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Decision No. 76814

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of HOLIDAY AIRLINES, INC., for authority to increase its passenger air carrier fares.	Application No. 51403 (Filed October 2, 1969; Amended November 24, 1969)

Loughran, Berol & Hegarty, by Marshall G. Berol, for applicant.
William C. Bricca, Counsel, M. J. DeBarr, and Richard Brozosky, for the Commission staff.

OPINION

Holiday Airlines, Inc. (Holiday) is a passenger air carrier operating pursuant to a certificate authorizing service between Tahoe Valley Airport (South Lake Tahoe), on the one hand, and Oakland, San Jose, Hollywood-Burbank and Long Beach, on the other hand.[1/]

In this application Holiday seeks to increase its fares, as set forth in the following table:

TABLE 1
HOLIDAY AIRLINES, INC.
PRESENT AND PROPOSED ADULT FARES

	Present	Proposed
Between Tahoe Valley Airport and:		
Oakland and San Jose Airports		
One Way	$11.95	$13.57
Round Trip (a)		
Monday through Thursday	23.90	23.00 (b)
Friday through Sunday	23.90	27.14
Hollywood-Burbank (c)		
One Way	$19.95	$24.52
Round Trip (a)		
Monday through Thursday	39.90	39.90
Friday through Sunday	39.90	49.05

(a) The proposed Monday through Thursday round-trip fare will be available only when both portions of the round-trip are taken during those days of the week.

(b) Reduction.

(c) Holiday proposes to establish the same fares at Long Beach, when service is initiated.

1/ The record shows that service has not been started at Long Beach because the City of Long Beach has not as yet agreed to provide Holiday with facilities at Long Beach International Airport.

Holiday estimates the proposed fares will result in an increase in ticket sales revenues of 9.759 percent.

Holiday has pending Application No. 51159 for authority to serve between Tahoe Valley Airport and Los Angeles International Airport, and Application No. 51346 to serve between Truckee-Tahoe Airport, on the one hand, and, on the other, Oakland International Airport, San Jose Municipal Airport, Hollywood-Burbank Airport, Long Beach Airport, Los Angeles International Airport, and Tahoe Valley Airport. Hearings in the aforementioned route proceedings have not been completed.[2/] Holiday plans to establish the same fares from and to Los Angeles International Airport as are sought to apply from and to Burbank.

The application herein alleges that Holiday has not sought any fare increases in connection with the services which it is authorized to perform since the initial grant of the respective authorities. Holiday was authorized to perform service between Lake Tahoe and Oakland and San Jose in 1966 at a fare of $11.95. The service between Lake Tahoe and Burbank and Long Beach was authorized in 1968 at a fare of $19.95.

The amendment to the application requests that the fare increases sought herein be authorized by ex parte order as interim fares, pending public hearing on its request. Interim ex parte relief was not authorized; the matter was heard before Examiner Mallory at San Francisco on December 29 and 30, 1969, and submitted on the latter date. There were no protests.

Evidence was adduced by Holiday's president and its secretary-treasurer, and by a Commission staff engineer. Inasmuch as interim relief was not granted on an ex parte basis, Holiday

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2/ Further hearings in Application No. 51159 were scheduled for January 21 and 22, 1970.

abandoned its request for an interim order. The Commission staff, as more fully discussed hereinafter, opposed the granting of the application.

Applicant's president testified as follows: Applicant began operations with two DeHaviland Doves (eleven seats)[3/] which were replaced by one DC 3 two-engine piston aircraft (28 seats) and one DC 6 four-engine piston aircraft (80 seats). On assuming the presidency of Holiday in March 1968, he recommended that the Douglas piston aircraft be replaced, which was accomplished by leasing (with option to buy) two Electra prop-jet aircraft (98 seats), one of which was placed in service in November 1968, and the other in March 1969. The Electras were selected because of their suitability to applicant's operations. Tahoe Valley Airport cannot accommodate pure jet aircraft because of safety regulations. Electras have wide public acceptance. Electras were being phased out by trunk airlines and could be acquired at a reasonable cost. The seating capacity of Electras exceeds that of any other suitable type of aircraft. With the acquisition of the two Electras, Holiday's capacity was substantially increased. The number of passengers handled has increased substantially, although maximum capacity has not been reached.

