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Decision No. 75899

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC SOUTHWEST AIRLINES for authority to increase its intrastate fares.	Application No. 50847 (Filed January 29, 1969; Petition for Interim Authority Filed February 5, 1969; and Amendment to Petition Filed February 10, 1969)

John W. McInnis and Lawrence L. Pillsbury, for applicant.
Gates, Talbot, Morris & Merrill, by J. Thomas Talbot, for Air California, and Brobeck, Phleger & Harrison, by Gordon E. Davis, for United Air Lines, Inc., interested parties.
Richard D. Gravelle and William C. Bricca, Counsel, and Charles W. Astrue, for the Commission staff.

OPINION

Pacific Southwest Airlines, a corporation, operates as a passenger air carrier under certificates issued by this Commission. In this proceeding it seeks interim and permanent authority to increase its fares. The following table sets forth present and proposed fares.

	Present	Proposed	% Increase
San Diego/ Los Angeles Burbank	$ 6.35	$ 7.14	12.4
Los Angeles/ San Francisco	13.50	14.52	7.5
San Jose	13.50	14.52	7.5
Oakland	13.50	14.52	7.5
Sacramento	15.24	16.19	6.2
Ontario/ San Francisco	15.24	16.19	6.2
Burbank/ San Francisco	13.50	14.52	7.5
San Jose	13.50	14.52	7.5
Oakland	13.50	14.52	7.5

	Present	Proposed	% Increase
San Diego/			
San Francisco (direct)	19.85	20.95	5.5
San Francisco (via Ontario)	19.85	20.95	5.5
Oakland	19.85	20.95	5.5
San Jose	19.85	20.95	5.5
Sacramento	21.59	22.86	5.9
Ontario	6.67	7.14	7.0

Public hearings were held before Examiner Mallory at San Francisco on February 25, and May 6, 7, and 8, 1969.[1/] Evidence was presented by a representative of applicant and three representatives of the Commission staff. The Commission staff opposed the granting of the interim relief.

Applicant's Direct Showing

Applicant's Vice-President of Finance testified substantially as follows: PSA operates Boeing 727-100, 727-200 aircraft, and Douglas DC9-30 aircraft.[2/] It now operates 20 aircraft and has seven 727-200 and six 737-200 aircraft on order for delivery in 1969. It expects to operate 24 aircraft, ten 737-200 and fourteen 727-200 aircraft at the end of 1969.[3/] The same equipment for passenger air transport service is also used in off-peak hours for jet flight training for commercial airlines. PSA's shops also perform jet engine

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1/ The interim phase was submitted February 25, 1968. The application for permanent relief was submitted May 8, 1968.

2/ The configurations of these aircraft are as follows:

727-100	---	128 seats
727-200	---	158 seats
737-200	---	112 seats
DC9-30	---	112 seats

3/ The DC9-30 and 727-100 aircraft will be phased out of operation.

overhaul work under contract to other airlines.[4/] In developing its financial data for presentation herein, revenues and expenses for the aforementioned nonutility services were separated from its revenues and expenses for passenger air service.

PSA has incurred increases in several items of expenses since 1965. As examples, flight crew salaries have increased 36 percent, fuel 11 percent, maintenance salaries 24 percent, passenger service personnel 18 percent, reservations and terminal personnel salaries 41 percent, landing fees 18.8 percent, and insurance 19.6 percent. Also, air congestion has increased at Los Angeles International and San Francisco International Airports, thus increasing flight time and pilot hours and flight hours of other flight personnel.

PSA has experienced a continuous increase in the number of passengers carried over the last seven years. Although PSA's gross revenues from passenger service have continuously increased, it has experienced a decline in net revenues. Its peak earning year was 1966, after which net revenues declined sharply. Further increases in operating costs and reductions in net revenues are expected in 1969.[5/]

4/ PSA also has the following non-air carrier operations which are conducted separately from its passenger air transport service:
   (a) Dual-engine airline pilot training at Brown Field, San Diego.
   (b) Light plane pilot training at Montgomery Field, San Diego.
   (c) Jet Air Leasing, which leases a 727-100 to a Mexican airline.
   (d) Valcar Corporation, an auto rental firm.

