our ability to maintain the image of our brand; breaches in data security; disruptions to the Internet or our technology infrastructure; our ability to accurately forecast our future capital investment needs; exposure to changing economic, political and social developments in international and emerging markets; changes in business strategy, government regulations, or economic or market conditions that may result in substantial impairment of our assets; increases in our expenses relating to employee health and retiree health and our contributions to pension benefits; the potential for various claims and litigation related to labor and employment, personal injury, property damage, business practices, environmental liability and other matters; our ability to realize the anticipated benefits from acquisitions, joint ventures or strategic alliances; our ability to manage insurance and claims expenses; and other risks discussed in our filings with the Securities and Exchange Commission from time to time, including our Annual Report on Form 10-K for the year ended December 31, 2014 or 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
June 30, 2015 (unaudited) and December 31, 2014
(In millions)

| | June 30, 2015 | December 31, 2014 |
|---|---|---|
| ASSETS | | |
| Current Assets: | | |
| Cash and cash equivalents | $3,430 | $2,291 |
| Marketable securities | 2,792 | 992 |
| Accounts receivable, net | 5,618 | 6,661 |
| Deferred income tax assets | 554 | 590 |
| Other current assets | 1,374 | 1,274 |
| Total Current Assets | 13,768 | 11,808 |
| Property, Plant and Equipment, Net | 17,970 | 18,281 |
| Goodwill | 2,214 | 2,184 |
| Intangible Assets, Net | 878 | 847 |
| Non-Current Investments and Restricted Cash | 469 | 489 |
| Derivative Assets | 435 | 515 |
| Deferred Income Tax Assets | 821 | 652 |
| Other Non-Current Assets | 696 | 695 |
| Total Assets | $37,251 | $35,471 |
| LIABILITIES AND SHAREOWNERS' EQUITY | | |
| Current Liabilities: | | |
| Current maturities of long-term debt and commercial paper | $3,252 | $923 |
| Accounts payable | 2,150 | 2,754 |
| Accrued wages and withholdings | 2,148 | 2,373 |
| Hedge margin liabilities | 753 | 548 |
| Self-insurance reserves | 621 | 656 |
| Other current liabilities | 1,379 | 1,385 |
| Total Current Liabilities | 10,303 | 8,639 |
| Long-Term Debt | 9,900 | 9,864 |
| Pension and Postretirement Benefit Obligations | 11,814 | 11,452 |
| Self-Insurance Reserves | 1,927 | 1,916 |
| Other Non-Current Liabilities | 1,339 | 1,442 |
| Shareowners' Equity: | | |
| Class A common stock (199 and 201 shares issued in 2015 and 2014) | 2 | 2 |
| Class B common stock (698 and 705 shares issued in 2015 and 2014) | 7 | 7 |
| Additional paid-in capital | — | — |
| Retained earnings | 5,668 | 5,726 |
| Accumulated other comprehensive loss | (3,727) | (3,594) |
| Deferred compensation obligations | 50 | 59 |
| Less: Treasury stock (1 share in 2015 and 2014) | (50) | (59) |
| Total Equity for Controlling Interests | 1,950 | 2,141 |
| Total Equity for Non-Controlling Interests | 18 | 17 |
| Total Shareowners' Equity | 1,968 | 2,158 |
| Total Liabilities and Shareowners' Equity | $37,251 | $35,471 |

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 June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue | $14,095 | $14,268 | $28,072 | $28,047 |
| Operating Expenses: | | | | |
| Compensation and benefits | 7,502 | 8,375 | 15,066 | 15,640 |
| Repairs and maintenance | 357 | 341 | 707 | 670 |
| Depreciation and amortization | 510 | 473 | 1,016 | 941 |
| Purchased transportation | 1,777 | 1,988 | 3,631 | 3,896 |
| Fuel | 639 | 980 | 1,283 | 1,952 |
| Other occupancy | 230 | 241 | 524 | 538 |
| Other expenses | 1,120 | 1,123 | 2,212 | 2,150 |
| Total Operating Expenses | 12,135 | 13,521 | 24,439 | 25,787 |
| Operating Profit | 1,960 | 747 | 3,633 | 2,260 |
| Other Income and (Expense): | | | | |
| Investment income | 4 | 25 | 8 | 25 |
| Interest expense | (86) | (89) | (173) | (179) |
| Total Other Income and (Expense) | (82) | (64) | (165) | (154) |
| Income Before Income Taxes | 1,878 | 683 | 3,468 | 2,106 |
| Income Tax Expense | 648 | 229 | 1,212 | 741 |
| Net Income | $1,230 | $454 | $2,256 | $1,365 |
| Basic Earnings Per Share | $1.37 | $0.49 | $2.50 | $1.48 |
| Diluted Earnings Per Share | $1.35 | $0.49 | $2.48 | $1.47 |

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

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Net income | $1,230 | $454 | $2,256 | $1,365 |
| Change in foreign currency translation adjustment, net of tax | 101 | 39 | (203) | 3 |
| Change in unrealized gain (loss) on marketable securities, net of tax | (1) | 2 | 1 | 2 |
| Change in unrealized gain (loss) on cash flow hedges, net of tax | (159) | (21) | 17 | (41) |
| Change in unrecognized pension and postretirement benefit costs, net of tax | 20 | (127) | 52 | (100) |
| Comprehensive income | $1,191 | $347 | $2,123 | $1,229 |

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)

| | Six Months Ended June 30, 2015 | 2014 |
|---|---|---|
| Cash Flows From Operating Activities: | | |
| Net income | $2,256 | $1,365 |
| Adjustments to reconcile net income to net cash from operating activities: | | |
| Depreciation and amortization | 1,016 | 941 |
| Pension and postretirement benefit expense | 539 | 1,523 |
| Pension and postretirement benefit contributions | (99) | (115) |
| Settlement of postretirement benefit obligation | — | (1,995) |
| Self-insurance provision | (22) | (77) |
| Deferred tax (benefit) | (140) | (192) |
| Stock compensation expense | 328 | 306 |
| Other (gains) losses | (51) | 144 |
| Changes in assets and liabilities, net of effect of acquisitions: | | |
| Accounts receivable | 880 | 585 |
| Other current assets | 301 | (269) |
| Accounts payable | (558) | (357) |
| Accrued wages and withholdings | (179) | (241) |
| Other current liabilities | 14 | 207 |
| Other operating activities | (46) | 7 |
| Net cash from operating activities | 4,239 | 1,832 |
| Cash Flows From Investing Activities: | | |
| Capital expenditures | (958) | (813) |
| Proceeds from disposals of property, plant and equipment | 8 | 10 |
| Purchases of marketable securities | (4,553) | (1,813) |
| Sales and maturities of marketable securities | 2,840 | 854 |
| Net (increase) decrease in finance receivables | (13) | 13 |
| Cash paid for business acquisitions | (90) | (22) |
| Other investing activities | (10) | (31) |
| Net cash (used in) investing activities | (2,776) | (1,802) |
| Cash Flows From Financing Activities: | | |
| Net change in short-term debt | 2,319 | 1,096 |
| Proceeds from borrowings | 1,572 | 764 |
| Repayments of borrowings | (1,488) | (1,020) |
| Purchases of common stock | (1,348) | (1,379) |
| Issuances of common stock | 140 | 149 |
| Dividends | (1,270) | (1,192) |
| Other financing activities | (177) | (50) |
| Net cash (used in) financing activities | (252) | (1,632) |
| Effect Of Exchange Rate Changes On Cash And Cash Equivalents | (72) | (7) |
| Net Increase (Decrease) In Cash And Cash Equivalents | 1,139 | (1,609) |
| Cash And Cash Equivalents: | | |
| Beginning of period | 2,291 | 4,665 |
| End of period | $3,430 | $3,056 |

