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Decision No. 76885

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of AIR CALIFORNIA for Authority to Increase its Intrastate Passenger Fares.	Application No. 51489 (Filed November 18, 1969; Amended December 1, 1969)
In the matter of the Application of AIR CALIFORNIA for a certificate of public convenience and necessity to provide passenger air service between Long Beach, on the one hand, and San Jose and Oakland, on the other hand.	Application No. 50381 (Petition Filed January 23, 1970)

Graham & James, by Boris H. Lakusta, Norriss M. Webb and Carl A. Benscoter, for Air California, applicant.
George M. Shortley, for Pacific Southwest Airlines, interested party.
B. A. Peeters, Counsel, for the Commission staff.

INTERIM OPINION

In Application No. 51489, as amended, Air California alleges that an extreme financial emergency exists which threatens its continued operations as an air carrier, and requests an order granting it an immediate interim fare increase pending further review by the Commission.

Public hearing on this application was held before Examiner Mallory at San Francisco on December 18 and 19, 1969, and the matter was submitted on applicant's request for interim relief.1/ The Commission staff opposed the granting of interim relief and requested

1/ The revenue and expense data for operations in a future test year included proposed operations at San Diego, as well as operations subsequently authorized to be discontinued at Hollywood-Burbank.

that the matter of permanent relief be considered after the staff had sufficient opportunity to review the data supplied by applicant. A request by the staff to temporarily remove the matter from the calendar pending such review was denied by the Examiner.

On January 9, 1970, Air California filed Application No. 51610, seeking authority to immediately discontinue service to and from Hollywood-Burbank; alleging that such service was unprofitable and would continue to be so in the future.[2/] On January 23, 1970, Air California filed a Petition to Extend Time in Application No. 50381, seeking to postpone to July 13, 1970, the commencement of service between San Diego and Oakland/San Jose authorized by Decision No. 76110, dated September 13, 1969. Thereupon, the Commission issued an order setting aside submission of Application No. 51489 and reopening this matter for further hearing, stating: "This application for increased fares was submitted December 19, 1969, upon applicant's request for interim relief. Since such date applicant has requested authority to discontinue service to and from Hollywood-Burbank Airport and to postpone inauguration of service to and from San Diego Airport. The record in this proceeding lacks evidence with respect to the effect of the above service changes upon the financial condition of Air California".[3/]

Further hearing in Application No. 51489 for interim fare relief was held on a common record with the petition in Application No. 50381 to postpone the inauguration of service at San Diego on February 10 and 11, 1970, and both matters were submitted on the latter date.

2/ Application No. 51610 was granted by Decision No. 76780, dated February 10, 1970.

3/ Decision No. 76727, dated January 27, 1970.

Evidence in support of the request for an immediate emergency increase in revenues and for postponement of service at San Diego was adduced by applicant's president, by its treasurer and chief financial officer, and by its manager of economic planning and scheduling. A senior transportation engineer of the Commission staff also presented evidence.

EVIDENCE ON INTERIM FARE INCREASE

Applicant's present and proposed one-way fares are set forth in the following table:

TABLE I

		Present		Proposed	
Between	And	Commuter	First Class	Commuter	First Class
Santa Ana	San Francisco	$16.90*	$23.33	$20.00	$27.00
	Oakland	16.90*	23.33	20.00	27.00
	San Jose	16.90*	23.33	20.00	27.00
Ontario	Oakland	16.19	23.33	20.00	27.00
	San Jose	16.19	23.33	20.00	27.00
Palm Springs	San Francisco	20.00**	27.00**	24.00	31.00
	Oakland	20.00**	27.00**	24.00	31.00
	San Jose	20.00**	27.00**	24.00	31.00

* Increased fares effective December 3, 1969, pursuant to Decision No. 76450 in Application No. 51295.

** New service initiated December 10, 1969, pursuant to Decision No. 76397 in Application No. 51194.

Applicant proposes to establish the foregoing increased fares both as interim fares and permanent fares, except that no interim increase is sought in Palm Springs fares.