The president also testified concerning the proposed reduction in round-trip fares for Monday through Thursday service. He stated that Holiday handles mainly resort type traffic, which is heavier on weekends than during the mid-week. He feels that the Friday through Sunday traffic will continue to grow without stimulation, but that mid-week traffic needs to be encouraged. He pointed out that mainland - Hawaii air fares are lower mid-week than on weekends.

3/ On June 15, 1965, Decision No. 71648, 66 Cal. PUC 537, 538.

Applicant's secretary-treasurer presented financial information for past periods and for a future test year. Exhibit 1-A contains comparative balance sheets as of October 31, 1968, and July 31, 1969. Said exhibit indicates that deficit from operations was $782,972 on October 31, 1968 and $2,033,802 on July 31, 1969. The witness testified that the unaudited deficits from operations as of October 31, 1969 was $2,311,339. Said financial statements also indicate that although the two Electra aircrafts are leased, they are carried on applicant's books as if owned. The witness testified that applicant has always intended to execute, and has recently executed, its option to purchase the aircraft. This was possible through a public stock offering, which resulted in sales of 400,000 shares at $7.50, producing approximately $2,750,000 in additional capitalization (less selling and legal costs). The proceeds will be reduced immediately by applicant's current net deficit in stockholder's equity occasioned by prior operating losses. Additional amounts are scheduled to apply against anticipated operating losses in current months and to retire past due and currently due obligations.

The following depicts applicant's unaudited revenues and expenses for the nine-month period November 1, 1968 through July 31, 1969 and audited figures for the fiscal years ended October 31, 1966, 1967 and 1968. The witness stated that applicant's fiscal year ended October 31, 1969, but that its books for said fiscal year had not been audited. Applicant has changed its accounting procedures during the year, and the witness did not believe unaudited expense figures would be accurate.

TABLE 2

HOLIDAY AIRLINES, INC.

STATEMENTS OF INCOME AND EXPENSE
FOR THE FISCAL YEARS ENDED
OCTOBER 31, 1966, 1967, AND 1968,
AND FOR NINE MONTHS ENDED JULY 31, 1969

Item	Year Ended October 31, 1966	1967	1968	Nine Months Ended July 31, 1969
Operating Revenues				
Ticketed sales	$ 107,795	$ 86,392	$ 45,752	$ 621,610
Charter revenue	17,001	2,768	79,386	33,676
Other	139	423	1,949	11,696
Total Operating Revenues	124,935	89,583	127,087	666,982
Operating Expense				
Flying operations	97,176	136,730	310,544	762,523
Maintenance	24,214	39,492	120,777	363,612
Depreciation	6,342	11,354	7,684	187,793
Selling, general and administrative expenses	38,804	69,565	219,826	540,117
Total Operating Expenses	166,536	257,141	658,831	1,854,045
Operating profit (loss)	(41,601)	(167,558)	(531,744)	(1,187,063)
Nonoperating Income or (Expense)				
Interest expense	(2,125)	(5,031)	(3,220)	(71,062)
Interest income	-	-	2,614	10,870
Miscellaneous - net	(106)	10	329	(1,124)
Net nonoperating income or (expense)	(2,231)	(5,021)	(277)	(61,316)
Profit (loss) before extraordinary items	(43,832)	(172.579)	(532,021)	(1,248,379)
Extraordinary Items				
Loss on sale of flight equipment, and provision for decline in market value of equipment not in service	-	-	(34,540)	(2,451)
Net profit (loss)	$ (43,832)	$(172,579)	$(566,561)	$(1,250,830)
Operating Ratio	133.3%	287.0%	518.4%	277.9%

The foregoing operating results reflect the closing of Tahoe Valley Airport during the period July 8, 1968 through November 8, 1968, for runway improvements; a reduction in passenger load factor during January and February 1969, because of unusually adverse weather conditions at Lake Tahoe; the substitution of one Electra prop-jet aircraft (98 seats) on November 8, 1968, and the second Electra prop-jet in March 1969. The first Electra replaced a Douglas DC-3 (28 seats) and the second replaced a Douglas DC-6 (80 seats).