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 June 30, 2015, our results of operations for the three and six months ended June 30, 2015 and 2014, and cash flows for the six months ended June 30, 2015 and 2014. 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, 2014.
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 amounts of our cash and cash equivalents, accounts receivable, finance receivables and accounts payable approximate fair value as of June 30, 2015. The fair values of our investment securities are disclosed in note 4, recognized multiemployer pension withdrawal liabilities are disclosed in note 6, 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.
NOTE 2. RECENT ACCOUNTING PRONOUNCEMENTS
Adoption of New Accounting Standards
In June 2014, the Financial Accounting Standards Board ("FASB") issued an accounting standards update for companies that grant their employees share-based payments in which the terms of the award provide that a performance target that affects vesting could be achieved after the requisite service period. This new guidance became effective for us in the first quarter of 2015, and did not have a material impact on our consolidated balance sheets and statements of income.
Other accounting pronouncements adopted during the periods covered by the consolidated financial statements did not have a material impact on our consolidated balance sheets and statements of income.
Accounting Standards Issued But Not Yet Effective

In May 2015, the FASB issued an accounting standards update that changes the disclosure requirement for reporting investments at fair value. This update removes the requirement to categorize investments for which fair value is measured using the net asset value per share practical expedient within the fair value hierarchy. These disclosures are limited to investments for which the entity has elected to measure the fair value using that practical expedient. This new guidance will be applied retrospectively and becomes effective for us in the first quarter of 2016, but early adoption is permitted. At this time, we do not expect this new guidance to have a material impact on our consolidated balance sheets or the related disclosures in the financial statements.

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In April 2015, the FASB issued an accounting standards update to simplify the presentation of debt issuance costs. This standard amends existing guidance to require the presentation of debt issuance costs in the consolidated balance sheets as a direct deduction from the carrying amount of the associated debt liability instead of a deferred charge. This new guidance will be applied retrospectively and becomes effective for us in the first quarter of 2016, but early adoption is permitted. This new guidance will not have a material impact on our consolidated balance sheets.

In May 2014, the FASB issued an accounting standards update that changes the revenue recognition for companies that enter into contracts with customers to transfer goods or services. This amended guidance requires revenue to be recognized in an amount that reflects the consideration to which the company expects to be entitled for those goods and services when the performance obligation has been satisfied. This amended guidance also requires enhanced disclosures regarding the nature, amount, timing and uncertainty of revenue and related cash flows arising from contracts with customers.

On July 9, 2015, the FASB voted to defer the effective date of this guidance by one year to interim and annual reporting periods beginning after December 15, 2017. Early adoption is permitted, but not before the original effective date beginning after December 15, 2016. At this time, we do not expect this accounting standards update to have a material impact on our consolidated balance sheets or statements of income.

Other accounting pronouncements issued, but not effective until after June 30, 2015, are not expected to have a material impact on our consolidated balance sheets or statements of income.

## NOTE 3. STOCK-BASED COMPENSATION

We issue employee share-based awards under the UPS Incentive Compensation Plan, which permits the grant of nonqualified and incentive stock options, stock appreciation rights, restricted stock and stock units, and restricted performance shares and performance units, to eligible employees (restricted stock and stock units, and restricted performance shares and performance units are herein referred to as "Restricted Units"). Upon vesting, Restricted Units result in the issuance of the equivalent number of UPS class A common shares after required tax withholdings. Dividends accrued on Restricted Units are reinvested in additional Restricted Units at each dividend payable date, and are subject to the same vesting and forfeiture conditions as the underlying Restricted Units upon which they are earned.

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 savings plan are made in shares of UPS class A common stock.

### Management Incentive Award Program ("MIP")

During the first quarter of 2015, we granted Restricted Units under MIP to eligible management employees. Restricted Units granted under MIP 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 MIP, we determined the award measurement date to be February 5, 2015 (for U.S.-based employees) and March 30, 2015 (for international-based employees); therefore, the Restricted Unit grant was valued for stock compensation expense purposes using the closing New York Stock Exchange price of $101.46 and $97.27 on those dates, respectively.

### Long-Term Incentive Performance Award Program ("LTIP")

We award Restricted Units under LTIP to certain eligible management employees. For grants prior to 2014, 90% of the target award was divided into three substantially equal tranches, one for each calendar year in the three-year award cycle, using performance criteria targets established each year. The targets consisted of consolidated operating return on invested capital and growth in consolidated revenue. The remaining 10% of the total award was based upon our achievement of adjusted earnings per share compared to a target established at the grant date. The performance targets for these historical awards will continue to be determined each year, and the awards will continue to vest through 2016.



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Beginning with the LTIP grant in the first quarter of 2014, the performance targets are equally-weighted among consolidated operating return on invested capital, growth in consolidated revenue, and total shareowner return relative to a peer group of companies. These Restricted Units generally vest at the end of a three-year period (except in the case of death, disability, or retirement, in which case immediate vesting occurs on a prorated basis). The number of Restricted Units earned will be based on the percentage achievement of the performance targets set forth on the grant date. The range of percentage achievement can vary from 0% to 200% of the target award.

For the two-thirds of the award related to consolidated operating return on invested capital and growth in consolidated revenue, we recognize the grant-date fair value of these Restricted Units (less estimated forfeitures) as compensation expense ratably over the vesting period, based on the number of awards expected to be earned. The remaining one-third of the award related to total shareowner return relative to a peer group is valued using a Monte Carlo model. This portion of the award was valued at a share payout of 65.86% of the target grant, and is recognized as compensation expense (less estimated forfeitures) ratably over the vesting period. Based on the date that the eligible management population and performance targets were approved for the 2015 LTIP Award, we determined the award measurement date to be March 26, 2015; therefore the target Restricted Units grant was valued for stock compensation expense using the closing New York Stock Exchange price of $96.64 on that date.

Nonqualified Stock Options

During the first quarter of 2015, we granted nonqualified stock option awards to a limited group of eligible senior management employees under the UPS Stock Option program. 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 2015 and 2014, we granted 0.2 and 0.1 million stock options, respectively, at a weighted average grant price of $101.93 and $96.98, respectively. The weighted average fair value of our employee stock options granted, as determined by the Black-Scholes valuation model, was $18.07 and $20.48 for 2015 and 2014, respectively, using the following assumptions:

| | 2015 | | 2014 | |
|---|---|---|---|---|
| Expected life (in years) | 7.5 | | 7.5 | |
| Risk-free interest rate | 2.07 | % | 2.40 | % |
| Expected volatility | 20.61 | % | 24.26 | % |
| Expected dividend yield | 2.63 | % | 2.56 | % |

Compensation expense for share-based awards recognized in net income for the three months ended June 30, 2015 and 2014 was $134 and $142 million pre-tax, respectively. Compensation expense for share-based awards recognized in net income for the six months ended June 30, 2015 and 2014 was $328 and $306 million pre-tax, respectively.