5/ Exhibit 7 portrays projected cost increases for fuel, aircraft hull and passenger liability insurance, retirement plan expense, salaries and wages, payroll taxes and property taxes. Said exhibit indicates that the increases in these expenses, all of which have occurred in 1969, will amount to $4,107,000 over corresponding 1968 expenses.

The following table sets forth PSA's summary of operating results and return on depreciated investment for airline operations only, and on a consolidated basis, based on data presented by applicant, for the twelve-month period ended September 30, 1968. The data therein have been restated to eliminate interest as an operating expense.

TABLE 1

Pacific Southwest Airlines
Income Statement for Twelve Months Ended September 30, 1968
(+000)

	Airline Operations Only		Consolidated	
	Present Fares	Proposed Fares	Present Fares	Proposed Fares
Revenues	$48,792	$52,524	$53,893	$57,625
Expenses:				
Flying Operations and Maintenance	22,193		)	
Passenger Service, Reservations and Terminal	9,897		)40,099	
Sales and Administrative	4,994		)	
Depreciation	6,828		6,988	
Total	43,912	43,912	47,087	47,087
Operating Income Before Taxes	4,880	8,612	6,806	10,538
Federal Income Tax	1,358	3,284	1,857	3,783
Income Before Gain on Aircraft Sales	3,522	5,328	4,949	6,755
Depreciated Rate Base*	92,317	92,317	93,592	93,592
Rate of Return on Depreciated Rate Base	3.82%	5.77%	5.29%	7.22%

* Rate Base includes average net book value of fixed assets, average inventory of spare parts, and average deposits with aircraft manufacturers for new equipment. By August 1969, deposits will be converted into book value of equipment.

The witness also presented an income statement for the three-month period ended March 31, 1969, which is summarized in the following table. Beverage profits are included in both revenue figures.

TABLE 2

Pacific Southwest Airlines
Income Statement for Three Months Ended March 31, 1969
(Present Rates)
(+000)

	Airline Operations Only	Consolidated
Revenues	$12,457	$14,379
Expenses		
Operating and Maintenance	8,547	9,686
Selling and Administration	1,455	1,506
Depreciation and Amortization	1,999	2,198
Total Expenses	12,001	13,390
Income or (Loss)	456	989
Interest	977	1,009
Credit for Taxes on Income	(292)	(189)
Net Income or (Loss)	(229)	169

In the foregoing table, income tax credits are those recorded on applicant's books, which will not reflect applicant's actual tax credit which would be greater if accelerated depreciation is claimed on applicant's aircraft equipment. The witness stated that the 939,000 passengers carried in the first quarter of 1969 was an approximate ten percent increase over the same quarter in 1968. Typically, the first quarter of each year is the lowest in number of passengers and earnings.

No forecast of revenues, expenses, and return on investment was presented by applicant for a future test year. As hereinafter explained, applicant's showing in this regard was a restatement of the staff's forecast exhibit to reflect the applicant's adjustment of said data.

Exhibit 8, presented by PSA's accounting witness, sets forth a comparison of changes in direct unit costs for 1966, 1967, 1968 with estimated direct unit costs for 1969. This exhibit is summarized in the following table.

TABLE 3

Pacific Southwest Airlines
Changes in Direct Out of Pocket Operating Costs
1966 through 1968

Per Revenue Plane Mile Flown

	1966	1967	1968	1968 pro-forma assuming 1969 incremental costs were added
Direct Out of Pocket Costs:				
Flying Operations	$ .61	$ .64	$ .82	$ .95
Maintenance	.52	.65	.53(1)	.55(1)
Passenger Service	.12	.12	.16	.17
Reservations and Terminals	.40	.43	.47	.50
Total	$1.65	$1.84	$1.98	$2.17
1968 actual to 1968 pro-forma percentage increase				10%
Percentage increase from 1966			20%	32%

Per Passenger Carried

	1966	1967	1968	1968 pro-forma assuming 1969 incremental costs were added
Flying Operations	$2.45	$2.71	$3.41	$3.94
Maintenance	2.10	2.77	2.21(1)	2.31(1)
Passenger Service	.49	.51	.65	.71
Reservations and Terminals	1.63	1.81	1.97	2.06
Total	$6.67	$7.80	$8.24	$9.02
1968 actual to 1968 pro-forma percentage increase				9.5%
Percentage increase from 1966			24%	35%

(1) The reduction from 1967 costs is principally due to the introduction of newly purchased aircraft which have not yet required significant maintenance expenditures.

