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ORIGINAL

Decision No. 75487

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of AIR CALIFORNIA for authority to increase its intrastate passenger fares.

Application No. 50770 (Filed December 19, 1968, and Petition for Interim Authority Filed February 7, 1969)

Gates, Talbot, Morris & Merrell, by J. Thomas Talbot, and Mark T. Gates, Jr., for applicant.
Brobeck, Phleger and Harrison, by Gordon E. Davis, for United Air Lines, Inc., interested party.
David R. Larrouy, Counsel, and M. J. DeBarr, for the Commission staff.

INTERIM OPINION

Air California, a corporation, is a passenger air carrier which provides scheduled air service between:

(a) Orange County Airport (Santa Ana) and San Francisco, Oakland and San Jose,

(b) Ontario and Oakland and San Jose, and

(c) Hollywood-Burbank and Oakland and San Jose.

In this application Air California seeks authority to increase its fares. Fare increase applications have also been filed by competing passenger air carriers serving the San Diego, Los Angeles and San Francisco metropolitan areas.1/ Air California, United, PSA and Western seek interim relief, pending completion of hearings on the applications filed by these carriers.2/

1/ Application No. 50464 - United Air Lines, Inc. (United);
Application No. 50847 - Pacific Southwest Airlines (PSA); and
Application No. 50888 - Western Air Lines, Inc. (Western).

2/ Application No. 50464 (United) and Application No. 50888 (Western) are submitted; further hearings are scheduled in Application No. 50847 (PSA) for May 5, 6 and 7, 1969.

Public hearing in Application No. 50770 was held before Examiner Mallory at San Francisco on February 24 and March 11, 1969, and the interim phase was submitted on the latter date. Evidence was presented by representatives of applicant and the Commission staff. No member of the public participated in this proceeding. The Commission staff opposed the granting of interim relief.

The proposed interim and permanent fares sought herein are as follows:

Route Segment	Present Fare	Proposed Fare	% Increase
SNA - SJC/OAK/SFO	$14.85	$16.19	9.0
ONT - SJC/OAK	15.24	16.19	6.2
BUR - SJC/OAK	13.50	14.52	7.6

Applicant's treasurer testified and presented documentary evidence in support of the application as summarized in the following statements. Service was commenced by applicant between San Francisco and Santa Ana on January 16, 1967, and between other points on later dates. The present fares of applicant were established when service commenced and have not been increased. Air California has operated at a loss since inception of service. The company expected initially to operate at a loss while developing its routes but it expected to operate at a profit prior to this time.

The witness presented in evidence balance sheets and operating statements for various periods. A comparative balance sheet for October 31, 1967 and October 31, 1968 (Exhibit F) shows that as of those dates Air California had sustained deficits from operations of $1,286,283 and $2,226,809, respectively. A balance sheet as of January 31, 1969 (Exhibit 4) reflects a corresponding operating deficit of $3,245,920. The latter balance sheet also shows that on January 31, 1969, total stockholders' equity was a deficit of $635,143.[3/]

Said balance sheets also depict the changes in property and equipment accounts resulting from the changeover from the operation of owned DC-9 and Electra aircraft to leased Boeing 737-200 aircraft commencing in the latter part of 1968 and completed in March, 1969.[4/]

Exhibit 2 reflects a comparison of actual operating results for a twelve-month period ending June 30, 1968 and a four-month period ending October 31, 1968 with projected operating results for the twelve-month period ending December 31, 1969, under present and proposed fares. Said data are restated and summarized in the following table.

3/ Total stockholders' equity as of October 31, 1967 was $1,244,873, and as of October 31, 1968 was $333,973.

4/ Applicant now leases a total of seven 737-200 aircraft at a cost of $43,000 per aircraft per month. Applicant indicated that said aircraft were leased, rather than purchased, in order to get immediate delivery. It was stated that purchase orders cannot be filled for periods of approximately one year from the date of the order.