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

## NOTE 4. INVESTMENTS AND RESTRICTED CASH

The following is a summary of marketable securities classified as trading and available-for-sale as of June 30, 2015 and December 31, 2014 (in millions):

| | Cost | Unrealized Gains | Unrealized Losses | Estimated Fair Value |
|---|---|---|---|---|
| June 30, 2015: | | | | |
| Current marketable securities: | | | | |
| U.S. government and agency debt securities | $319 | $1 | $— | $320 |
| Mortgage and asset-backed debt securities | 82 | — | — | 82 |
| Corporate debt securities | 1,835 | 1 | (1) | 1,835 |
| Other debt, equity and investment securities | 546 | 11 | (2) | 555 |
| Total marketable securities | $2,782 | $13 | $(3) | $2,792 |
| | | | | |
| December 31, 2014: | | | | |
| Current marketable securities: | | | | |
| U.S. government and agency debt securities | $321 | $1 | $(1) | $321 |
| Mortgage and asset-backed debt securities | 89 | 1 | (1) | 89 |
| Corporate debt securities | 534 | — | — | 534 |
| Other debt, equity and investment securities | 48 | — | — | 48 |
| Total marketable securities | $992 | $2 | $(2) | $992 |

Of the total estimated fair value in marketable securities listed above, $2.007 billion and $430 million as of June 30, 2015 and December 31, 2014, respectively, have been classified as "trading", with unrealized gains and losses recognized in investment income within the statements of consolidated income. The remaining estimated fair value of marketable securities was classified as "available-for-sale", with related unrealized gains and losses, net of tax, recognized in accumulated other comprehensive income ("AOCI").

### Investment Other-Than-Temporary Impairments

We have concluded that no other-than-temporary impairment losses existed as of June 30, 2015. 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 June 30, 2015, 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 | $2,039 | $2,039 |
| Due after one year through three years | 428 | 428 |
| Due after three years through five years | 14 | 15 |
| Due after five years | 73 | 73 |
| | 2,554 | 2,555 |
| Equity and other investment securities | 228 | 237 |
| | $2,782 | $2,792 |

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Non-Current Investments and Restricted Cash

We had $442 million of restricted cash related to our self-insurance requirements as of June 30, 2015 and December 31, 2014, which is reported in “non-current investments and restricted cash” on the consolidated balance sheets. This restricted cash is invested in money market funds and similar cash equivalent type assets.

At June 30, 2015 and December 31, 2014, we held a $19 million investment in a variable life insurance policy to fund benefits for the UPS Excess Coordinating Benefit Plan. Additionally, we held escrowed cash related to the acquisition and disposition of certain assets of $8 and $28 million as of June 30, 2015 and December 31, 2014, respectively. The amounts described above are classified as “non-current investments and restricted cash” on the consolidated balance sheets, while the quarterly change in investment fair value is recognized in "investment income" on 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 non-current 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 with two significant inputs: (1) the after-tax cash flow projections for each partnership and (2) the risk-adjusted discount rate consistent with the duration of the expected cash flows for each partnership. The weighted-average discount rates used to value these investments were 8.29% and 7.81% as of June 30, 2015 and December 31, 2014, respectively. These inputs, and the resulting fair values, are updated on a quarterly basis.

The following table presents information about our investments measured at fair value on a recurring basis as of June 30, 2015 and December 31, 2014, 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 |
|---|---|---|---|---|
| June 30, 2015: | | | | |
| Marketable Securities: | | | | |
| U.S. government and agency debt securities | $320 | $ — | $— | $320 |
| Mortgage and asset-backed debt securities | — | 82 | — | 82 |
| Corporate debt securities | — | 1,835 | — | 1,835 |
| Other debt, equity and investment securities | — | 555 | — | 555 |
| Total marketable securities | 320 | 2,472 | — | 2,792 |
| Other non-current investments | 19 | — | 48 | 67 |
| Total | $339 | $ 2,472 | $48 | $2,859 |

| | | | | |
|---|---|---|---|---|
| December 31, 2014: | | | | |
| Marketable Securities: | | | | |
| U.S. government and agency debt securities | $321 | $— | $— | $321 |
| Mortgage and asset-backed debt securities | — | 89 | — | 89 |
| Corporate debt securities | — | 534 | — | 534 |
| Other debt, equity and investment securities | — | 48 | — | 48 |
| Total marketable securities | 321 | 671 | — | 992 |
| Other non-current investments | 19 | — | 64 | 83 |
| Total | $340 | $671 | $64 | $1,075 |

The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the three months ended June 30, 2015 and 2014 (in millions):

| | Marketable Securities | Other Non-Current Investments | Total |
|---|---|---|---|
| Balance on April 1, 2015 | $— | $56 | $56 |
| Transfers into (out of) Level 3 | — | — | — |
| Net realized and unrealized gains (losses): | | | |
| Included in earnings (in investment income) | — | (8) | (8) |
| Included in accumulated other comprehensive income (pre-tax) | — | — | — |
| Purchases | — | — | — |
| Sales | — | — | — |
| Balance on June 30, 2015 | $— | $48 | $48 |

| | Marketable Securities | Other Non-Current Investments | Total |
|---|---|---|---|
| Balance on April 1, 2014 | $— | $99 | $99 |
| Transfers into (out of) Level 3 | — | — | — |
| Net realized and unrealized gains (losses): | | | |
| Included in earnings (in investment income) | — | (4) | (4) |
| Included in accumulated other comprehensive income (pre-tax) | — | — | — |
| Purchases | — | — | — |
| Sales | — | — | — |
| Balance on June 30, 2014 | $— | $95 | $95 |

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The following table presents the changes in the above Level 3 instruments measured on a recurring basis for the six months ended June 30, 2015 and 2014 (in millions):

| | Marketable Securities | Other Investments | Total |
|---|---|---|---|
| Balance on January 1, 2015 | $— | 64 | 64 |
| Transfers into (out of) Level 3 | — | — | — |
| Net realized and unrealized gains (losses): | | | |
| Included in earnings (in investment income) | — | (16) | (16) |
| Included in accumulated other comprehensive income (pre-tax) | — | — | — |
| Purchases | — | — | — |
| Sales | — | — | — |
| Balance on June 30, 2015 | $— | $48 | $48 |

| | Marketable Securities | Other Investments | Total |
|---|---|---|---|
| Balance on January 1, 2014 | $— | 110 | 110 |
| Transfers into (out of) Level 3 | — | — | — |
| Net realized and unrealized gains (losses): | | | |
| Included in earnings (in investment income) | — | (15) | (15) |
| Included in accumulated other comprehensive income (pre-tax) | — | — | — |
| Purchases | — | — | — |
| Sales | — | — | — |
| Balance on June 30, 2014 | $— | $95 | $95 |

There were no transfers of investments between Level 1 and Level 2 during the three and six months ended June 30, 2015 and 2014.

NOTE 5. PROPERTY, PLANT AND EQUIPMENT
Property, plant and equipment as of June 30, 2015 and December 31, 2014 consist of the following (in millions):

| | 2015 | 2014 |
|---|---|---|
| Vehicles | $7,667 | $7,542 |
| Aircraft | 15,808 | 15,801 |
| Land | 1,190 | 1,145 |
| Buildings | 3,225 | 3,276 |
| Building and leasehold improvements | 3,319 | 3,266 |
| Plant equipment | 7,630 | 7,649 |
| Technology equipment | 1,678 | 1,608 |
| Equipment under operating leases | 30 | 34 |
| Construction-in-progress | 398 | 299 |
| | 40,945 | 40,620 |
| Less: Accumulated depreciation and amortization | (22,975) | (22,339) |
| | $17,970 | $18,281 |

We continually monitor our aircraft fleet utilization in light of current and projected volume levels, aircraft fuel prices and other factors. Additionally, we monitor our other property, plant and equipment categories for any indicators of potential impairment. No impairment charges on property, plant and equipment were recorded during the three and six months ended June 30, 2015 and 2014.

