

hjh

77991

Decision No. _____

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of PACIFIC SOUTHWEST
AIRLINES for an ex-parte order
or expedited authority to increase
its intrastate fares. }

Application No. 52016
(Filed July 6, 1970;
Amended October 20, 1970)

John W. McInnis, for Pacific Southwest Airlines,
applicant.
Brobeck, Phleger & Harrison, by Gordon E. Davis,
for United Air Lines, Inc., interested party.
Gary L. Hall, Counsel, A. L. Gielegem,
M. J. DeBarr, and R. Brozosky, for the
Commission staff.

O P I N I O N

Pacific Southwest Airlines (PSA), is a California corporation operating as an air passenger carrier exclusively between points in California. In this application it seeks authority to increase its passenger air fares. Present and proposed air fares are set forth in Appendix A.

Applicant's present fares were established pursuant to Decision No. 76447, dated November 18, 1969, in Application No. 51278. Said decision authorized revenue increases designed to offset cost increases not considered in PSA's general fare increase authorized by Decision No. 75899, dated July 8, 1969, in Application No. 50847. In that proceeding, the Commission staff recommended that a rate of return of 10.3 percent be found reasonable for PSA's airline operations.^{1/} The Commission found that operating results under applicant's proposed fares in that

^{1/} Said recommended rate of return reflected an average cost of long-term debt of 7.07 percent and a return on common equity of approximately 22 percent.

proceeding would produce an estimated rate of return of 9.35 percent and a corresponding operating ratio of 83.8 percent for a test year ended June 30, 1970. Said test-year operating results reflected 482,000 flying hours and the operation of 22 aircraft, which the Commission found to be adequate to continue the type of service theretofore provided to the public by PSA.

Public hearing on Application No. 52016 was held before Examiner Mallory at San Francisco on September 22, 23 and 24, 1970, and the matter was submitted. Evidence was adduced by applicant's controller and by an engineer from the staff of the Commission's Transportation Division. Commission Staff Counsel moved that, based solely upon applicant's showing, the application be dismissed. Said motion was taken under submission, pursuant to Rule 63 of the Commission's Rules of Procedure, to be ruled upon herein.

Applicant's witness testified that the purpose of the sought fares are two-fold: to produce additional revenues, and to adjust basic fares so that when such fares are subjected to the increased federal transportation tax, the total fare will again end in even 50-cent increments.^{2/} In addition, PSA seeks to further increase its through San Diego-Bay Area fare so that said fare will equal the sum of its proposed fares between San Diego-Los Angeles, and Los Angeles-Bay Area. The witness testified that PSA had historically maintained San Diego-Bay Area fares in the manner proposed herein until the fares authorized by Decision No. 76447.

^{2/} Federal transportation tax on airline travel was increased, effective July 1, 1970, from 5 percent to 8 percent. (See Appendix A).

The fares proposed herein assertedly will produce \$2,075,145 additional annual revenue, and will result in an average revenue increase of approximately 2.7 percent. The witness testified that such increase in revenue is required because of increased operating expenses. The witness presented Exhibit 2, which details significant areas of cost increases. Said exhibit lists known annual increased costs for property taxes, federal use taxes, federal payroll taxes, wages costs for all personnel except flight personnel, liability insurance and retirement plans. Said cost increases amount to \$2,617,607 annually. Exhibit 2 also contains the following statement:

"PSA's flight crew contract expires December 31, 1970, and if the pay increase is only the same 9% as negotiated in the last contract the increase would be approximately \$500,000."

PSA's witness presented in evidence the following estimates of airline operations for a test year under present and proposed fares.

TABLE 1
PACIFIC SOUTHWEST AIRLINES
(Airline Operations Only)
Projected statement of income and rate of
return on depreciation rate base
Twelve months ended June 30, 1971

	<u>Present fares</u>	<u>Proposed fares</u>
Passenger revenue	\$75,176,000	\$77,212,000
Other revenue (beverage, freight, baggage and mail)	<u>1,400,000</u>	<u>1,400,000</u>
	76,576,000	78,612,000
Costs and expenses:		
Flying operations	19,149,000	19,149,000
Direct and indirect maintenance	13,640,000	13,640,000
Passenger service	5,300,000	5,300,000
Terminal operations	7,950,000	7,950,000
Reservations and ticket sales	4,240,000	4,240,000
Selling general and administrative	6,400,000	6,400,000
Depreciation of property and equipment	11,100,000	11,100,000
Interest expense	<u>5,140,000</u>	<u>5,140,000</u>
	<u>72,919,000</u>	<u>72,919,000</u>
Income before federal income tax	3,657,000	5,693,000
Federal income tax	<u>1,755,000</u>	<u>2,733,000</u>
Net income	<u>\$ 1,902,000</u>	<u>\$ 2,960,000</u>
Rate Base	\$117,774,000	\$117,774,000
Rate of return	1.6%	2.5%
Operating ratio	97.5%	96.2%