The following table sets forth applicant's estimates of operating income and expense, operating ratio and return on rate base under present and proposed fares for a test year covering the twelve-month period ended November 30, 1970. Applicant's Exhibit 3-A, showing estimated revenues and expenses for the test year includes provision for income taxes, although applicant has net operating loss carryovers and unapplied investment tax credits available for application against taxable income in future years. Therefore, income taxes have been eliminated in the following table. Applicant's Exhibit 4-A shows its rate base calculations and return on rate base. The rate base data shown in Exhibit 4-A is for July 31, 1969. Applicant's estimated total depreciation amounts to approximately $27,000 per month ($324,000 per year). Applicant's witness agreed that a mid-year depreciated rate base would be appropriate for the purposes of this proceeding. Therefore, the rate base set forth in Exhibit 4-A has been adjusted to reflect the depreciated rate base as of May 30, 1970, by reducing applicant's rate base in Exhibit 4-A by $270,000, resulting in a mid-year depreciated rate base of $1,343,000.

TABLE 3
HOLIDAY AIRLINES, INC.

Projected Statement of Income and Expense for the twelve months ended November 30, 1970, under present and proposed fares for presently authorized routes

	Present fares	Proposed fares
Revenue Passengers	156,530	156,530
Flight Hours	2,880	2,880
OPERATING REVENUES		
Ticket sales	$2,521,400	$2,767,545
Charter	108,000	108,000
Other	75,600	75,600
Total operating revenues	$2,705,000	$2,951,145
OPERATING EXPENSES		
Flying Operations	$ 930,000	
Maintenance	520,500	
Depreciation	324,000	
Passenger service	42,000	
Aircraft and traffic servicing	312,000	
Selling, general and administrative	744,000	
Total operating expenses	$2,872,500	$2,872,500
Profit or (loss)	($ 167,500)	$ 78,645
Depreciated Rate Base	$1,343,000	$1,343,000
Rate of Return	-	5.9%
Operating Ratio	106.2%	97.3%

The witness testified expenses were developed based on actual expenses for the latest available period, plus known increases which will occur in the test period. Revenues were based on a projection developed from actual experience of Holiday for the four months ended July 31, 1969 and a market survey made by a consulting firm. The witness testified that a greater number of passengers travel in summer months and that Holiday enjoyed the following load factors in mid-1969:

April	30.8 percent
May	44.4 percent
June	39.7 percent
July	46.5 percent
August	61.0 percent

The test-year operating results reflect a load factor of 55.5 percent for a full year.

An engineer from the Commission's Transportation Division presented in evidence an exhibit containing a preliminary study of applicant's actual operating results for the five-month period, April through August 1969, and estimates of operating results for a 1970 test year. The estimated revenues and expenses were based primarily on projections of Holiday's recorded operating results for the five months' period ended August 31, 1969.

The record shows that the Electra aircraft operated by Holiday were purchased from Pacific Southwest Airlines (PSA), which had operated them in California service. The engineer substituted for Holiday's recorded costs and depreciation expense for these aircraft, the original cost of these aircraft to PSA, and depreciation expense based on the schedule approved by Commission in a 1960 fare increase proceeding of PSA. This has the result of substantially reducing depreciation and rate base in the test year, as one aircraft would be fully depreciated; thus, no depreciation would be accrued on one aircraft and rate base would reflect only the salvage value of that aircraft. The witness stated that these adjustments were consistent with past Commission actions.

The engineer also reduced the test year rate base by the amount of Holiday's airworthiness reserve. The witness did not use the amounts recorded on applicant's books, but developed his own estimate of this account for the test year. Holiday performs no major maintenance on its aircraft, but contracts for this work to be done by another airline. The Federal Aviation Authority (FAA) requires that aircraft be maintained in accordance with safety schedules established by it. The periods vary for different parts of the aircraft. (For example, required periodic maintenance of the air frame is a longer interval than for aircraft engines or propellers.) Regular monthly charges are made to this account based on FAA maintenance schedules. The account is debited when actual maintenance work is done.