## NOTE 6. EMPLOYEE BENEFIT PLANS

### Company-Sponsored Benefit Plans

Information about net periodic benefit cost for our company-sponsored pension and postretirement benefit plans is as follows for the three and six months ended June 30, 2015 and 2014 (in millions):

| | U.S. Pension Benefits | | U.S. Postretirement Medical Benefits | | International Pension Benefits | |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Three Months Ended June 30: | | | | | | |
| Service cost | $381 | $285 | $8 | $18 | $13 | $15 |
| Interest cost | 424 | 401 | 30 | 34 | 11 | 14 |
| Expected return on assets | (622) | (565) | (4) | (6) | (16) | (15) |
| Amortization of: | | | | | | |
| Transition obligation | — | — | — | — | — | — |
| Prior service cost | 42 | 43 | 1 | (4) | 1 | (3) |
| Other net (gain) loss | — | — | — | — | — | — |
| Actuarial (gain) loss | — | — | — | 746 | — | — |
| Settlement and curtailment loss | — | — | — | $320 | — | — |
| Net periodic benefit cost | $225 | $164 | $35 | $1,108 | $9 | $11 |

| | U.S. Pension Benefits | | U.S. Postretirement Medical Benefits | | International Pension Benefits | |
|---|---|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 | 2015 | 2014 |
| Six Months Ended June 30: | | | | | | |
| Service cost | $763 | $569 | $17 | $39 | $25 | $27 |
| Interest cost | 847 | 802 | 61 | 86 | 22 | 26 |
| Expected return on assets | (1,244) | (1,129) | (8) | (12) | (31) | (30) |
| Amortization of: | | | | | | |
| Transition obligation | — | — | — | — | — | — |
| Prior service cost | 84 | 85 | 2 | (3) | 1 | (3) |
| Other net (gain) loss | — | — | — | — | — | — |
| Actuarial (gain) loss | — | — | — | 746 | — | — |
| Settlement and curtailment loss | — | — | — | $320 | — | — |
| Net periodic benefit cost | $450 | $327 | $72 | $1,176 | $17 | $20 |

During the first six months of 2015, we contributed $45 and $54 million to our company-sponsored pension and postretirement medical benefit plans, respectively. We also expect to contribute $1.075 billion and $50 million over the remainder of the year to the pension and U.S. postretirement medical benefit plans, respectively.

### Multiemployer Benefit Plans

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 on annual contribution rates will remain in effect throughout the terms of the existing collective bargaining agreements.

As of June 30, 2015 and December 31, 2014 we had $875 and $878 million, respectively, recognized in "other non-current liabilities" on our consolidated balance sheets associated with our previous withdrawal from a multiemployer pension plan. This liability is payable in equal monthly installments over a remaining term of approximately 47 years. Based on the borrowing rates currently available to the Company for long-term financing of a similar maturity, the fair value of this withdrawal liability as of June 30, 2015 and December 31, 2014 was $834 and $913 million, respectively. We utilized Level 2 inputs in the fair value hierarchy of valuation techniques to determine the fair value of this liability.

Collective Bargaining Agreements

As of December 31, 2014, we had approximately 270,000 employees employed under a national master agreement and various supplemental agreements with local unions affiliated with the International Brotherhood of Teamsters (“Teamsters”). In addition, our airline pilots, airline mechanics, ground mechanics and certain other employees are employed under other collective bargaining agreements. During the second quarter of 2014, the Teamsters ratified a new national master agreement (“NMA”) with UPS that will expire on July 31, 2018. The economic provisions in the NMA included wage rate increases, as well as increased contribution rates for healthcare and pension benefits. Most of these economic provisions were retroactive to August 1, 2013, which was the effective date of the NMA. In the second quarter of 2014, we remitted $278 million for these retroactive economic benefits; this payment had an immaterial impact on net income, as these retroactive economic benefits had been accrued since the July 31, 2013 expiration of the prior agreement.

In addition to the retroactive economic provisions of the NMA, there were certain changes to the delivery of healthcare benefits that were effective at various dates. These changes impact approximately 36,000 full-time and 73,000 part-time active employees covered by the NMA and the UPS Freight collective bargaining agreement (collectively referred to as the “NMA Group”), as well as approximately 16,000 employees covered by other collective bargaining agreements (the “Non-NMA Group”). These provisions are discussed further below in the "Changes to the Delivery of Active and Postretirement Healthcare Benefits" section.

We have approximately 2,600 pilots who are employed under a collective bargaining agreement with the Independent Pilots Association ("IPA"), which became amendable at the end of 2011. The ongoing contract negotiations between UPS and the IPA are in mediation by the National Mediation Board.

Our airline mechanics are covered by a collective bargaining agreement with Teamsters Local 2727, which became amendable November 1, 2013. In addition, approximately 3,100 of our auto and maintenance 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”) that will expire on July 31, 2019.

Changes to the Delivery of Active and Postretirement Healthcare Benefits

Prior to ratification, the NMA Group and Non-NMA Group employees received their healthcare benefits through UPS-sponsored active and postretirement health and welfare benefit plans. Effective June 1, 2014, we ceased providing healthcare benefits to active NMA Group employees through these UPS-sponsored benefit plans, and the responsibility for providing healthcare benefits for active employees was assumed by three separate multiemployer healthcare funds (the “Funds”). The responsibility for providing healthcare benefits for the active Non-NMA Group employees was also assumed by the Funds on various dates up to January 1, 2015, depending on the ratification date of the applicable collective bargaining agreement. We will make contributions to the Funds based on negotiated fixed hourly or monthly contribution rates for the duration of the NMA and other applicable collective bargaining agreements.

Additionally, the Funds assumed the obligation to provide postretirement healthcare benefits to the employees in the NMA Group who retire on or after January 1, 2014. The postretirement healthcare benefit obligation for the employees in the Non-NMA Group was assumed by the Funds for employees retiring on or after January 1, 2014 or January 1, 2015, depending on the applicable collective bargaining agreement. In exchange for the assumption of the obligation to provide postretirement healthcare benefits to the NMA Group and Non-NMA Group, we transferred cash totaling $2.271billion to the Funds in the second quarter of 2014. UPS-sponsored health and welfare benefit plans retained responsibility for providing postretirement healthcare coverage for employees in the NMA Group who retired from UPS prior to January 1, 2014, and for employees in the Non-NMA Group who retired from UPS prior to the January 1, 2014 or January 1, 2015 effective date in the applicable collective bargaining agreement.

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Accounting Impact of Health and Welfare Plan Changes

Income Statement Impact:

We recorded a pre-tax charge of $1.066 billion ($665 million after-tax) in the second quarter of 2014 for the health and welfare plan changes described above. The components of this charge, which was included in "compensation and benefits" expense in the statement of consolidated income, are as follows:

- Partial Plan Curtailment: We recorded a $112 million pre-tax curtailment loss due to the elimination of future service benefit accruals. This curtailment loss represents the accelerated recognition of unamortized prior service costs.
- Remeasurement of Postretirement Obligation: We recorded a $746 million pre-tax loss due to the remeasurement of the postretirement benefit obligations of the affected UPS-sponsored health and welfare benefit plans.
- Settlement: We recorded a $208 million pre-tax settlement loss, which represents the recognition of unamortized actuarial losses associated with the postretirement obligation for the NMA Group.