The data set forth in Table 1 was presented at the initial hearing involving applicant's request for interim relief. The data in Tables 2 and 3 were introduced at the subsequent hearings relating to the request for permanent relief.

Commission Staff Evidence

Staff witnesses from the Commission's Finance and Accounts Division and Transportation Division testified at the initial hearing in opposition to the granting of interim relief. As such relief will not be granted, their testimony need not be summarized. Their position was that interim relief should not be granted in the circumstance where a utility is not facing a financial emergency.

At the subsequent hearings, a financial examiner from the Commission's Finance and Accounts Division presented in evidence a report containing accounting and financial data developed from information contained in applicant's books and records (Exhibit 9). The report indicates that net depreciated operating property, passengers carried, and carrier operating income (revenues) and operating expenses have each increased substantially both in total dollars, and on a per passenger basis, in the three-year period 1966 through 1968. Net carrier operating income remained relatively stable in the same period; thus return on average investment decreased. Certain operating statistics relating to these data are set forth in the table below:

TABLE 4

Pacific Southwest Airlines
Operating Revenue, Average Net Carrier
Investment, and Miles Flown, Per Revenue Passenger

	Calendar Years		
	1966	1967	1968
Thousands of Revenue Passengers:	2,713	3,346	3,997
Per Revenue Passenger Carried:			
Average Net Carrier Investment	$14.24	$15.22	$20.02
Operating Revenue	12.42	12.52	13.04
Miles Flown	307	308	308

In addition to other statistical comparisons, Exhibit 9 contains a comparative balance sheet for the years 1965 through 1968; a summary of net depreciated operating properties as of the year-end for 1966, 1967, and 1968; and a comparative income statement for the years 1966, 1967, and 1968. The latter statement indicates the following:

TABLE 5

Pacific Southwest Airlines
(+000)

	Calendar Years		
	1966	1967	1968
Net Flight Income (Before Taxes on Income)	$6,478	$5,531	$6,549
Consolidated Net Income (After Taxes)	4,307	4,167	3,955*

* Federal Income Taxes estimated by witness.

The financial examiner also presented in evidence a report on the cost of money and recommended rate of return for a future year (Exhibit 10). The witness determined that applicant's pro-forma average cost of long-term debt for a future year would be 7.07 percent. The witness recommended a rate of return of 10.3 percent on the rate base set forth in the staff engineer's report be found reasonable for the purposes of this proceeding.6/ These two factors, when related to applicant's pro-forma capital structure and ratios, result in approximately a 22 percent return on common equity.

A Transportation Engineer presented in evidence Exhibit 11, which contains a report showing the estimated results of operation for PSA for the rate year beginning July 1, 1969 and ending June 30, 1970. This study reflects the estimated revenues, expenses and investment of PSA in providing services for all existing certificated

6/ As hereinafter discussed, the rate base used by the staff engineer included 20 of the 24 aircraft which will be owned by PSA in the test year.

routes. Revenue and expenses for service over the Ontario and San Diego segment authorized by Decision No. 75297 dated February 4, 1969 have not been included. The revenues and expenses for nonutility operations are not reflected in the report.

The following table depicts the staff engineer's estimate of rate base and depreciation expense for the test year adjusted to reflect the maximum number of 727-200 aircraft (14) which the company will operate in the test year. The rate base includes only the equipment estimated to be required in providing the services for present certificated routes other than between Ontario and San Diego, plus material and supplies and prepayments.