Applicant's president appeared as its policy witness. His testimony was as follows: Air California has consistently maintained a record of on-time performance and reliability; its average passengers per aircraft-mile is better than all trunk-line air carriers in recent months; except for June and August, 1968 and August, 1969, Air California has never realized a profit from its operations in its two years and ten months of existence; therefore, it is the conclusion of Air California's management that it has not been adequately paid for the services it renders. If Air California had been adequately paid for its services in the past, it would not now be before the Commission. The witness testified that Air California's stockholders expect a profit, and that profits are necessary in order that Air California may continue in existence and are necessary to encourage additional equity investment and enable debt financing to service new routes and equipment. Because of prior losses applicant has not been able to attract additional equity capital necessary to purchase aircraft now leased, or to acquire additional aircraft. Also Air California's loans from two lenders are technically in default, although no foreclosure or similar action by lenders is contemplated at this time. The foregoing, the witness testified, forms the basis for the emergency requiring an immediate fare increase.

Applicant's president also testified as to the tentative acquisition agreement by Pacific Southwest Airlines (PSA) announced in the press just prior to the initial day of hearing in the application. The witness stated that the agreement was in skeleton form and would, if approved by Air California's stockholders, form the basis for further and more detailed discussions with PSA. Applicant's president urged that the agreement, if it is to be consummated, will require several months to conclude and will require approval of regulatory agencies, including this Commission. In the meantime, applicant is in urgent need of additional revenues to continue operations. (Application No. 51736, filed February 25, 1970, seeks authorization of the purchase of Air California's properties and certificates by PSA.)

Applicant's manager of economic planning and scheduling testified and presented several exhibits, including an analysis of traffic handled in 1969 compared with applicant's forecast for such period. The witness testified that Air California's forecast for 1969 was accurate within generally acceptable limits[4/] through August, but that beginning with September, actual traffic was from 11.2 percent (November) to 16.9 percent (October) below the forecast. The witness stated that other airlines and business, generally, had similar decreases in business activity in the same period because of the general slowdown in the economy, and the resulting tightening in the area of discretionary spending. The foregoing analysis, made at the beginning of 1970, after the initial hearings in Application No. 51489, indicated that applicant's forecast traffic and test-year operating results based thereon were substantially overstated and should be revised. Therefore, the witness prepared revised traffic estimates for 1970, reflecting more accurately the traffic trends occurring in the last five months of 1969. Applicant now estimates that it will handle the following passengers on its existing system and receive the following revenues in 1970:

4/ The witness testified that forecasts which are $\pm$ 2.5 percent are considered to be reasonably accurate.

TABLE 2

AIR CALIFORNIA PASSENGER AND PASSENGER REVENUE FORECAST 1970

		At Existing Fares		At Proposed Fares (1)	
		1970 Forecast Passengers	Total Passenger Revenue	1970 Forecast Passengers	Total Passenger Revenue
Orange County-	SFO	325,916	$ 5,710,048	320,375	$ 6,631,762
	SJC	193,450	3,385,375	190,449	3,942,294
	OAK	159,399	2,792,670	155,016	3,208,831
Ontario-	SJC	91,922	1,535,097	90,648	1,876,414
	OAK	68,857	1,148,535	67,917	1,405,882
Palm Springs-	SFO	24,198	499,447	24,198	499,447
	SJC	20,025	408,110	20,025	408,110
	OAK	20,025	408,110	20,025	408,110
TOTAL SYSTEM		903,792	$15,887,392	888,653	$18,381,850
Less Dilution @ 7% (2)			1,112,117		1,286,729
TOTAL REVENUE			$14,775,275		$17,095,121

(1) Palm Springs at present fares.

(2) In order to give effect to reduced children's, clergy and military fares.