The witness testified that the data contained in the above table were developed from the books and records of the company, adjusted to eliminate revenues and expenses for non-utility flight training and maintenance operations conducted with personnel and equipment used also in scheduled flight operations.^{3/} The witness testified that the data in Table 1 originally were developed in connection with Application No. 51736,^{4/} based on certain assumptions as set forth in Exhibit 3. Said assumptions are as follows:

1. Number of passengers - 5,300,000. This represents approximately an 11% increase over the 4,775,000 passengers projected for the period July 1, 1969, through June 30, 1970.
2. Flight hours - 55,000. Based on current schedule and current flight hours and projected schedules.
3. Average fare - \$14.04. Based on the first two months of 1970.
4. Flying operations cost per hour - based on the first two months of 1970, with a 1% increase in costs. Costs were increased only 1% based on projected higher utilization during the projection period.
5. Direct and indirect maintenance cost per hour - based on the first two months of 1970, with a 10% increase and a maintenance reserve, to mature the aircraft fleet, of \$36 per hour.
6. Passenger service, terminal operations, and reservations and ticket sales - based on the twelve months ended December 31, 1969 with a 10% cost increase.

^{3/} In addition to the foregoing non-utility operations, PSA also has several subsidiaries which are operated independently from its scheduled flight services.

^{4/} In Application No. 51736, PSA sought to acquire Air California; said application was dismissed by Decision No. 77341, dated June 9, 1970.

7. Selling, general and administrative - based on the year ended December 31, 1969, with a 17% cost increase. Increased property taxes, accounts for approximately 14% of the 17% increase.
8. Lease rental - Actual as of April, 1970.
9. Depreciation and interest expense - based on the projected fleet size and borrowings.
10. Federal income tax - 48% rate.

The witness testified that the foregoing assumptions were developed in early 1970 and, therefore, do not reflect the more current information available at the time of hearing.^{5/}

The witness indicated that certain of the above assumptions are incorrect. PSA will incur no federal income tax liability in the test year; the actual number of passengers handled in the period July 1, 1969 through June 30, 1970 was 4,929,000; and no maintenance reserve is established on PSA's books, thus maintenance expense which exceeds the actual expense to be incurred in the test period is inappropriate for this proceeding. The witness presented no data showing complete results of operations to which the foregoing assumptions were applied. It is not possible to relate the dollar amount of increased expenses in Exhibit 2 to the percentage figures adopted in the various assumptions set forth above.

Applicant's witness presented Exhibit 1, which shows the calculations underlying the rate base figure set forth in Table 1, above. The witness testified that PSA now operates 24 aircraft in its common carrier airline operations.^{6/} PSA, under its

^{5/} Exhibit 4, presented by PSA, shows actual expenses (but not revenues) for the fiscal year ending June 30, 1970. The Commission staff, in Exhibit 5, shows actual airline revenues and expenses for said fiscal year.

^{6/} The 24 aircraft consist of fifteen 727-200's and nine 737-200's.

agreements with Boeing Aircraft Company, will take delivery on three additional aircraft in the test-year.^{7/} The witness stated that PSA intends to use the three additional aircraft in its common carrier operations. During the test year three complete overhauls ("D" checks) of the airframes of two 727-200 and one 737-200 aircraft will be required.^{8/} The so-called "D" checks require that each of the aircraft involved be out of service for about three months. One new aircraft would replace the three out-of-service aircraft undergoing "D" checks during the test year. The other new aircraft are not required to provide PSA's current level of service over existing routes.^{9/}

The rate base data contained in Exhibit 1 include the 24 aircraft regularly operated in PSA's airline operations on June 30, 1970, and the addition of the three new aircraft to be acquired during the test year period. The witness calculated the mid-year net book value (less depreciation) of its equipment (including 24 aircraft now in operation) as \$114,274,487. The addition of the first new aircraft to be acquired would raise this amount to \$118,263,528. With the addition of two additional new aircraft, the estimated rate base would be \$120,471,448.