TABLE I

Actual and Estimated Results of Operation For Air California For Various Periods (Thousands of Dollars)

	Actual		Projected
	Year Ended 6-30-68	4-Months Ended 10-31-68	Year Ended 12-31-69
Revenue Passengers	446,936	229,382	1,011,772
Operating Revenues			
Passenger Transp:			
Present Fares	$6,532	$3,132	$14,368
Proposed Fares	7,134	3,439	15,277
Charter and Other	80	120	505
Total:			
Present Fares	6,612	3,252	14,873
Proposed Fares	7,214	3,559	15,782
Operating Expenses	7,134	3,353	15,122
Operating Income (Loss):			
Present Fares	(522)	(101)	(249)
Proposed Fares	80	206	660
Interest and Amortization (Net)	(436)	(309)	(420)
Net Income (Loss):			
Present Fares	(958)	(410)	(669)
Proposed Fares	(356)	(103)	240

The witness further testified that Air California is in need of an emergency increase in rates because of its present poor financial condition. To support this contention, the witness enumerated the following facts:

(a) Stockholders' equity is continuously lessening, so that at the beginning of the current year it was a deficit amount.

(b) Portions of long-term debt held by an insurance company may be called or converted into common stock if the ratio of current assets to current liabilities falls below 3:1; such ratio as of January 31, 1969 was less than 3:1.

(c) Applicant's cash position, while in excess of $3,000,000 on January 31, 1969, is deteriorating at a rate of about $400,000 per month.

A supervising transportation engineer testified that, in his opinion, the request for interim relief should be denied for the reason that Air California will not realize any substantial amount of increased revenues from a fare increase unless the air carriers with which it competes are concurrently authorized to increase their fares. The engineer pointed out that the Transportation Division staff strongly opposes the granting of an interim fare increase to PSA, as that carrier is currently operating at a profit and, therefore, cannot show that a current financial emergency exists with respect to it.

A financial examiner in the Commission's Finance and Accounts Division presented in evidence Exhibit 8, designed to show that Air California's operating loss under present fares at the end of 1969 would be greatly in excess of the loss projected in applicant's Exhibit 2. The projected results of operation were developed from the operating revenues and expenses in Exhibit 4, for the month of January, 1969, by expanding the one-month expenses in proportion to the projected increase in passengers as reflected in Exhibit 5. Operating expenses, particularly those for flying services, are not, however, directly variable with the number of passengers carried. The assumptions on which the projections in Exhibit 8 were developed do not appear to be reasonable and, therefore, no consideration should be given herein to that exhibit.

A principal financial examiner on the Commission's staff also testified in opposition to an interim fare increase for applicant.[5] It was his position that, although applicant is currently operating at a loss and will continue to do so in the future, it should not be authorized an interim increase in fares because it is not in any financial emergency. He testified that the only basis under which an interim fare increase should be authorized is upon the showing of an extreme financial emergency. Applicant's latest balance sheet of January 31, 1969, indicated that it had more than $3,000,000 in cash and temporary certificates of deposit; its current net operating loss is approximately $380,000 per month; therefore, applicant can continue to pay its current debts for a period of several months. The witness stated that in that period the Commission should have sufficient time to complete hearings and issue a decision on applicant's request for a permanent fare increase.

5/ The following are excerpts from Exhibit 9 presented by this witness:

"The following summarizes a review of January, 1969 financial and operating data submitted March 7, 1969 in connection with this proceeding:

"1. The current position represented by current assets of $6,303,895 less current liabilities of $2,430,067, a net of $3,873,828 and representing a ratio of nearly 2.6:1 indicates no dearth of either working capital or working cash. It is also noted that cash funds at January 31, 1969 total $3,059,563, and that appreciable cash flow can be expected from the $1,428,572 equipment sale generated note receivable from Gatx-Boothe."

* * *

"3. Applicant's January, 1969 operations show a cash loss of $387,259 and a total loss of $410,376. A continuation of this pattern, even on a lesser scale, applied to applicant's previously described financial condition, could be fatal to applicant's survival...."

"Conclusion: Applicant's past operations, and particularly the disposal of its fleet and long-term lease of 737-200's for all its routes, have made serious inroads on its financial condition, and would seem to impair its future prospects...."