This witness also presented in evidence comparisons of ground transportation trip costs for an Orange County passenger using Orange County Airport, Ontario Airport and Los Angeles International Airport; and for an Oakland or San Jose passenger using San Francisco International Airport. This information was designed to show that applicant could maintain higher fares from and to satellite airports as compared to its competitors' fares from and to Los Angeles and San Francisco Airports, because of the differences in ground transportation costs and travel times. In the foregoing table, the witness used a diminution factor of two percent to give effect to loss of traffic because of increased fares. However, he testified that in his opinion the loss of traffic because of increased fares would be limited to the nonbusiness portion of Air California's passengers, which is 30 percent of total traffic and that it might lose 15 percent of that traffic, or an overall diversion of five percent. The witness also testified that Air California had initiated service at Palm Springs only a few days before the initial hearing herein; that it had advertised widely its new Palm Springs service at a $20.00 commuter fare; and, therefore, does not seek interim authority to increase its Palm Springs' fares, as the initial development period for such routes is still in progress.

Applicant's accounting witness presented in evidence balance sheets, statements of operations for historical periods, and estimates of revenues, expenses and rate base for a 1970 test year at present and proposed fares. The following table is extracted from applicant's Exhibit No. 9 containing, among other data, an unaudited profit and loss statement for the year 1969. These data are compared with corresponding audited data for 1968.

TABLE 3

AIR CALIFORNIA COMPARATIVE STATEMENTS OF OPERATIONS

	(UNAUDITED) Twelve Months Ended 12/31/69	Twelve Months Ended 12/31/68
Revenues:		
Passenger transportation	$ 12,686,521	$ 8,685,787
Other	792,722	48,036
Total revenues	$ 13,479,243	$ 8,733,823
Expenses:		
Operations	$ 7,022,897	$ 4,442,106
Aircraft rental	3,247,619	440,000
Aircraft maintenance	1,357,236	1,522,997
Provision for overhauls	831,041	561,315
Depreciation and amortization	205,430	751,059
Selling, general and administrative	2,768,417	2,118,924
Amortization of deferred charges	146,481	155,368
Total expenses	$ 15,579,121	$ 9,991,769
Net income (loss)	$ (2,099,878)	(1,257,946)

The following table depicts applicant's estimates of revenues and expenses for a test year. Revenues are those shown in Table 2. Expenses were developed by adjusting 1969 expenses for known increases; principally increases in union wages, fringe benefits, operating taxes, property taxes and related items. Applicant's witness testified that applicant would not be required to pay federal income taxes if it earned an operating profit in 1970 because of a large tax loss carry-forward, the initial portion of which does not expire until after the 1971 tax year.

TABLE 4

AIR CALIFORNIA STATEMENT OF ESTIMATED INCOME (LOSS)
FOR THE TEST YEAR ENDING DECEMBER 31, 1970
PRESENT AND PROPOSED FARES
($000)

	Present Fares	Proposed Fares
Revenue Passengers	903,792	888,653
Revenues:		
Passenger Transportation	$ 14,775	$17,095
Other (Freight, Liquor, etc.)	655	650
Total	15,430	17,745
Expenses:		
Operations	8,088	8,072
Aircraft Maintenance	1,530	1,530
Selling; General and Administrative	2,916	2,966
Depreciation	350	350
Provision for Overhauls	845	845
Amortization of Deferred Charges	258	258
Aircraft Lease Cost	3,096	3,096
Total	17,083	17,117
Income (Loss) Before Taxes	(1,653)	628
Net Income (Loss)	$ (1,653)	$ 628
Operating Ratio	110.7%	96.5%
Yield Per Revenue Passenger Mile	4.5¢	5.3¢

Applicant's financial witness also presented in evidence Exhibit No. 8 designed to show applicant's cash flow at present fares during the test year. According to the witness applicant will have a cash balance of $47,000 at the end of the 1970 third quarter (vs. $344,000 at the end of the current quarter), and thereafter will have exhausted its available cash. The witness stated that such showing indicated that while applicant will not be insolvent in the next quarter, it is in urgent need of additional funds at the earliest possible time.