^{7/} One 727-200 on November 19, 1970, and one 737-200 on April 7, 1971, and one 727-200 on May 27, 1971.

^{8/} These are denominated "D" checks by the F.A.A. They are to be performed at 8,000 hours.

^{9/} PSA also operates a 727-100 as back-up during peak service periods. Said aircraft is not included in PSA's rate base calculation. Said aircraft and two other 727-100 aircraft will be disposed of when the new aircraft are purchased.

Based on the foregoing showing, the Commission staff counsel moved that the application be dismissed as applicant had not made a sufficient showing that the increases are justified. As indicated heretofore, applicant's showing contains deficiencies, but these deficiencies are not sufficient to warrant dismissal.

An associate engineer from the Commission's Transportation Division presented in evidence Exhibit 5, which contains his study and report of PSA's request for fare increases. The engineer's report shows actual airline operating revenues and expenses for year ended June 30, 1970. The witness included in the revenues for this period and in his test year (1971), the revenues accruing from the non-utility services of pilot training and aircraft maintenance. He included such revenues because he did not feel that PSA's allocations of expenses between utility and non-utility operations were correct. Having accepted PSA's method of allocations in prior proceedings, and without specific facts to show such methods are inappropriate, we must rely herein on PSA's methods. Therefore, inclusion of non-operating revenues is arbitrary and unsupported on this record. Such revenues should be eliminated. The revenues and expenses for PSA common carrier airline operations, as set forth in Exhibit 5, adjusted to eliminate revenues from non-utility services are the following:

TABLE 2
RESULTS OF OPERATION
PACIFIC SOUTHWEST AIRLINES

Historic Year
7-1-69 to 6-30-70

<u>Statistics</u>	
Passengers	4,929,218
Passenger Miles (000)	1,539,501
Flight Hours	54,205
<u>Revenue</u>	
Passenger	\$ 68,327,044
Beverage (Net)	685,483
Baggage, Freight & Mail	784,759
Total Revenue	\$ 69,797,286
<u>Expenses</u>	
Flying Operations	\$ 19,254,921
Direct Maintenance	7,822,237
Indirect Maintenance	1,748,417
Passenger Service	5,057,878
Airport Terminal Operations	6,674,380
Reservations & Ticket Sales	3,528,317
Sales & Advertising	1,957,190
General & Administrative	4,012,200
Depreciation	10,506,400
Total Expenses	\$ 60,571,940
Operating Income	\$ 9,225,346
Income Taxes	100
Net Income	\$ 9,225,246
Operating Ratio - %	86.8
Rate of Return - %	7.5
Rate Base	\$123,382,100

A. 52016 af

The staff witness also presented estimates of operation under present and proposed fares for a 1971 test year. The following table sets forth the engineer's estimates, adjusted to eliminate non-utility revenues.

TABLE 3
ESTIMATED
RESULTS OF OPERATION
PACIFIC SOUTHWEST AIRLINES
APPLICATION NO. 52016

	<u>Rate Year</u> <u>1971</u>	
	<u>Present</u> <u>Fares</u>	<u>Requested</u> <u>Fares</u>
<u>Statistics</u>		
Passengers	5,286,000	5,286,000
Passenger Miles (000)	1,637,640	1,637,640
Flight Hours	58,646	58,646
<u>Revenue</u>		
Passenger	\$ 74,154,000	\$ 76,118,000
Beverage (Net)	735,000	735,000
Baggage, Freight & Mail	785,000	785,000
Total Revenue	\$ 75,674,000	\$ 77,638,000
<u>Expenses</u>		
Flying Operations	\$ 20,832,200	\$ 20,832,000
Direct Maintenance	8,463,200	8,463,200
Indirect Maintenance	1,891,900	1,891,900
Passenger Service	5,410,900	5,410,900
Airport Terminal Operations	7,157,500	7,157,500
Reservations & Ticket Sales	3,796,700	3,835,400
Sales & Advertising	2,082,000	2,082,000
General & Administrative	4,322,500	4,322,500
Depreciation	11,078,000	11,078,000
Total Expenses	\$ 65,034,900	\$ 65,073,600
Operating Income	\$ 10,639,100	\$ 12,564,400
Income Taxes	100	100
Net Income	\$ 10,639,000	\$ 12,564,300
Operating Ratio - %	85.9	83.8
Rate of Return - %	9.4	11.1
Rate Base	\$113,232,000	\$113,232,000

The engineer testified that the estimates in Table 3 do not include increases in operating expenses other than for those for increased flight hours and the expenses of one additional aircraft. He did not include the additional maintenance expenses resulting from the required "D" checks. The record indicates that figures in Table 3 should be modified to the following extent:

1. Operating expenses should be increased by \$2,617,600 to reflect the known increases in operating expenses set forth in applicant's Exhibit 2.