Balance Sheet and Cash Flow Impact:

During the second quarter of 2014, as part of the health and welfare plan changes described previously, we transferred cash totaling $2.271 billion to the Funds, which was accounted for as a settlement of our postretirement benefit obligations. As of June 30, 2014, we had received approximately $375 million of cash tax benefits (through reduced U.S. Federal and state quarterly income tax payments) and we received the remaining cash tax benefits of approximately $479 million resulting from these payments over the remainder of 2014.

For NMA Group employees who retired prior to January 1, 2014 and remained with the UPS-sponsored health and welfare plans, the changes to the contributions, benefits and cost sharing provisions in these plans resulted in an increase in the postretirement benefit obligation, and a corresponding decrease in pre-tax AOCI, of $13 million upon ratification.

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NOTE 7. GOODWILL AND INTANGIBLE ASSETS
The following table indicates the allocation of goodwill by reportable segment as of June 30, 2015 and December 31, 2014 (in millions):

| | U.S. Domestic Package | International Package | Supply Chain & Freight | Consolidated |
|---|---|---|---|---|
| December 31, 2014: | $— | $449 | $1,735 | $2,184 |
| Acquired | — | — | 72 | 72 |
| Currency / Other | — | (16) | (26) | (42) |
| June 30, 2015: | $— | $433 | $1,781 | $2,214 |

The goodwill acquired in the Supply Chain & Freight segment was related to our March 2015 acquisition of Poltraf Sp. z.o.o. ("Poltraf"), a Polish-based pharmaceutical logistics company recognized for its temperature-sensitive warehousing and transportation solutions, and our June 2015 acquisitions of Parcel Pro, Inc. ("Parcel Pro") and the Insured Parcel Services division of G4S International Logistics ("IPS"), which are businesses that provide services and insurance coverage for the transport of high value luxury goods. The purchase price allocation for acquired companies can be modified for up to one year from the date of acquisition. Our purchase price allocations for Parcel Pro and IPS have not been finalized. These acquisitions were not material to our consolidated financial position or results of operations.
The remaining change in goodwill for both the International Package and Supply Chain & Freight segments was due to the impact of changes in the value of the U.S. Dollar on the translation of non-U.S. Dollar goodwill balances.
The following is a summary of intangible assets as of June 30, 2015 and December 31, 2014 (in millions):

| | Gross Carrying Amount | Accumulated Amortization | Net Carrying Value |
|---|---|---|---|
| June 30, 2015: | | | |
| Capitalized software | $2,613 | $(1,934) | $679 |
| Licenses | 214 | (152) | 62 |
| Franchise rights | 121 | (80) | 41 |
| Customer lists | 144 | (71) | 73 |
| Trademarks, patents, and other | 35 | (12) | 23 |
| Total Intangible Assets, Net | $3,127 | $(2,249) | $878 |
| December 31, 2014: | | | |
| Capitalized software | $2,641 | $(1,997) | $644 |
| Licenses | 217 | (133) | 84 |
| Franchise rights | 117 | (77) | 40 |
| Customer lists | 123 | (66) | 57 |
| Trademarks, patents, and other | 31 | (9) | 22 |
| Total Intangible Assets, Net | $3,129 | $(2,282) | $847 |

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NOTE 8. DEBT AND FINANCING ARRANGEMENTS
The carrying value of our outstanding debt as of June 30, 2015 and December 31, 2014 consists of the following (in millions):

| | Principal Amount | Maturity | Carrying Value 2015 | Carrying Value 2014 |
|---|---|---|---|---|
| Commercial paper | $3,210 | 2015 | $3,209 | $772 |
| Fixed-rate senior notes: | | | | |
| 1.125% senior notes | 375 | 2017 | 372 | 370 |
| 5.50% senior notes | 750 | 2018 | 798 | 802 |
| 5.125% senior notes | 1,000 | 2019 | 1,073 | 1,076 |
| 3.125% senior notes | 1,500 | 2021 | 1,612 | 1,617 |
| 2.45% senior notes | 1,000 | 2022 | 975 | 977 |
| 6.20% senior notes | 1,500 | 2038 | 1,481 | 1,481 |
| 4.875% senior notes | 500 | 2040 | 489 | 489 |
| 3.625% senior notes | 375 | 2042 | 368 | 367 |
| 8.375% Debentures: | | | | |
| 8.375% debentures | 424 | 2020 | 477 | 480 |
| 8.375% debentures | 276 | 2030 | 283 | 283 |
| Pound Sterling notes: | | | | |
| 5.50% notes | 105 | 2031 | 101 | 99 |
| 5.125% notes | 717 | 2050 | 683 | 673 |
| Floating rate senior notes | 463 | 2049-2064 | 459 | 459 |
| Capital lease obligations | 434 | 2015-3005 | 434 | 505 |
| Facility notes and bonds | 320 | 2015-2036 | 320 | 320 |
| Other debt | 18 | 2015-2022 | 18 | 17 |
| Total Debt | $12,967 | | 13,152 | 10,787 |
| Less: Current Maturities | | | (3,252) | (923) |
| Long-term Debt | | | $9,900 | $9,864 |

Sources of Credit
We are authorized to borrow up to $10.0 billion under the U.S. commercial paper program we maintain. We had $2.547 billion outstanding under this program as of June 30, 2015, with an average interest rate of 0.10%. We also maintain a European commercial paper program under which we are authorized to borrow up to €5.0 billion in a variety of currencies. We had £420 million ($662 million) outstanding under this program as of June 30, 2015 with an average interest rate of 0.49%. As of June 30, 2015, we have classified the entire commercial paper balance as a current liability on our consolidated balance sheet.
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 March 26, 2016. 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 the highest of (1) JPMorgan Chase Bank’s publicly announced prime rate; (2) the Federal Funds effective rate plus 0.50%; and (3) LIBOR for a one month interest period plus 1.00%, 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 prime 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 June 30, 2015.

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The second agreement provides revolving credit facilities of $3.0 billion, and expires on March 27, 2020. 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 the highest of (1) JPMorgan Chase Bank's publicly announced prime rate; (2) the Federal Funds effective rate plus 0.50%; and (3) LIBOR for a one month interest period plus 1.00%, 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, 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 minimum applicable margin rate is 0.10% and the maximum applicable margin rate is 0.75% per annum. The applicable margin for advances bearing interest based on the prime 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 June 30, 2015.

Debt Covenants

Our existing debt instruments and credit facilities subject us to certain financial covenants. As of June 30, 2015 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 June 30, 2015, 10% of net tangible assets was equivalent to $2.386 billion; however, we have no covered sale-leaseback transactions or secured indebtedness outstanding. 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, was approximately $14.337 and $12.257 billion as of June 30, 2015 and December 31, 2014, 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 (except as otherwise noted herein) 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 The UPS Store, Inc., are defendants in Morgate v. The UPS Store, Inc. et al. an action in the Los Angeles Superior Court brought on behalf of a certified class of all franchisees who chose to rebrand their Mail Boxes Etc. franchises to The UPS Store in March 2003. Plaintiff alleges that UPS and The UPS Store, Inc. misrepresented and omitted facts to the class about the market tests that were conducted before offering the class the choice of whether to rebrand to The UPS Store. The court has scheduled a trial for November 2015, limited to the claim of the class representative. After that trial is complete, the court will consider how to proceed with respect to the claims of the other class members.

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There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from the remaining aspects of this case, including: (1) we are vigorously defending ourselves and believe we have a number of meritorious legal defenses; and (2) it remains uncertain what evidence of damages, if any, plaintiffs will be able to present. 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.

