NB

Decision No. 81080

ORIGINAL

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

In the Matter of the Application of AIR CALIFORNIA and PACIFIC SOUTHWEST AIRLINES, for an order authorizing purchase by PACIFIC SOUTHWEST AIRLINES, a passenger air carrier, of control of Air California, a passenger air carrier, and for authorization for the transfer by Air California to Pacific Southwest Airlines of certificate of public convenience and necessity.	Application No. 53442 (Filed July 7, 1972)

Friedman, Heffner, Kahan, and Dysart, by C. Hugh Friedman and Edward J. Pulaski, Attorneys at Law, for Air California, applicant.

McInnis, Fitzgerald, and Wilkey, by John W. McInnis, Attorney at Law, Dietsch, Gates, Morris, and Merrell, by Mark T. Gates, Jr., and Brownell Merrell, Jr., Attorneys at Law, for Pacific Southwest Airlines, applicant.

Richard A. Fitzgerald and Arthur M. Taylor, Attorneys at Law, for Hughes Air West, protestant.

Darling, Hall, Rae, and Gute, by Donald K. Hall and Ernest P. Kaufmann, Attorneys at Law, for Western Airlines; Brundage, Neyhart, Miller, Riech, and Pappy, by Daniel Feins and Julius Reich, Attorneys at Law, for Airline, Aerospace and Allied Employees, Local Union No. 2707, International Brotherhood of Teamsters; Rosenthal and Leff, Inc., by Irwin Leff, Attorney at Law, for Transport Workers Union, Local 505; Bodle, Fogel, Julber, Reinhardt, and Rothschild, by Loren Rothschild, Attorney at Law, for Southwest Flight Crew Association and Southwest Independent Stewardesses Association; Dennis O'Neil, Attorney at Law, for City of Newport Beach; and Robert L. Pleines, Deputy County Counsel, for County of Sacramento, intervenors.

J. Kerwin Rooney, Port Attorney, and John E. Nolan, Assistant Port Attorney, for the Port of Oakland; and Clifford E. Nelson, for himself, interested parties.

Scott Carter, Attorney at Law, William H. Well, and Milton DeBarr, for the Commission staff.

OPINION

By this application Pacific Southwest Airlines (PSA), a California corporation, and Air California (Air Cal), a California corporation, are seeking Commission approval of an agreement which was undertaken on July 6, 1972, and which provides for the acquisition of control of Air Cal by PSA. The joint application was filed on July 7, 1972. After formal execution of the written agreement on July 25, 1972, it was filed with the Commission on July 26, 1972 as an amendment to the application. By further amendment during the hearing PSA's counsel stated that the application is filed under Public Utilities Code Section 2757(a)[1] and that PSA is requesting authority to merge or consolidate the two carriers into one carrier with PSA as the surviving company (Tr. 414, 1170).

In addition to the applicants, various other parties participated in the proceeding. These included two interstate air carriers certificated by the Civil Aeronautics Board (CAB), Hughes Air West (Air West) and Western Airlines (Western); the Port of Oakland, which operates Oakland Metropolitan International Airport (OAK); Sacramento County, which operates Sacramento Metropolitan Airport (SMF); and the Commission staff. The city of Newport Beach

1 Section 2757 provides as follows:

"2757. It is unlawful, unless authorized by order of the Commission as provided in this section:

(a) For two or more passenger air carriers, or for any passenger air carrier and any other common carrier, to consolidate or merge their properties, or any part thereof, into one person for the ownership, management, or operation of the properties theretofore in separate ownerships.

(b) For any passenger air carrier, or any person controlling a passenger air carrier or any other common carrier, to purchase, lease or contract to operate the properties, or any substantial part thereof, of any passenger air carrier.

(c) For any passenger air carrier, or any person controlling a passenger air carrier or any other common carrier, to acquire control of any passenger air carrier in any manner whatsoever. (Former Sec.2757, renumbered 2761. New Sec.2757 added 1967, Ch. 318.)"

took a formal position in opposition to the proposed merger, but did not participate actively in the public hearing.