TABLE 6

Pacific Southwest Airlines
Estimated Rate Base and Depreciation Expense
Year Ending June 30, 1970
(Figures in Thousands)

Line No.	Item (1)	Rate Base (2)	Annual Depreciation Expense (3)
1	Aircraft & Equipment in service as of 12-31-68	$ 52,916	$5,124
2	Seven 727-214 (1969 Delivery)	38,404	2,992
3	Two 737-214 (1969 Delivery)	6,968	544
4	B-727 Electronic Equipment	635	85
5	Ground Equipment	1,583	405
6	Building and Improvements	4,885	271
7	Allocation to nonutility	(300)	(20)
8	Subtotal	105,091	9,401
9	Materials and Supplies	3,000	
10	Prepayments	1,200	
11	Estimated Rate Base*	109,291	

*Estimated Rate Base in Exhibit 11 is $111,293,000, based on fifteen 727-200's and five 737-200's. Estimated Rate Base in the above table is based on fourteen 727-200's and six 737-200's.

(Red Figure)

The following table reflects the witness' estimates of revenues, expenses and rate of return in the test year, adjusted for the changed aircraft mix described above. The passenger revenues are based on the projected passenger traffic for each segment and reflect the trend of passenger traffic increases which have been experienced in the past. Beverage profits reflect the traffic increase. The expenses are shown by account groups and functions as recorded by the company and reflect salary levels as of January 1969 and other known expense increases.

TABLE 7

Pacific Southwest Airlines
Estimated Result of Utility Operations
Year Ending June 30, 1970
(Figures in Thousands)**

Item (1)	Present Fares (2)	Proposed Fares (3)
Operating Revenues		
Passenger Revenue	$ 61,732	$ 66,341
Beverage Profit	554	554
Freight Revenue	309	309
Baggage & Miscellaneous Revenue	8	8
	62,603	67,212
Operating Expenses		
Flying Operations	16,118	16,118
Direct Maintenance	9,220	9,220
Indirect Maintenance	1,511	1,511
Passenger Service	3,275	3,275
Airport Terminal Operations	5,137	5,137
Reservations & Ticket Sales	3,410	3,501
Sales & Advertising	2,027	2,150
General & Administration	3,178	3,178
Depreciation	9,401	9,401
	53,277	53,491
Income Before Taxes	9,326	13,721
Income Taxes	*	*
Net Income	9,326	13,721
Rate Base	109,291	109,291
Operating Ratio	85.1%	79.6%
Rate of Return	8.5	12.6

* Accelerated depreciation and interest eliminates all taxable income.

** Based upon the following flying hours:

Total Flying hours	44,600
B-727-200	31,200
B-737-200	13,400

The estimates for test year expenses and rate base include the operation of 20 of the 24 aircraft applicant intends to have in service in its common carrier operations in the test year.[7/] The witness testified that applicant's present schedules adequately could be met with 20 aircraft. The witness also concluded that the estimated increase in number of passengers for the test year could be handled with the number of scheduled flights in 1968, and without any increase in the number of flying hours. The witness stated that current schedules are being met with less than the twenty aircraft owned at the end of 1968; and that the purchase of 727-200 aircraft will add sufficient seats to handle added passengers without a significant increase in the number of flights.[8/] Thus the decision of PSA's management to add a net increase of four aircraft in the test year over those operated at the end of 1968 may have been for the purpose of serving new routes for which authority has not yet been received, rather than for the purpose of servicing existing authorized routes.

The witness proposed a schedule of alternate fares designed to produce a rate of return of 10.3 percent on the rate base contained in his study. Inasmuch as the original rate base figures in Exhibit 11 require adjustment to reflect the different mix of aircraft, the schedule of alternate fares set forth in Exhibit 11 would no longer result in a rate of return of 10.3 percent; and, therefore has not been reproduced herein.

7/ Aircraft in excess of that required for scheduled service, which will be owned by applicant in the test year, will be leased to others by an affiliated company.

8/ The witness increased the number of flights by one round-trip per day, with a corresponding increase in flying hours, to provide for service between Sacramento and Los Angeles, to accommodate the anticipated increase in traffic between these points in the test year. The number of schedules and flying hours were also adjusted to reflect a full year's operations between Ontario and San Francisco.