The engineer stated that his recommendation with respect to the airworthiness reserve is consistent with the decisions of the Civil Aeronautics Board (CAB) in general fare proceedings. Citation was given to a CAB decision as authority.

The engineer also included in 1970 test-year estimates, revenues and expenses covering proposed operations to and from Los Angeles International Airport. The preliminary results of operations set forth in the staff study (Exhibit 103) are portrayed in Table 4, below. Based on the data set forth in his study, the engineer reached the following conclusions:

> "In view of the pending application to serve Los Angeles International Airport (LAX) (A. 51159) and the significant effect that will have on the company's estimated results of operations as shown in Table 4 (below), it is recommended that any adjustment of fares be deferred until after a decision is issued in that proceeding. It may be noted that if operation to LAX is authorized, the rate of return for the entire operation will be 17.3% with present fares and thus no increase would be indicated."

On cross-examination, the staff witness stated that he was not prepared to make a recommendation as to what a reasonable rate of return would be for Holiday.

TABLE 4

COMMISSION STAFF'S
PRELIMINARY
ESTIMATED RESULTS OF OPERATION
HOLIDAY AIRLINES, INC.

Item	Carrier's Record 5-Mo. Total	Yr. 1970 Present Oper. Present Fares	Yr. 1970 Present Oper. Requested Fares	Year 1970 with LAX* Present Fares	Year 1970 with LAX* Requested Fares
Statistics					
Passengers	42,931	148,130	148,130	175,300	175,300
Flights	967	2,320	2,320	2,320	2,320
Block Hours	1,316	3,160	3,160	3,770	3,770
Revenue					
Passenger	$ 630,209	$2,384,400	$2,684,500	$2,927,000	$3,310,000
Charter	27,798	108,000	108,000	108,000	108,000
Other	19,013	57,000	57,000	57,000	57,000
Total	$ 677,020	$2,549,400	$2,849,500	$3,092,000	$3,475,000
Expenses					
Flying Operations	$ 371,410	$ 891,500	$ 891,500	$1,029,900	$1,029,900
Direct Maintenance	147,353	353,700	353,700	421,600	421,600
Maintenance Burden	77,651	186,400	186,400	222,200	222,200
Passenger Service	20,146	48,300	48,300	48,300	48,300
Aircraft & Traffic Ser.	104,613	251,100	251,100	268,300	268,300
Promotion and Sales	172,031	352,400	355,900	436,400	440,400
General & Administrative	137,401	338,100	338,100	342,100	342,100
Depreciation	125,732	192,200	192,200	192,200	192,200
Total	$1,156,337	$2,613,700	$2,617,200	$2,961,000	$2,965,000
Operating Income	$ (479,317)	$ (64,300)	$ 232,300	$ 131,000	$ 510,000
Income Taxes	-	-	-	-	-
Net Income			232,300	131,000	510,000
Operating Ratio - %	170.8	102.5	91.8	95.8	85.3
Rate of Return - %			30.7	17.3	67.4
Rate Base		$ 756,700	$ 756,700	$ 756,700	$ 756,700

(Red Figure)

* LAX = Los Angeles International Airport.

The staff argued that there is no showing of dire financial need which would warrant an emergency increase in fares; that the losses applicant is now experiencing can be absorbed by the additional capital resulting from its recent stock issue; that there is an insufficient historical basis to develop meaningful revenues and expenses for a future period; that the proposed operations from LAX will have a substantial influence on applicant's future operating results; that there are too many "gray areas" involved, as the future of the company appears to depend in great part on the accuracy of its traffic projections; and for all the foregoing reasons no action should be taken on applicant's request at this time, but the matter should be recalendared after a decision is issued in the LAX route application.