A prehearing conference was held on August 2, 1972 before Examiner William N. Foley in San Francisco. Ten days of public hearing were held in San Francisco between September 27, 1972 and October 11, 1972. Sixteen witnesses were heard and 62 exhibits were introduced into the record. Concurrent opening briefs were mailed by the parties on November 16, 1972 and closing briefs were mailed on November 30, 1972.

STATUTORY ISSUES

The issues presented in this proceeding are those set forth in Public Utilities Code Section 2758.[2]

1. Is the acquisition of Air Cal by PSA in the public interest?

This issue is a general one; it involves a balancing of the public benefits and detriments resulting from the transaction, keeping in mind that the public interest as set forth in Public Utilities

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2 The relevant portion of Section 2758 provides as follows:

"Any person seeking authorization for a consolidation, merger, purchase, lease, operating contract, or acquisition of control, specified in Section 2757, shall file an application, and thereupon the Commission shall notify all persons known to have a substantial interest in the proceeding of the time and place of a public hearing. The Commission shall by order authorize such consolidation, merger, purchase, lease, operating control, or acquisition of control, upon such terms and conditions as it shall find to be just and reasonable, after hearing, if the consolidation, merger, purchase, lease, operating contract or acquisition of control, is in the public interest. The Commission shall not authorize, however, any consolidation, merger, purchase, lease, operating contract, or acquisition of control which would result in creating a monopoly or monopolies and thereby restrain competition, or jeopardize another passenger air carrier not a party to the consolidation, merger, purchase, lease, operating contract, or acquisition of control ...."

Code Section 2739 is to have an orderly, efficient, economical, and healthy intrastate passenger air network.

2. Will the acquisition result in creating a monopoly and thereby restrain competition, or jeopardize any other passenger air carrier?

3. Should the Commission attach any terms or conditions if it approves the acquisition?

THE MERGER PARTIES

PSA is the major intrastate passenger air carrier in California. It serves San Diego, Los Angeles, Ontario, Hollywood, Burbank, Long Beach, San Jose, San Francisco, Oakland, Fresno, Stockton, and Sacramento. It commenced operations in 1949, during which it carried 15,000 passengers. Its greatest growth dates from 1959 when it introduced Lockheed Electra aircraft on its Los Angeles-San Francisco route at a reduced fare of $12.99. At that time over the same route, Western and United Airlines (UAL) were charging from $18.10 to $30.31 depending upon service and type of aircraft. By mid-1962 PSA was carrying over 50 percent of the passengers in this market. At this point Western and UAL began to compete -- reducing fares and offering service comparable to PSA's. In 1965 PSA instituted operations with pure jet aircraft. It expanded service to various satellite airports after Air Cal commenced operations to Orange County.

As of June 30, 1972 PSA owns 15 Boeing 727-200 jet aircraft, has two more on order, and leases one. It also owns nine Boeing 737-200 jet aircraft, and, since September 1972, has one under lease from Air Cal. This lease is scheduled to terminate in April 1973. In addition, PSA owns one Boeing 727-100 jet aircraft, and leases one.

Currently, PSA is negotiating with the Lockheed Aircraft Corporation for the purchase of one or more Lockheed L-1011 Airbus aircraft. If five of these aircraft are purchased, the total investment will exceed $100 million. At the earliest, the first of these aircraft could not be introduced into service until 1974 or 1975.

PSA's consolidated total assets have grown from $14.8 million in 1962 to over $206 million at the end of 1971. The growth in systemwide passengers and operating revenues is shown by the following figures:

Year	Passengers	Operating Revenue (000)
1960	621,000	$ 8,130
1965	1,863,000	24,015
1966	2,713,000	38,139
1967	3,346,000	48,825
1968	3,998,000	51,139
1969	4,488,000	59,840
1970	5,162,000	72,950
1971	5,623,000	81,981

PSA's financial statements disclose that its consolidated net income increased from $4.9 million in 1970 to $5.43 million during 1971 (Exhibit No. 3). During the first six months of 1972 PSA achieved consolidated net income of $3.4 million. As of June 30, 1972 PSA's stockholders' equity was $80.0 million; its long-term debt was $95.9 million; it had cash of $29.1 million, and working capital of $24.5 million (Exhibits Nos. 20, 37).