Applicant's Rebuttal Evidence

Applicant's witness testified in rebuttal to the staff showing and presented additional exhibits to reflect applicant's revisions of the staff estimates and supporting data. This witness testified that he agreed in principle with the estimated results of operations for a test year presented by the staff engineer, except in the following respects:

1. The staff study does not reflect a sufficient number of aircraft to perform adequate service in the test year.

2. The staff study does not reflect sufficient number of flights (therefore flying hours) to reflect the level of service PSA states is required to be offered in the test year.

3. The staff income tax calculation indicates that there will be no income tax liability in the test year, based on the "flow-through" method of tax calculation, using the full amount of accelerated depreciation and investment tax credit which is authorized to be taken by PSA under the Internal Revenue Code and depreciation guidelines. PSA's income taxes are not recorded on its books in this manner.

4. The staff study fails to include an additional ad valorem tax liability of $800,000 which will be incurred in the test year.

The PSA witness proposed that the staff test year estimates be amended in the following respects:

(a) That the test year results be based on the operation of 24 aircraft (instead of 20) resulting in an adjustment of $1,641,000 in annual Depreciation Expense.

(b) That the number of flights be increased to reflect PSA's schedule which will be in effect in June, 1969; resulting in an increase of approximately 600 flying hours per month. PSA urges that 50,000 flying hours per year (rather than the 44,600 used by the staff) would reflect its actual scheduling. Said adjustment would amount to $1,685,000 annually in Flying Operations Expense, and $769,000 annually in Direct Maintenance Expense.

(c) That General and Administrative Expense be increased by $800,000 annually to reflect the expected increase in ad valorem taxes, based on the known increase in assessed value of applicant's property and current tax rates.

(d) That Income Taxes be computed at the current income tax rates, without consideration to investment tax credit or accelerated depreciation on aircraft and parts, because of the circumstances peculiar to PSA's current tax situation. PSA does not accrue on its books accelerated depreciation for its common carrier operations because of the short (6-year) tax depreciation lives for aircraft equipment which results in its aircraft being 50 percent depreciated after two years (under double-declining balance method of accruing depreciation for tax purposes). Nor does it accrue investment tax credit, because some aircraft have been disposed of before they have been held the minimum

> of four years required to earn any portion of the investment tax credit which may be taken only in the year of purchase. PSA asks that income taxes be computed at the rate of 50 percent of net operating income.

PSA's witness testified that it requires more aircraft than reflected in the staff study in order to provide aircraft to meet its service peaks and to provide for sufficient out-of-service time for adequate maintenance. The witness stated that PSA operates second sections during its peak service periods (which are not shown in its published schedule) in order to meet its service requirements on weekends and in holiday and vacation periods. Second-section operations require aircraft in addition to those necessary to provide service under its published schedule. Also, adequate maintenance requires that aircraft used in its regular schedule be withdrawn on a regular basis. The witness stated that PSA did not operate sufficient aircraft in 1968 to adequately cover maintenance schedules and also provide adequate service during peak periods.

PSA's witness testified that all of its passengers could be transported under the present number of schedules, if traffic was equally distributed on the year. However, traffic varies considerably during any period. Scheduling to provide excellent service during all hours of the day, all days of the week, and in the heavier traffic periods, requires additional flights to those represented in the staff study. The witness testified that PSA must maintain a high level of service in order to gain the number of additional passengers estimated for it in the test year because of the highly competitive situation in the California corridor. Inasmuch as its fares and its aircraft are the same as its principal competitors', competition for traffic is limited to availability of service at the times when people desire to travel. PSA must provide service in this manner in order to retain its position in the markets it serves; therefore, estimates of operations for the test period should reflect such manner of operations.

Issues

The material issues in this proceeding are the following:

1. Should fares be determined herein on the level of service that PSA claims it is necessary to perform in order to maintain its competitive position in the California corridor; or should fares be determined on a level of service which will reflect in the test year the service now offered by PSA (or some alternate level)?

2. Is PSA the rate-making carrier for operations in the California corridor? If so, what consideration, if any, should be given herein to this fact in the establishment of increased air fares herein?

3. What should be the Commission's policy with respect to flow-through of investment tax credit and accelerated depreciation in computing the federal income tax liability of air carriers for rate-making purposes.