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. UPS and FedEx have moved for summary judgment. The Court granted these motions on April 30, 2015, entered judgment in favor of UPS and FedEx, and dismissed the case. On May 21, 2015, plaintiff filed a notice of appeal to the Court of Appeals for the Ninth Circuit. The Antitrust Division of the U.S. Department of Justice (“DOJ”) has an open civil investigation of our policies and practices for dealing with third-party negotiators. We have cooperated 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) the DOJ investigation is pending; (2) the Court granted our motion for summary judgment; and (3) plaintiff has filed a notice of appeal. 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, four purported class-action cases were filed against us in British Columbia (2006); Ontario (2007) and Québec (2006 and 2013). 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 motion to authorize the 2006 Québec litigation as a class action was dismissed by the motions judge in October 2012; there was no appeal, which ended that case in our favor. The 2013 Québec litigation also has been dismissed. We deny all liability and are vigorously defending the one outstanding case in Ontario. 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 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 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.

Other Matters

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. After two rounds of motions to dismiss, in October 2014, UPS entered into a settlement agreement with the plaintiffs to settle the remaining claims asserted against UPS for an immaterial amount. The court granted preliminary approval of the settlement on December 16, 2014. The settlement is subject to final court approval, which is currently scheduled to be considered by the Court on November 2, 2015.

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 submitted its written defenses to these allegations in April 2014. UPS intends to continue to defend itself in these proceedings. In November 2012, the Commerce Commission of Singapore initiated an investigation with respect to similar matters. On May 29, 2015, the Commerce Commission of Singapore informed UPS that it was closing the investigation with no action.

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 this matter including: (1) we are vigorously defending the 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 this matter, 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 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.

In January 2014, we received a Civil Investigative Demand from the DOJ seeking documents related to possible damages under the False Claims Act ("FCA") in connection with delivery services provided to government customers where guaranteed commitment times allegedly were not met. The General Services Administration - Office of Inspector General had previously sought similar documents. We also have been contacted by multiple states requesting this information. The Company cooperated with these inquiries. The Company reached agreements in principle during the second quarter of 2015 with the DOJ and a group of state and local governments to resolve all of their respective claims. We do not believe that the terms of the settlements will have a material adverse effect on our financial condition, results of operations or liquidity.

In February 2015, the State and City of New York filed suit against UPS in the U.S. District Court for the Southern District of New York, arising from alleged shipments of cigarettes to New York State and City residents. The complaint asserts claims under various federal and state laws. The complaint also includes a claim that UPS violated the Assurance of Discontinuance it entered into with the New York Attorney General in 2005 concerning cigarette deliveries. The court held a hearing on our motion to dismiss in July 2015. There are multiple factors that prevent us from being able to estimate the amount of loss, if any, that may result from this case, including: (1) we are vigorously defending ourselves and believe we have a number of meritorious factual and legal defenses; and (2) it remains uncertain what evidence of their claims and damages, if any, plaintiffs will be able to present. 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.

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.

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## 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 on a one-to-one basis 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 June 30, 2015, 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 June 30, 2015, no preferred shares had been issued.

The following is a rollforward of our common stock, additional paid-in capital and retained earnings accounts for the six months ended June 30, 2015 and 2014 (in millions, except per share amounts):

| | 2015 | | 2014 | |
|---|---|---|---|---|
| | Shares | Dollars | Shares | Dollars |
| Class A Common Stock | | | | |
| Balance at beginning of period | 201 | $2 | 212 | $2 |
| Common stock purchases | (2) | — | (3) | — |
| Stock award plans | 4 | — | 4 | — |
| Common stock issuances | 1 | — | 1 | — |
| Conversions of class A to class B common stock | (5) | — | (6) | — |
| Class A shares issued at end of period | 199 | $2 | 208 | $2 |
| Class B Common Stock | | | | |
| Balance at beginning of period | 705 | $7 | 712 | $7 |
| Common stock purchases | (12) | — | (11) | — |
| Conversions of class A to class B common stock | 5 | — | 6 | — |
| Class B shares issued at end of period | 698 | $7 | 707 | $7 |
| Additional Paid-In Capital | | | | |
| Balance at beginning of period | | $— | | $— |
| Stock award plans | | 265 | | 232 |
| Common stock purchases | | (392) | | (481) |
| Common stock issuances | | 173 | | 147 |
| Option premiums received (paid) | | (46) | | 102 |
| Balance at end of period | | $— | | $— |
| Retained Earnings | | | | |
| Balance at beginning of period | | $5,726 | | $6,925 |
| Net income attributable to common shareowners | | 2,256 | | 1,365 |
| Dividends ($1.46 and $1.34 per share) | | (1,348) | | (1,253) |
| Common stock purchases | | (966) | | (882) |
| Balance at end of period | | $5,668 | | $6,155 |

In total, we repurchased 13.5 million shares of class A and class B common stock for $1.358 billion during the six months ended June 30, 2015, and 13.7 million shares for $1.363 billion during the six months ended June 30, 2014. In February 2013, the Board of Directors approved a new share repurchase authorization of $10.0 billion, which has no expiration date. As of June 30, 2015, we had $2.794 billion of this share repurchase authorization available.

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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 second quarter of 2015, we entered into an accelerated share repurchase program which allowed us to repurchase 4.0 million shares for $400 million. The program was completed in June 2015.
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. We received (paid) net premiums of $(46) and $102 million during the first six months of 2015 and 2014, respectively, related to entering into and settling capped call options for the purchase of class B shares. As of June 30, 2015, we had outstanding options for the purchase of 2.3 million shares, with a weighted average strike price of $89.91 per share, that will settle in the third and fourth quarters of 2015.
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 six months ended June 30, 2015 and 2014 is as follows (in millions):

| | 2015 | 2014 |
|---|---|---|
| Foreign currency translation gain (loss): | | |
| Balance at beginning of period | $(457) | $(126) |
| Reclassification to earnings (no tax impact in either period) | — | — |
| Translation adjustment (net of tax effect of $0 and $3) | (203) | 3 |
| Balance at end of period | (660) | (123) |
| Unrealized gain (loss) on marketable securities, net of tax: | | |
| Balance at beginning of period | — | (1) |
| Current period changes in fair value (net of tax effect of $0 and $1) | 1 | 2 |
| Reclassification to earnings (no tax impact in either period) | — | — |
| Balance at end of period | 1 | 1 |
| Unrealized gain (loss) on cash flow hedges, net of tax: | | |
| Balance at beginning of period | 61 | (219) |
| Current period changes in fair value (net of tax effect of $56 and $(27)) | 91 | (44) |
| Reclassification to earnings (net of tax effect of $(45) and $1) | (74) | 3 |
| Balance at end of period | 78 | (260) |
| Unrecognized pension and postretirement benefit costs, net of tax: | | |
| Balance at beginning of period | (3,198) | (114) |
| Reclassification to earnings (net of tax effect of $35 and $430) | 52 | 715 |
| Remeasurement of plan assets and liabilities (net of tax effect of $0 and $(488)) | — | (815) |
| Balance at end of period | (3,146) | (214) |
| Accumulated other comprehensive income (loss) at end of period | $(3,727) | $(596) |