In addition to passenger air carrier operations, PSA also conducts leasing, aircraft maintenance, and pilot training operations. Since 1969, it has expanded into non-airline activities, including the hotel business and the broadcasting field. As a consequence, PSA has reorganized its corporate structure by establishing a holding company, PSA Inc., a Delaware corporation, incorporated on March 8, 1972. By Decision No. 80684, dated October 31, 1972 in Application No. 53633, PSA Inc. was granted authority to control PSA so that the airline is now operated as a wholly owned subsidiary.

Air Cal was incorporated in 1966, and it commenced operations between Santa Ana (SNA)and San Francisco International Airport (SFO) in 1967 with two Lockheed Electra aircraft. It presently serves the following cities: San Francisco, Oakland, San Jose, Ontario, San Diego, Palm Springs, Sacramento, and Santa Ana. It has authority to serve but is not now serving, Hollywood-Burbank and Long Beach.

Air Cal has an operating fleet of eight Boeing 737 jet aircraft, all of which are leased. Because it has been plagued with overcapacity due to excess aircraft, it leased one of these aircraft to Aloha Airlines in March 1972, and one to PSA in September 1972. These two subleases are scheduled to terminate in early 1973. Air Cal also leases one Lockheed Electra aircraft which it utilizes in charter operations.

According to its audited balance sheet of December 31, 1971 Air Cal had total assets of $6.62 million at that time. By its balance sheet dated June 30, 1972, prepared without audit, it now has total assets of $6.57 million. The carrier's systemwide passengers and operating revenue for the full four calendar years it has operated are as follows:

Year	Passengers	Operating Revenue (000)
1968	600,758	$ 8,686
1969	835,702	13,449
1970	801,783	16,034
1971	896,130	19,024

During the hearing Air Cal estimated that its 1972 total traffic would exceed one million passengers.

Since commencement of operations in 1967 Air Cal has sustained net losses in the following amounts as of December 31 of each year as shown below:

Year	Net Loss (Rounded Figures)
1967	$1,120,000
1968	1,760,000
1969	2,444,000
1970	376,000
1971	923,000

During the first six months of 1972 Air Cal sustained a net loss of $105,000. Its unaudited balance sheet dated June 30, 1972 shows a negative stockholders' equity of $1.57 million and $571,000 in cash (Exhibit No. 21). It has total debt of $700,000, excluding its 7 percent subordinated convertible debentures, in the amount of $4.85 million due June 1, 1988 (Tr. 310-11).

In 1970 Air Cal passed through a financial crisis. After falling into technical default under the terms of some of its debt obligations in effect at that time, Air Cal and PSA filed a joint application for the approval of the acquisition of Air Cal by PSA (Application No. 57736 dated February 25, 1970). This application was dismissed after 14 days of hearing when PSA terminated its acquisition offer (Decision No. 77341 dated June 9, 1970). By the end of June Air Cal's financial position was critical. It could not fulfill its contract with the Boeing Company for the purchase of three 737 aircraft at a total price of $12,300,000 upon which it had made advance payment of $455,000; it was in default with respect to the net worth requirements of $2,150,000 worth of notes with Allstate Insurance Company and Bankers Life Insurance Company of Nebraska; it could not pay the balance due on its agreement to purchase a Pratt & Whitney engine for $245,000 on which it had made a down payment of $48,000; and it was finding it difficult to keep experienced personnel. On June 27, 1970, Air Cal was acquired by Westgate-California Corporation (Westgate) by means of a stock purchase. The Commission authorized this acquisition over the opposition of PSA and Western, subject to certain conditions, in Re Westgate-California Corp., Decision No. 78399 dated March 2, 1971 in Application No. 52036.

THE MERGER AGREEMENT

The merger plan was agreed to on July 6, 1972. The written agreement was executed on July 25, 1972 by Westgate, owner of 81 percent of Air Cal's stock, by PSA Inc., and by PSA. Under the plan PSA will purchase all the Air Cal shares held by Westgate for $10,887,664, of which $5,445,000 will be in the form of a subordinated note payable in ten years with interest at 7 percent. The balance is to be paid in cash. In addition, Westgate will receive warrants for 100,000 shares of PSA common stock exercisable for 10 years at a price of $26 per share. These shares represent 2.6 percent of PSA's total issued and outstanding shares as of December 31, 1971.