Discussion

With respect to the first issue, PSA has shown that some increase in the number of aircraft (above the twenty aircraft used in the staff report) is necessary to provide the desired level of service. Such increase in the number of aircraft will provide for adequate maintenance schedules, and for extra service in the peak holiday and vacation periods, and during weekends and peaks in daily traffic. Some consideration also must be given to PSA's past history in its current markets, wherein it has achieved a continuously larger portion of these markets based primarily on frequency of service. It appears that to maintain its current competitive position, and thus to achieve the anticipated 10 percent growth in the test year, PSA must offer more than merely adequate scheduling. It must anticipate the needs of its customers by providing regular schedules at times and on days when such schedules, at least initially, will have low load factors. The addition in the test year of regular schedules above those presently operated requires that more hours be flown, as well as that more aircraft be placed in service. From this record it appears that adequate consideration will be given to the factors of competition, service requirements and growth of present markets, by basing test year expenses on the operation of twenty-two aircraft and 48,200 flying hours per year.

On the second issue, we recognize that, among the four carriers (PSA, United, Western and Air California) which conduct jet commuter service in the California corridor, only PSA's operations are profitable under present fares.[9/] The testimony of the staff witnesses at the hearings in the current fare applications clearly shows that none of the four carriers can compete effectively in that market at fares higher than its competitors, when all competitors operate a similar type of jet aircraft. It is clear that PSA is the rate-making carrier in this market. We reach this conclusion from the following facts: PSA's share of the market in California has exceeded 50 percent in recent years (Exhibit 2);

9/ In decisions issued today in Applications Nos. 50464 and 50888, we found that United and Western operated at a loss in the California corridor in 1968. Under fares on the same level sought herein United would have a slight profit (operating ratio before taxes of 98.2 percent) and Western would have a loss.

PSA is the only carrier in this market operating at a profit at current fares; and no other carrier can compete effectively at fares higher than those which will be authorized to PSA herein (testimony of staff witness herein and by United in Application No. 50464). The fares authorized herein thus become the maximum fares for all air carriers operating in the California market. Maximum fares, historically, have been set at the upper limit of the zone of reasonableness.

The third issue concerns flow-through of investment tax credit and accelerated depreciation in the computation of federal income liability in rate cases involving air carriers. This issue is complex. The Commission has not heretofore considered this matter, as this issue has not been raised heretofore in the air carrier rate proceedings. The Commission has stated that, for a passenger stage corporation, income taxes should reflect, as nearly as possible, taxes actually paid and the methods of tax calculation authorized under Federal and State laws. (Greyhound Lines, Inc., 64 Cal. P.U.C. 641, 653.) The record herein discloses that there may be a carry-forward into a future period beyond the rate year used herein of the unused portion of income deductions for accelerated depreciation and interest reflected in the test year operating results in Table 1. Also, there may be a recapture of unearned investment tax credit in the test year. This record is not complete on this issue and, therefore, would not be appropriate for a determination for future actions of the Commission. Moreover, this issue need not be resolved in order to reach a decision herein.

Table 8, which follows, shows calculations of federal income taxes using the method suggested by the staff, i.e., immediate flow-through of accelerated depreciation and investment tax credit. This method is less favorable to PSA than the method of tax calculation urged by it. Table 8 indicates that, with adjustments to reflect the operation of twenty-two aircraft in the test year and 48,200 flying hours, operations under proposed fares will result in an operating ratio (with no consideration of income taxes) of 83.8 percent and a rate of return of 9.35 percent. It is reasonably certain that the proposed fares will produce revenues and a rate of return within reasonable limits for PSA's operations in the test year. Therefore, issues concerning investment tax credit and the tax effect of liberalized depreciation need not be resolved herein. The estimated results of operation set forth in Table 8, which are based on current expense levels adjusted for known increases, are adopted for the purposes of this proceeding.