"It is our conclusion that an increase in rates for applicant will not seriously brighten its long-term prospects. To make any such increase interim must ignore applicant's present well-padded cash and working capital position. Traffic diminution resulting from increase rates, and rates granted competing carriers, may also have negative effects."

Discussion

The record herein on the request for an interim fare adjustment is complete insofar as applicant's showing is concerned. Applicant's showing was fully tested by cross-examination and we consider it to be reasonable for the purposes of this proceeding. The staff indicated that if more time were available, it would have prepared and presented more detailed studies. The Commission has carefully considered the showing made by applicant and the staff, and our conclusions differ, in part, from those proffered by the staff.

It is inescapable on this record that applicant must immediately take steps to improve its financial condition. The question then presented is whether relief in form of an interim fare increase should be granted or should be withheld pending final completion of this proceeding. The Commission is of the opinion that a sufficient emergency exists which warrants the granting of a measure of interim relief.

As heretofore indicated, the fare levels of applicant are inextricable from those of the major competing air carriers in the so-called "California corridor". The staff financial witness's recommendation failed to consider that permanent relief to the applicant herein is not solely dependent upon completion of the instant proceeding; permanent relief must also await completion of the PSA application, which may be so delayed that applicant's financial position will be irreparable. This witness conceded that applicant, on January 31, 1969, could be considered to be technically bankrupt, under accepted accounting principles.

Questions raised by this witness concerning the wisdom of applicant in converting its entire operating fleet to new 737-200 aircraft is a management decision made in face of competition from PSA and United which recently completed the conversion of their fleets to 727-300 and 737-200 aircraft, and from Western, which also operates only pure-jet aircraft. The questions raised by this witness concerning debt versus equity financing by Air California is a matter not directly in issue in the interim phase of this proceeding.

Air California contends that it should be authorized to increase its fares on an interim basis whether or not competing air carriers are authorized to increase their fares. In view of the present financial condition of the carrier, its management should be permitted to exercise its judgment as to whether or not a fare increase will result in substantial diversion of passengers from it to competing air carriers, or whether the fare increase will cause substantial diversion at particular points. Air California competes with other airlines at Burbank and at Ontario; but serves Santa Ana (Orange County Airport) exclusively. Applicant has indicated that it may exercise the authority only to the latter point. Applicant herein has, in effect, been provided the opportunity to determine what fares are the maximum fares it can maintain in face of the strong competition of other airlines.

Findings and Conclusions

The Commission finds that:

1. Air California is a passenger air carrier operating under certificates from this Commission. It provides passenger air service between Santa Ana and San Francisco, Oakland and San Jose;

between Ontario and Oakland and San Jose; and between Burbank and Oakland and San Jose. Operations commenced in January, 1967.

2. Applicant has not increased fares since the inception of its operations.

3. Applicant's operations have never been conducted at a profit.

4. Applicant's deficit from operations for the year ended June 30, 1968 was $522,000; for the four-month period ended October 31, 1968 was $101,000; and for the month of January, 1969 was $382,000.

5. Applicant's projected results of operation for the year 1969 under present fares indicate a net operating loss of $249,000, and a net loss after interest and amortization charges of $669,000.

6. Applicant's present financial status requires an immediate adjustment in fares.

7. The fare increases proposed in the application herein are justified.

The Commission concludes that the fares sought in the application should be granted.

The proceeding will remain open for the receipt of additional evidence.

INTERIM ORDER

IT IS ORDERED that:

1. Air California, a corporation, is authorized to establish the increased air passenger fares proposed in Application No. 50770. Tariff publications authorized to be made as a result of the order herein shall be filed not earlier than the effective date of this

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order and may be made effective not earlier than ten days after the effective date of this order on not less than ten days' notice to the Commission and to the public.

2. The authority granted herein shall expire unless exercised within ninety days after the effective date of this order.

The effective date of this order shall be ten days after the date hereof.

Dated at San Francisco, California, this 25th day of MARCH, 1969.

William Symons Jr.
President

Commissioners

Commissioner Fred P. Morrissey, being necessarily absent, did not participate in the disposition of this proceeding.