PSA agrees to make a tender offer at a price of $15.75 cash per share to all shareholders of Air Cal's common stock and holders of its convertible debentures who exercise their conversion rights. The tender offer is to be made within 60 days after the closing date and it is to be held open for at least 15 days. The staff estimates the purchase price of all of Air Cal's shares to be $20,646,880, and the excess cost over the net assets acquired by PSA to be $17,369,880. This can be considered as the price paid for goodwill or for Air Cal's certificate authority (Exhibit No. 55, pp. 2-3).

PSA will continue the aircraft leases presently undertaken by Air Cal, including the lease of two Boeing 737 aircraft from West Coast Properties, a wholly owned subsidiary of Westgate. PSA also agrees to continue to perform charter operations for Westgate and the San Diego Padres professional baseball team with the Lockheed Electra aircraft that Air Cal leases from West Coast Properties.

POSITIONS OF THE PARTIES

The position of PSA and Air Cal is that the proposed merger conforms fully with the requirements of Section 2758. They argue that it is in the public interest because:

1. Air Cal's financial condition is weak and its future prospects are poor despite its improved operating results in 1972.
2. Fare reductions will be introduced on Air Cal's routes which will directly benefit the public.
3. Service on four routes will be upgraded by the introduction of new nonstop flights.
4. Operating efficiencies and economies will be achieved which will strengthen PSA and enable it to meet competition from the larger CAB carriers.

Further, applicants contend that there are no serious anti-competitive effects involved in the merger because PSA and Air Cal engage in actual competition in only four small city-pair markets within California, and because PSA will continue to face actual or potential competition in most of its markets from the CAB carriers.

The opponents disagree. They assert that Air Cal's financial position has "turned the corner", and that its prospects for the future are excellent. They doubt that the fare reductions and service improvements will be any more than temporary improvements, soon to disappear through fare increase applications or service reductions in the near future. Finally, they urge that the merger is forbidden because it would create a monopoly and restrain competition in conflict with Section 2758. Although the Commission staff's initial position was one of neutrality, it subsequently adopted the position of the opponents.

AIR CAL'S FINANCIAL CONDITION

There is no dispute that since commencing operations in 1967 Air Cal has incurred net losses which total $6.7 million as of December 31, 1971, and that it has a negative stockholders' equity of $1.57 million. As of the same date, the book value of Air Cal's common stock was a minus $1.84 per share. There is also no doubt that the carrier's financial situation has improved to some degree during 1972. For the first six months of 1972 it sustained a loss of $135,000 before tax credit, or a net loss of $105,000. A profit of about $200,000 - $250,000 is forecast for the full year (Exhibits Nos. 1, 2, and 55; Tr. 231). This is less than the $500,000 profit which had been forecast for the year. Air Cal's executive vice-president and treasurer attributed the profitable results to the rental received from the sublease of two aircraft, and not to operations (Tr. 308).

Aside from its convertible debentures, Air Cal has total debt of $700,000 (Tr. 310-11). This includes cash advances of $260,000 from Westgate. In order to acquire one recent bank loan of $267,000, it was necessary for Air Cal to secure the guarantee of Westgate (Exhibit No.2, pp. 2-3; Tr. 239). This means that Air Cal's financial condition standing alone was not sufficient to satisfy this lender. With respect to its 7 percent subordinated convertible debentures in the amount of $4.85 million, they are subject to annual sinking fund payments commencing in 1977 which approximate $300,000 per year (Exhibit No. 21, Note 4). Air Cal apparently continues to have a $4 million line of credit from the U. S. National Bank in San Diego, an affiliate of Westgate (Tr. 133). Other than this, it does not have any other commitments for credit.

Three witnesses, its president, treasurer, and an investment banker experienced in airline financial matters who reviewed its financial reports, testified that Air Cal's profitable results in 1972 are only temporary. They explained that without a fare increase in 1973 the airline would sustain new losses (Exhibits Nos. 1, 2, 26). The investment banker stated that without a proven record of profitability there was little prospect that Air Cal could raise capital by independent debt or equity financing. It was pointed out that Air Cal received a freight rate increase in 1972 (Decision No. 80628 dated October 17, 1972 in Application No. 53589), and that it presently has a passenger fare increase application on file (Application No. 53308 dated May 3, 1972). A net loss of $300,000 is forecast for 1973, assuming no fare increase and that the carrier operates all eight Boeing aircraft (Exhibit No. 11).