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Detail of the gains (losses) reclassified from AOCI to the statements of consolidated income for the three and six months ended June 30, 2015 and 2014 is as follows (in millions):
Three Months Ended June 30:

| | Amount Reclassified from AOCI | | Affected Line Item in the Income Statement |
|---|---|---|---|
| | 2015 | 2014 | |
| Unrealized gain (loss) on marketable securities: | | | |
| Realized gain (loss) on sale of securities | $— | $— | Investment income |
| Income tax (expense) benefit | — | — | Income tax expense |
| Impact on net income | — | — | Net income |
| Unrealized gain (loss) on cash flow hedges: | | | |
| Interest rate contracts | (6) | (5) | Interest expense |
| Foreign exchange contracts | 11 | 20 | Interest expense |
| Foreign exchange contracts | 77 | (12) | Revenue |
| Income tax (expense) benefit | (31) | (2) | Income tax expense |
| Impact on net income | 51 | 1 | Net income |
| Unrecognized pension and postretirement benefit costs: | | | |
| Prior service costs | (44) | (36) | Compensation and benefits |
| Settlement and curtailment loss | — | (320) | Compensation and benefits |
| Remeasurement of benefit obligation | — | (746) | Compensation and benefits |
| Income tax (expense) benefit | 18 | 414 | Income tax expense |
| Impact on net income | (26) | (688) | Net income |
| Total amount reclassified for the period | $25 | $(687) | Net income |

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Six Months Ended June 30:

| | Amount Reclassified from AOCI | | Affected Line Item in the Income Statement |
|---|---|---|---|
| | 2015 | 2014 | |
| Unrealized gain (loss) on marketable securities: | | | |
| Realized gain (loss) on sale of securities | $— | $— | Investment income |
| Income tax (expense) benefit | — | — | Income tax expense |
| Impact on net income | — | — | Net income |
| Unrealized gain (loss) on cash flow hedges: | | | |
| Interest rate contracts | (12) | (11) | Interest expense |
| Foreign exchange contracts | (25) | 28 | Interest expense |
| Foreign exchange contracts | 156 | (21) | Revenue |
| Income tax (expense) benefit | (45) | 1 | Income tax expense |
| Impact on net income | 74 | (3) | Net income |
| Unrecognized pension and postretirement benefit costs: | | | |
| Prior service costs | (87) | (79) | Compensation and benefits |
| Settlement and curtailment loss | — | (320) | Compensation and benefits |
| Remeasurement of benefit obligation | — | (746) | Compensation and benefits |
| Income tax (expense) benefit | 35 | 430 | Income tax expense |
| Impact on net income | (52) | (715) | Net income |
| Total amount reclassified for the period | $22 | $(718) | Net income |

Deferred Compensation Obligations and Treasury Stock

Activity in the deferred compensation program for the six months ended June 30, 2015 and 2014 is as follows (in millions):

| | 2015 Shares | 2015 Dollars | 2014 Shares | 2014 Dollars |
|---|---|---|---|---|
| Deferred Compensation Obligations: | | | | |
| Balance at beginning of period | | $59 | | $69 |
| Reinvested dividends | | 2 | | 1 |
| Benefit payments | | (11) | | (12) |
| Balance at end of period | | $50 | | $58 |
| Treasury Stock: | | | | |
| Balance at beginning of period | (1) | $(59) | (1) | $(69) |
| Reinvested dividends | — | (2) | — | (1) |
| Benefit payments | — | 11 | — | 12 |
| Balance at end of period | (1) | $(50) | (1) | $(58) |

Noncontrolling Interests:

We have noncontrolling interests in certain consolidated subsidiaries in our International Package and Supply Chain & Freight segments. Noncontrolling interests increased $1 and $3 million for the six months ended June 30, 2015 and 2014, respectively, mainly due to noncontrolling interests associated with acquisitions during the period.

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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 U.S. export and U.S. import shipments. Our International Package reporting segment includes the operations of our Europe, Asia, Americas and ISMEA (Indian Subcontinent, Middle East and Africa) operating segments.
Supply Chain & Freight
Supply Chain & Freight includes the operations of our forwarding, logistics and freight units, as well as other aggregated businesses. 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 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, 2014, 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.
Segment information for the three and six months ended June 30, 2015 and 2014 is as follows (in millions):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Revenue: | | | | |
| U.S. Domestic Package | $8,808 | $8,668 | $17,622 | $17,156 |
| International Package | 3,045 | 3,252 | 6,015 | 6,379 |
| Supply Chain & Freight | 2,242 | 2,348 | 4,435 | 4,512 |
| Consolidated | $14,095 | $14,268 | $28,072 | $28,047 |
| Operating Profit: | | | | |
| U.S. Domestic Package | $1,201 | $209 | $2,225 | $1,136 |
| International Package | 552 | 444 | 1,050 | 882 |
| Supply Chain & Freight | 207 | 94 | 358 | 242 |
| Consolidated | $1,960 | $747 | $3,633 | $2,260 |

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NOTE 12. EARNINGS PER SHARE

The following table sets forth the computation of basic and diluted earnings per share for the three and six months ended June 30, 2015 and 2014 (in millions, except per share amounts):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Numerator: | | | | |
| Net income attributable to common shareowners | $1,230 | $454 | $2,256 | $1,365 |
| Denominator: | | | | |
| Weighted average shares | 899 | 916 | 901 | 918 |
| Deferred compensation obligations | 1 | 1 | 1 | 1 |
| Vested portion of restricted units | 1 | 1 | 1 | 1 |
| Denominator for basic earnings per share | 901 | 918 | 903 | 920 |
| Effect of dilutive securities: | | | | |
| Restricted units | 6 | 8 | 7 | 8 |
| Stock options | 1 | 1 | 1 | 1 |
| Denominator for diluted earnings per share | 908 | 927 | 911 | 929 |
| Basic earnings per share | $1.37 | $0.49 | $2.50 | $1.48 |
| Diluted earnings per share | $1.35 | $0.49 | $2.48 | $1.47 |

Diluted earnings per share for the three months ended June 30, 2015 and 2014 excluded the effect of 0.2 and 0.1 million shares of common stock, respectively (0.2 and 0.1 million for the six months ended June 30, 2015 and 2014, respectively), that may be issued upon the exercise of employee stock options because such effect would be antidilutive.

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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 by monitoring counterparty credit risk to prevent concentrations of credit risk with any single counterparty.

We have agreements with all of our active counterparties (covering the majority of our derivative positions) containing early termination rights and/or zero threshold bilateral collateral provisions whereby cash is required based on the net fair value of derivatives associated with those counterparties. Events such as a counterparty credit rating downgrade (depending on the ultimate rating level) could also allow us to take additional protective measures such as the early termination of trades. At June 30, 2015 and December 31, 2014, we held cash collateral of $753 and $548 million, respectively, under these agreements; this collateral is included in "cash and cash equivalents" on the consolidated balance sheets and its use by UPS is not restricted.

In connection with the zero threshold bilateral collateral provisions described above, we were required to post $4 and $1 million in collateral with our counterparties as of June 30, 2015 and December 31, 2014, respectively. As of those dates, there were no instruments in a net liability position that were not covered by the zero threshold bilateral collateral provisions. Additionally, in connection with the agreements described above, we could be required to terminate transactions with certain counterparties in the event of a downgrade of our credit rating.

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 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, British Pound Sterling, Canadian Dollar, Chinese Renminbi and Hong Kong 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; 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.

Interest Rate Risk Management

Our indebtedness under our various financing arrangements creates interest rate risk. We use a combination of derivative instruments 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.