Holiday argued that the application should be decided upon the evidence adduced thus far; that to await conclusion of its LAX route application would indefinitely delay action on a needed rate increase, as no one knows when the Commission will act in that proceeding nor whether it will grant the sought certificate; that applicant disagrees with the staff adjustments to rate base, particularly as to the adjustment of aircraft acquisition costs to those of PSA and the related computation of depreciation expense (including service lives and salvage value) over the span of years since the date the aircraft were first placed in service by PSA. Holiday moved that the portion of staff Exhibit 103 with respect to proposed operations at LAX and the related staff testimony be stricken from the record as being outside the issues in this proceeding. Said motion was taken under submission, to be ruled on in the decision herein.

Discussion

The staff recommendation that no action be taken on this application until after Application No. 51159 is decided will be denied. Applicant is entitled to a decision on its application within a reasonable time and applicant would effectively be denied the relief it seeks for an indefinite period of time if required to wait until its route application is decided. (In re Minimum Rate Tariff No. 17, 66 Cal. PUC 298.) Morever, Application No. 51159 is actively opposed, thus it cannot be concluded at this time that the Commission will act favorably upon the application. The application herein should be decided upon the facts relating solely to applicant's current routes. In view of the foregoing conclusion, the evidence adduced by the staff concerning operating results for Holiday's proposed service at LAX will be given no further consideration in this proceeding. It will not be necessary to strike the testimony from the record. Holiday's motion to this effect will be denied.

Other issues to be decided herein concern:

1. Whether, for rate-making purposes, the cost, depreciation, service lives and salvage value of the two Electra aircraft purchased by Holiday from PSA should be based on the cost of said equipment at the time the aircraft were first placed in service in California using service lives and salvage values found reasonable for PSA (Decision No. 61102, dated November 22, 1960, in Application No. 42253, 58 Cal. PUC 248, 251); or the original cost to Holiday and its estimate of service lives and salvage values recorded on Holiday's books should be used.

2. Whether rate base should be reduced by the accumulated airworthiness reserve recorded on Holiday's books (or as estimated by the staff).

Concerning the first issue, the staff witness testified that he would not have recommended substitution of original cost of equipment for recorded cost and depreciation expense if the aircraft had been acquired from an airline which did not provide service in California. Applicant's president testified that one of the main reasons Holiday purchased the aircraft from PSA was because operations in California's moderate climate is less harmful to the aircraft than when used in the eastern or midwestern states having cold winters and heavy snow and ice conditions.

The principal reason cited by the staff witness for his adjustment is that the Commission has followed the so-called "original cost" concept in other utility rate proceedings. The Commission has adopted such concept when the utility acquiring the property is a direct successor in interest to the utility originally owning the property and is rendering service for generally the same portion of the public as the utility from which the property was acquired [MGRS, Inc., Decision No. 66794 dated February 11, 1964 in Application No. 45455 (citing Decision No. 59710 dated February 23, 1960 in Applications Nos. 41589 and 41613), and California Water & Tel. Co., 65 Cal. PUC 281, 286]. The Commission has not required that the original cost concept be followed when the operating property is purchased from a non-affiliated company or a non-successor company and when the sale price of the operating property is the result of arm's-length negotiation, such as is the case herein.

Applicant in this proceeding should not be penalized because it purchased operating property from a California utility, rather than from an out-of-state carrier.[4] It will not be reasonable

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4/ It is recognized that in certain instances, it may be to a utility's advantage to apply the "original cost" concept in a rate proceeding.

to apply the "original cost concept" to separate items of utility property sold by one operating utility to another at a price arrived at through arm's-length negotiations. In the circumstances, we find that the proposed adjustments to rate base and depreciation for the two Electra aircrafts will not be reasonable and should not be adopted herein.

We turn now to the question whether rate base should be reduced by accrued airworthiness reserves. The accepted elements of rate base include, in addition to the depreciated cost of utility property, a provision for working cash. Applicant's fares are generally collected in advance of service; therefore, it has no requirement for working cash. The accrual on applicant's books of an airworthiness reserve results in the charge of repair and maintenance costs to current operating expenses well in advance of the time and actual expense is incurred.