TABLE 8

Pacific Southwest Airlines
Adjusted Results of Operation Year Ending June 30, 1970
(Amounts in Thousands)

Item (1)	Present Fares (2)	Applicant's Proposed Fares (3)
Total Flying Hours	482	482
B-727-200 (14)	284	284
B-737-200 (8)	198	198
Operating Revenues	$ 62,603	$ 67,212
Expenses		
Flying Operations	16,768	16,768
Direct Maintenance	10,709	10,709
Indirect Maintenance	1,511	1,511
Passenger Service	3,346	3,346
Airport Terminal Operations	5,137	5,137
Reservations & Ticket Sales	3,452	3,542
Sales & Advertising	2,084	2,206
General & Administration	3,178	3,178
Depreciation	9,945	9,945
Total Expenses	56,130	56,342
Income Before Taxes	6,473	10,870
Income Taxes	-0-	-0-
Net Income	6,473	10,870
Rate Base	116,259	116,259
Operating Ratio	89.7%	83.8%
Rate of Return	5.6	9.35

Findings and Conclusions

The Commission finds:

1. PSA is a passenger air carrier operating wholly within the State of California. By the application herein it seeks to increase all of its passenger air fares.

2. PSA's operations have been profitable in past years, as represented by net carrier income (after taxes) of $5,701,000 in 1966, $5,249,000 in 1967, and $6,020,000 in 1968 (Paragraph 19 (table) of Exhibit 9). Said data compare with estimated net carrier income (after taxes) of $6,473,000 for operations under present fares in the year ended June 30, 1970 (Table 8).

3. The estimates of revenues, expenses, rate base, rate of return and operating ratio set forth in Table 8 in the preceding opinion reasonably represent PSA's results of operations under present and proposed fares for the year ended June 30, 1970, and are adopted for the purposes of this proceeding.

4. In order to achieve in the test year the quality of service heretofore provided to the public, PSA will need to operate a greater number of aircraft and a greater number of scheduled flights and flying hours than set forth in Table 7 in the preceding opinion.

5. The adopted results of operation set forth in Table 8 give adequate effect to the type of service heretofore provided to the public by PSA, under which PSA has sustained a continuous growth in number of passengers.

6. PSA is the rate-making carrier in said markets. Other carriers cannot compete effectively in said markets at fares exceeding those authorized herein to PSA, considering that all carriers in this market operate similar jet aircraft at this time.

7. PSA's operations at present fares in the year ended June 30, 1970 will be profitable (Table 8), but its rate of return will be less than reasonable. Net income under present fares of $6,473,000 will be slightly less than current interest expense of $6,503,000 on debt related to the twenty-two aircraft and related property in rate base.

8. The fares proposed in the application herein will provide an estimated rate of return of 9.35 percent and an operating ratio of 83.8 percent (Table 8).

9. The fares proposed herein will be just and reasonable, and the fare increases have been shown to be justified.

10. The Petition For Interim Authority should be denied.

11. The record in this proceeding is not sufficiently adequate or complete to enable determination or resolution of the following matters of principle for rate-making purposes:

(a) Treatment of investment tax credit on an immediate flow-through versus a normalized basis.

(b) Treatment of income tax savings resulting from use of liberalized depreciation on an immediate flow-through versus a normalized basis.

(c) Amortization of deferred credits arising from (a) and (b) above, and modification of rate for any unamortized balance which might represent cost free capital financing a portion of such rate base.

(d) Disposition of gains or losses on sale of air carrier property and equipment, and the income tax consequences thereof.

(e) Group method accounting for the retirement of air carrier property and use of straight-line remaining life depreciation method as a corollary to (d) above.

The Commission concludes that the fares proposed in the application should be granted and that the matters referred to in

Finding 11, above, need not be resolved in this proceeding. The increased jet commuter air fares authorized herein should be permitted to be established on five days' notice to the Commission and the public.

O R D E R

IT IS ORDERED that:

1. Pacific Southwest Airlines, a corporation, is authorized to establish the increased passenger fares proposed in Application No. 50847. Tariff publication authorized to be made as a result of the order herein shall be filed not earlier than the effective date of this order and may be made effective not earlier than five days after the effective date hereof on not less than five days' notice to the Commission and to the public.

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

3. The Petition For Interim Authority filed February 5, 1969 is denied.

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

Dated at San Francisco, California, this 8th day of JULY, 1969.

William Symons Jr.
President

Commissioners