The Commission staff witness testified concerning a study made of the expenses of Pacific Southwest Airlines (PSA) and Air California to develop a total cost per passenger for the main route segments of each carrier (SFO-LAX and SFO-SNA). Costs per flight hour and per passenger were computed on the recorded expenses for the nine months ended September 30, 1969 as shown in his Exhibit No. 12. The costs per passenger for Air California were also shown on an adjusted basis with the equipment lease costs for items other than depreciation eliminated and the traffic, passenger and sales expense adjusted to be more comparable with PSA costs. The witness stated that per passenger costs for Air California, as adjusted, were $13.05 and for PSA were $12.39. The equipment lease cost adjustment is required to make a reasonable comparison of operating costs. The costs with that adjustment only are Air California $14.25 per passenger and PSA $12.39 per passenger, with Air California costs $1.86 per passenger higher than PSA.

The staff witness concluded that, based on his study, it is indicated that existing differential of Air California's fare between San Francisco and Orange County over the fare of PSA between San Francisco and Los Angeles is adequate to cover reasonable cost differences and that the increased fares requested in Application No. 51489 are not justified. The witness stated that his exhibit gives no consideration to Air California's revenue needs or to factors other than relative efficiency; his exhibit assertedly demonstrates that Air California is less efficient than PSA and, therefore is not entitled to an interim fare increase. No consideration was given to applicant's current and projected operating losses at present fares.

The staff witness also urged that the sought fare increase would cause a loss of traffic of about 15 percent and that such loss of traffic would offset any increased revenue gained from the fare increase. The witness relied on limited studies and analyses to support his judgment with respect to the amount of traffic which would be lost under the sought fare increase.

Evidence Re San Diego Service.

Applicant's manager of economic planning and scheduling presented in evidence a revised estimate of passenger traffic on its route between San Diego and San Jose/Oakland, prepared in conjunction with its revised system passenger estimates for 1970 set forth in Table 2. The forecast of San Diego passengers reflects the general trend of passengers experienced by applicant in the period September through December 1969 on its existing routes. The current forecast of traffic from and to San Diego covers the period March through December, 1970. Applicant estimated in its September 1968 forecast submitted in Application No. 50381, that its estimate of its share of the 1969 market is 81,000 between San Diego and San Jose and 79,000 between San Diego and Oakland.

Applicant has shown that the aircraft on order from Boeing will not be purchased, as applicant does not have sufficient equity capital to complete the purchase, nor can it borrow the necessary funds. The witness explained that two additional aircraft are necessary to adequately serve the San Diego market. Service to this market with applicant's existing fleet would require that San Diego schedules be operated during the times of day when aircraft are available, which would not be at the times that the majority of potential passengers would desire to fly. Thus, it could not offer sufficient service to attract the number of passengers it originally estimated. Applicant now estimates that it will handle, in the 10-month period, 27,400 passengers between San Diego and San Jose and 28,365 passengers between San Diego and Oakland, with corresponding load factors of 19.9 and 20.5 percent.

Applicant's witness testified that the foregoing load factors indicate that operations would be conducted at a substantial loss and, in view of applicant's present financial situation, it would not be prudent to initiate operations to and from San Diego on or before the current date which it must inaugurate service or lose its certificate. Applicant's president testified that applicant seeks an extension of time to July 13, 1970; during this period applicant will further analyze the feasibility of inaugurating service to and from San Diego.

Argument

The Commission staff and applicant presented trial briefs concerning the criteria for and need for interim rate relief.

As pointed out by the staff, it is well established that the Commission may, in an emergency, grant interim rate relief. PT&T, 48 CPUC 487 (1949), aff'd. 48 CPUC 823. However, interim relief is an extraordinary remedy which should be employed only if from the evidence before it the Commission is persuaded that the time involved in the usual disposition of the case will cause irreparable financial harm. It is a remedy which by its very nature must be employed to arrest an existing or imminent deterioration in the financial condition of the applicant. San Diego G&E, 58 CPUC 684 (1961).

Applicant urges that generally the Commission cases have spoken in terms of "emergency" as the prerequisite to interim relief.