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Outstanding Positions

As of June 30, 2015 and December 31, 2014, the notional amounts of our outstanding derivative positions were as follows (in millions):

| | June 30, 2015 | | December 31, 2014 | |
|---|---|---|---|---|
| Currency hedges: | | | | |
| British Pound Sterling | GBP | 1,282 | GBP | 1,149 |
| Canadian Dollar | CAD | 320 | CAD | 293 |
| Euro | EUR | 2,148 | EUR | 2,833 |
| Indian Rupee | INR | 231 | INR | 85 |
| Malaysian Ringgit | MYR | — | MYR | 150 |
| Mexican Peso | MXN | 5,977 | MXN | 152 |
| | | | | |
| Interest rate hedges: | | | | |
| Fixed to Floating Interest Rate Swaps | $ | 5,799 | $ | 5,799 |
| Floating to Fixed Interest Rate Swaps | $ | 779 | $ | 779 |
| Interest Rate Basis Swaps | $ | — | $ | 1,500 |
| | | | | |
| Investment market price hedges: | | | | |
| Marketable Securities | EUR | 202 | EUR | — |

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.

We have master netting arrangements with substantially all of our counterparties giving us the right of offset for our derivative positions. However, we have not elected to offset the fair value positions of our derivative contracts recorded on our consolidated balance sheets. The columns labeled "Net Amounts if Right of Offset had been Applied" indicate the potential net fair value positions by type of contract and location on the consolidated balance sheets had we elected to apply the right of offset.

| | | | Gross Amounts Presented in Consolidated Balance Sheets | | Net Amounts if Right of Offset had been Applied | |
|---|---|---|---|---|---|---|
| Asset Derivatives | Balance Sheet Location | Fair Value Hierarchy Level | June 30, 2015 | December 31, 2014 | June 30, 2015 | December 31, 2014 |
| Derivatives designated as hedges: | | | | | | |
| Foreign exchange contracts | Other current assets | Level 2 | $337 | $204 | $337 | $204 |
| Foreign exchange contracts | Derivative assets | Level 2 | 161 | 229 | 161 | 229 |
| Interest rate contracts | Derivative assets | Level 2 | 218 | 227 | 185 | 194 |
| Derivatives not designated as hedges: | | | | | | |
| Foreign exchange contracts | Other current assets | Level 2 | 19 | 2 | 19 | 2 |
| Investment market price contracts | Other current assets | Level 2 | 1 | — | — | — |

| | | | | | | |
|---|---|---|---|---|---|---|
| Interest rate contracts | Derivative assets | Level 2 | 56 | 59 | 54 | 57 |
| Total Asset Derivatives | | | $792 | $721 | $756 | $686 |

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| Liability Derivatives | Balance Sheet Location | Fair Value Hierarchy Level | Gross Amounts Presented in Consolidated Balance Sheets | | Net Amounts if Right of Offset had been Applied | |
|---|---|---|---|---|---|---|
| | | | June 30, 2015 | December 31, 2014 | June 30, 2015 | December 31, 2014 |
| Derivatives designated as hedges: | | | | | | |
| Foreign exchange contracts | Other non-current liabilities | Level 2 | $— | $34 | $— | $34 |
| Interest rate contracts | Other non-current liabilities | Level 2 | 34 | 35 | 1 | 2 |
| Derivatives not designated as hedges: | | | | | | |
| Foreign exchange contracts | Other current liabilities | Level 2 | 2 | — | 2 | — |
| Interest rate contracts | Other current liabilities | Level 2 | — | 1 | — | 1 |
| Investment market price contracts | Other current liabilities | Level 2 | 10 | — | 9 | — |
| Interest rate contracts | Other non-current liabilities | Level 2 | 8 | 7 | 6 | 5 |
| Total Liability Derivatives | | | $54 | $77 | $18 | $42 |

Our foreign currency, interest rate and investment market price 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 investment forward prices; therefore, these derivatives are classified as Level 2.

Income Statement and AOCI Recognition

The following table indicates the amount of gains and losses that have been recognized in AOCI for the three and six months ended June 30, 2015 and 2014 for those derivatives designated as cash flow hedges (in millions):

Three Months Ended June 30:

| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in AOCI on Derivative (Effective Portion) | |
|---|---|---|
| | 2015 | 2014 |
| Interest rate contracts | $1 | $(1) |
| Foreign exchange contracts | (173) | (31) |
| Total | $(172) | $(32) |

Six Months Ended June 30:

| Derivative Instruments in Cash Flow Hedging Relationships | Amount of Gain (Loss) Recognized in OCI on Derivative (Effective Portion) | |
|---|---|---|
| | 2015 | 2014 |
| Interest rate contracts | $— | $(3) |
| Foreign exchange contracts | 147 | (68) |
| Total | $147 | $(71) |

As of June 30, 2015, $278 million of pre-tax gains related to cash flow hedges that are currently deferred in AOCI are expected to be reclassified to income over the 12 month period ended June 30, 2016. The actual amounts that will be reclassified to income over the next 12 months will vary from this amount as a result of changes in market conditions.

The maximum term over which we are hedging exposures to the variability of cash flow is 17 years.

The amount of ineffectiveness recognized in income on derivative instruments designated in cash flow hedging relationships was immaterial for the three and six months ended June 30, 2015 and 2014.

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The following table indicates the amount and location in the statements of consolidated income in which derivative gains and losses, as well as the associated gains and losses on the underlying exposure, have been recognized for those derivatives designated as fair value hedges for the three and six months ended June 30, 2015 and 2014 (in millions):

| Derivative Instruments in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income 2015 | 2014 | Hedged Items in Fair Value Hedging Relationships | Location of Gain (Loss) Recognized In Income | Amount of Gain (Loss) Recognized in Income 2015 | 2014 |
|---|---|---|---|---|---|---|---|
| Three Months Ended June 30: | | | | | | | |
| Interest rate contracts | Interest Expense | $(64) | $53 | Fixed-Rate Debt and Capital Leases | Interest Expense | $64 | $(53) |
| Six Months Ended June 30: | | | | | | | |
| Interest rate contracts | Interest Expense | $(9) | $83 | Fixed-Rate Debt and Capital Leases | Interest Expense | $9 | $(83) |

Additionally, we maintain some interest rate swap, foreign currency forward, and investment market price forward contracts that are not designated as hedges. These interest rate swap contracts are intended to provide an economic hedge of a portfolio of interest bearing receivables. These foreign exchange forward contracts are intended to provide an economic offset to foreign currency remeasurement and settlement risk for certain assets and liabilities on our consolidated balance sheets. These investment market price forward contracts are intended to provide an economic offset to fair value fluctuations of certain investments in marketable securities.

We also periodically terminate interest rate swaps and foreign currency options by entering into offsetting swap and foreign currency positions with different counterparties. As part of this process, we de-designate our original swap and foreign currency contracts. These transactions provide an economic offset that effectively eliminate the effects of changes in market valuation.

The following is a summary of the amounts recorded in the statements of consolidated income related to fair value changes and settlements of these interest rate swaps, foreign currency forward and investment market price forward contracts not designated as hedges for the three and six months ended June 30, 2015 and 2014 (in millions):

| Derivative Instruments Not Designated in Hedging Relationships | Location of Gain (Loss) Recognized in Income | Amount of Gain (Loss) Recognized in Income 2015 | 2014 |
|---|---|---|---|
| Three Months Ended June 30: | | | |
| Interest rate contracts | Interest Expense | $(2) | $(1) |
| Foreign exchange contracts | Other Operating Expenses | (5) | (2) |
| Foreign exchange contracts | Investment Income | 33 | 2 |
| Foreign exchange contracts | Interest Expense | 36 | — |
| Investment market price contracts | Investment Income | (7) | — |
| | | $55 | $(1) |
| Six Months Ended June 30: | | | |
| Interest rate contracts | Interest Expense | $(3) | $(3) |
| For | | | |