This is proper for accounting purposes and such accruals are included in test year operating expenses in both the applicant's and the staff's estimates. However, the accumulation of such a reserve provides funds in the nature of a "negative" working cash requirement, that is: cash in excess of that required to meet day-to-day expenses. These cash amounts are available for short term investment or for deposit in interest-bearing bank accounts. Therefore, we find that funds provided by the airworthiness reserve accounts should not earn a return from carrier operations. The manner in which the foregoing conclusion should be reflected in test year operating results is to deduct the average (mid-year) airworthiness reserve from rate base.

Applicant and the Commission staff test-year operating results differ as to the number of flights which will occur in the test year, and to related expenses. However, these differences need not be resolved herein.

Based on the foregoing preliminary findings and the evidence of record, we find that:

1. Holiday Airlines, Inc. (Holiday) is a passenger air carrier providing service between Tahoe Valley Airport, on the one hand, and Hollywood-Burbank, Oakland and San Jose Airports, on the other hand. It seeks to increase its fares as set forth in Table 1.

2. Holiday's operations have not resulted in a profit since their inception (Table 2).

3. Holiday's lessors acquired two Electra prop-jet aircraft from Pacific Southwest Airlines, Inc. (PSA) and Holiday placed said aircraft in revenue service on November 8, 1968 and March 7, 1969. Said aircraft were leased with option to purchase. Holiday has exercised its option to purchase from the lessors.

4. The fair and reasonable amounts to be included in rate base for the two aircraft are the purchase prices, as recorded on applicant's books less accumulated depreciation, as reflected in Table 3. The fair and reasonable annual depreciation for these aircraft is that reflected in Table 3.

5. The airworthiness reserve accumulated on applicant's books provides funds in excess of those needed for working cash; such funds may be invested in short term securities or interest-bearing bank accounts; therefore, such funds should be excluded from rate base. The reasonable amount of this reserve for the test year is $108,000.

6. In view of findings 4 and 5, the applicable mid-year (June 30) rate base for the 1970 test year is $1,209,000.

7. No consideration should be given herein to operating routes applied for, but not granted to applicant.

8. Test year estimates furnished by applicant and the Commission staff vary as to estimated numbers of passengers, flights and flight or block hours. However, in view of the foregoing findings, such differences need not be resolved.

9. The operating results for a 1970 test year as estimated by the staff in Table 4, adjusted to give effect to the foregoing findings, are as follows:

HOLIDAY AIRLINES, INC.
ESTIMATED RESULTS OF OPERATION
FOR YEAR ENDING DECEMBER 31, 1970

	Present Fares	Proposed Fares
Revenues	$2,549,400	$2,849,500
Expenses	$2,745,500	$2,749,000
Operating Income (Loss)	$ (196,100)	100,500
Operating Ratio	107.7%	96.5%
Rate Base	$1,219,000	$1,209,000
Rate of Return	-	8.3%

10. The estimates of operating revenues, expenses, including taxes and depreciation, and rate base as set forth in the foregoing finding reasonably represent the results of applicant's operations for the purposes of prescribing rates herein.

11. The operating results in finding 9 indicate that operations under such fares will result in a loss for the test year. Applicant is in need of additional revenues.

12. The operating results in finding 9 indicate that operation under proposed fares will result in a rate of return of 8.3 percent, and an operating ratio of 96.5 percent. Said rate of return and operating ratio are not excessive for local airline operations.

13. The increased fares proposed herein will be reasonable and are justified.

The Commission concludes that the application should be granted.

ORDER

IT IS ORDERED that:

1. Holiday Airlines, Inc., is authorized to establish the increased fares proposed in Application No. 51403. Tariff publications 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 sixty days after the effective date of this order.

3. The motion of Holiday Airlines, Inc., to strike portions of the staff's Exhibit 103 is denied.

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

Dated at San Francisco, California, this 17th day of FEBRUARY, 1970.

William Symons Jr.
President

Vernon L. Sturgeon
Commissioners