2. Maintenance expenses should be increased by \$900,000 to cover the added costs of three F.A.A. "D" checks to be performed in the test year.

The estimates of operating results developed in Table 3, adjusted to give effect to the foregoing changes, are as follows:

TABLE 4

PACIFIC SOUTHWEST AIRLINES
ADOPTED ESTIMATES OF
OPERATING RESULTS FOR
1971 TEST YEAR

	<u>Present Fares</u>	<u>Proposed Fares</u>
<u>TOTAL REVENUE</u>	\$ 75,674,000	\$ 77,638,000
<u>TOTAL EXPENSES</u>	\$ 67,652,500	\$ 67,691,200
<u>NET INCOME</u>	\$ 8,021,500	\$ 9,946,800
<u>OPERATING RATIO</u>	89.4%	87.2%
<u>RATE OF RETURN</u>	7.1%	8.8%
<u>RATE BASE</u>	\$113,232,000	\$113,232,000

PSA's witness testified that the average capital structure of its airline operations in the test year ended June 30, 1971, would be as follows:

<u>Type</u>	<u>Amount</u>	<u>Percent</u>
Long Term Debt	\$ 79,160,000	63.6
Stockholders' Equity	<u>\$ 45,500,000</u>	<u>36.4</u>
Total	\$124,660,000	100.0

The witness testified that PSA's average cost of long-term debt in test year would be 7.72 percent. The net income figures set forth in Table 4 would produce returns on stockholders' equity less than PSA's average cost of long-term debt, and substantially less than the return on stockholders' equity resulting from prior increase proceedings.

Based on the foregoing, the Commission finds:

1. The estimates of operating revenues, expenses, including taxes and depreciation, and rate base set forth in Table 4 of the preceding opinion reasonably represent the results of applicant's operations for the purpose of this proceeding.

2. Estimated net income under present fares, as set forth in Table 4, which result in a rate of return of 7.1 percent and an operating ratio (after taxes) of 89.4 percent are inadequate and insufficient for airline operations in the test year.

3. The rate of return of 8.8 percent and corresponding operating ratio of 87.2 percent resulting from estimates of operations under fares proposed herein, would not provide excessive earnings for PSA's airline operations in the test year. As measured against the rate of return of 9.35 percent and operating ratio (after taxes) of 83.8 percent previously found reasonable for 1969-1970 fiscal-year operations in Decision No. 75899 (supra), the net income resulting from fares proposed herein will produce less than maximum reasonable earnings.

4. The fare increases proposed herein are justified.

The Commission concludes that the application herein should be granted, and that the motions to dismiss should be denied.

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. 52016 as amended. 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 motions to dismiss the application herein are denied.

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

Dated at Los Angeles, California, this 1st day of DECEMBER, 1970.

[Signature]
Chairman

[Signature]
Commissioners

Commissioner William Symons, Jr., being necessarily absent, did not participate in the disposition of this proceeding.

APPENDIX A
PACIFIC SOUTHWEST AIRLINES

<u>Route/ Between Points</u>	<u>Current Fare</u>	<u>Present Fare Including 5% Transp. Tax</u>	<u>Present Fare Including 8% Transp. Tax</u>	<u>Proposed Increase</u>	<u>Proposed Fare</u>	<u>Proposed Fare Plus 8% Tax</u>
San Diego/ Los Angeles Burbank Ontario	\$ 7.38	\$ 7.75	\$7.91	.03	\$ 7.41	\$ 8.00
Los Angeles/ Burbank San Francisco Oakland San Jose	15.00	15.75	16.20	.28	15.28	16.50
Burbank/ Ontario Sacramento via San Francisco	19.05	20.00	20.57	.39	19.44	21.00
San Diego/ Sacramento	22.86	24.00	24.69	.28	23.14	25.00
Ontario/ San Francisco	16.19	17.00	17.49	.47	16.66	18.00
Los Angeles/ Sacramento	16.19	17.00	17.49	.47	16.66	18.00
San Diego/ San Francisco Oakland San Jose	20.95	22.00	22.63	1.73	22.68	24.50
San Francisco/ Sacramento	7.14	7.50	7.71	.27	7.41	8.00