However, emergency takes many forms, and the Commission has recognized this by granting interim relief under varying degrees of emergency. The most obvious case is the one in which the utility would be in jeopardy of immediate financial failure and cessation of operation in the absence of such relief. At the other end of the scale is the case in which the only emergency is the need for obtaining additional financing to finance an expansion program. Assertedly, the basis urged by Air California is between these two extremes.

Findings and Conclusions

1. Applicant, Air California, has requested an immediate emergency interim fare increase, pending further review by this Commission, alleging that without such increase Air California may not be able to continue operations.

2. Public hearing was held on said request for interim relief and the matter was submitted.

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

4. Applicant's balance sheet as of September 30, 1969 records a deficit stockholders' equity of $2,190,544, and reflects cumulative operating losses of $4,801,321.

5. Applicant has been granted authority to withdraw its services to and from Hollywood-Burbank Airport on the basis that such operations were unprofitable. (Decision No. 76780, dated February 10, 1970, in Application No. 51610).

6. Applicant seeks in Application No. 50381, to postpone the inauguration of service to and from San Diego for a period of four months, to July 13, 1970. Applicant has shown that under current conditions it cannot achieve a level of passenger traffic which

would produce sufficient passenger revenues to cover the incremental costs of providing service to and from San Diego. Postponement of service, as requested, will not be adverse to the public interest.

7. Applicant does not have, and cannot attract sufficient capital to purchase aircraft now on order and is taking steps to transfer or terminate such purchase contracts. Additional aircraft is not required to provide its present service.

8. Applicant's estimate of operations at present fares will result in an operating loss for the year 1970 of $1,653,000 (Table 4).

9. Applicant does not own its aircraft and spare engines. Its lease expense includes depreciation and return on investment for the lessor of this equipment. The excess of lease expense over reasonable depreciation expense is approximately $1,634,000 per year (Exhibit AC 106).

10. The estimated loss in Finding 8 adjusted to reflect ownership expenses of its equipment is $19,000. Lease expenses should be adjusted by the Commission to an ownership basis in the determination of permanent fares.

11. Applicant's estimated cash position indicates it will be insolvent before the close of 1970 (Exhibit 8).

12. Applicant's principal long-term loans are technically in default because covenants concerning cash position and stockholders' equity have been abrogated. Requests for waiver have been denied by both lenders (Exhibit 10).

13. Applicant is in urgent need of additional cash.

14. Applicant has taken steps to minimize its current losses through discontinuance of service at Hollywood-Burbank, postponement of service at San Diego, and to transfer or terminate contracts to purchase new aircraft (Findings 5, 6 and 7).

15. Based on applicant's testimony that its operations are as efficient as its major competitor and on the cost comparisons in Exhibit 12 there is no justification for a permanent increase in applicant's fares.

16. Based on the overall emergency financial condition of applicant, as evidenced by Findings 3, 4, 11, 12 and 13, interim rate relief is necessary to improve applicant's cash position.

17. Air California should be authorized to establish the requested fares which we find to be justified for a temporary interim period of 120 days. Based on applicant's estimates this will generate approximately $700,000 additional revenues in said 120-day period.

The Commission concludes that interim fare relief as provided in the following order should be granted and that inauguration of service at San Diego should be postponed.

INTERIM ORDER

IT IS ORDERED that:

1. Air California is authorized to increase passenger air fares between Santa Ana and Ontario, on the one hand, and San Francisco, Oakland and San Jose, on the other hand, as requested in Application No. 51489 for a period of 120 days from the effective date of the increased fares. 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 the public.

2. The authority granted in ordering paragraph 1 shall expire unless exercised within sixty days after the effective date of this order.

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3. The date by which Air California shall inaugurate passenger air transportation service to and from San Diego pursuant to the certificate granted in Decision No. 76110 in Application No. 50381 is hereby extended to July 13, 1970.

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

Dated at San Francisco, California, this 3rd day of MARCH, 1970.

William Symons Jr.
President

Augustus

J. P. Vukasin Jr.

Thomas Moran

Vernon L. Sturgeon
Commissioners