Since Westgate acquired the carrier in 1970, it has taken various steps to support Air Cal; it secured a loan which permitted the carrier to retire three substantial notes totaling over $2 million which were in default; it assumed Air Cal's obligation to purchase three Boeing 737 aircraft, thereby releasing cash deposits on them and then assisted in reducing the purchase by one aircraft; and it purchased additional shares of stock in 1971 valued at $2.5 million to provide funds for the payment of debt and for working capital. Westgate's president testified that it is selling its interest because Air Cal has failed to produce a reasonable return on its $5 million investment, and that although it will not financially support any new route expansion, it will not at the same time act to jeopardize its current investment in the carrier (Tr. 153-57, 199).

The opponents contend that Air Cal has achieved a financial turnaround and is now a viable carrier. However, they did not introduce any studies which support this optimism. They rely entirely on Air Cal's improved results during 1972, which although not insignificant, are also not great considering its total losses.

In the Commission's judgment the opponents' position is not supported by the evidence. This position overlooks several important factors. Among these is that Air Cal's 1972 operations have proved profitable largely because it subleased one aircraft to Aloha Airlines in March and a second to PSA in September. These lease payments amount to at least $700,000 (Exhibit No. 21, p. 3, Note 2). Without these payments Air Cal's small 1972 profit would have been replaced by a net loss.

Other factors are the inherent weakness in the carrier's route system and its high breakeven load factor, which is 60 percent. This is at least 10 percentage points higher than the level for PSA or the CAB trunk carriers (Exhibit No. 38). Air Cal's route structure is unbalanced in that 70 percent of its total traffic is generated to or from Santa Ana (Tr. 40). The Santa Ana-Bay Area routes are profitable ones which in effect subsidize the remaining routes, all of which are unprofitable. In particular its San Diego-Bay Area service has not achieved substantial traffic. Recently Air Cal was granted an extension of time to reinstitute daily San Diego-San Jose nonstop flights which had been discontinued because of very low load factors and because it could not provide sufficient aircraft for the route without disrupting its systemwide schedule (Decision No. 80841 dated December 12, 1972 in Applications Nos. 52165 and 51080). Moreover, in 1973 Air Cal will have at least one excess aircraft as its proposed schedules for the year are based upon the utilization of only seven aircraft (Tr. 527, 631). Assuming that it is unable to continue subleasing this excess aircraft, it projects a net loss of $315,000 in 1973 (Exhibit No. 11). Western correctly points out that this forecast fails to include the remaining payments Air Cal will receive from PSA and Aloha Airlines under its present sublease agreements. However, after including these remaining payments the forecast still reflects a loss of about $80,000. Since Air Cal's monthly lease payment for this excess aircraft is over $40,000, it is clear that it will be a drain on Air Cal's financial resources unless a sublease is arranged or traffic justifies its utilization in Air Cal's scheduled operations.

Even though it may succeed in securing an additional sublease arrangement, or if it carries more traffic than forecast, it seems clear that 1973 prospects are marginal at best. They can fairly be summarized as unclear and uncertain. Its president's statements that the availability of sufficient working capital has always been a serious problem, that with increased costs in 1973 its marginally profitable operation will become unprofitable, and that it lacks the cash resources to sustain the burden required to attempt the development of new markets, are unrefuted (Tr. 48-9). Furthermore, the Commission staff financial examiner, who conducted a review of the carrier's financial position, concluded that it continues to be in an under-capitalized position (Exhibit No. 55, p. 6). More important, upon learning that the 1972 profit was based upon sublease payments, he testified that his conclusion that Air Cal had achieved a "definite turnaround" was not justified (Tr. 882). In such circumstances we conclude that Air Cal's financial position must be considered weak, and dependent to a large degree upon the support of its parent, as is demonstrated by its need for Westgate's advances and guarantee for a recent bank loan.

FARE REDUCTIONS

PSA will introduce lower fares on thirteen of Air Cal's routes, as summarized below:

Market	Air California Present Fare[1]	PSA Proposed Fare[1]	Reduction
SNA/SFO/SJC/OAK	$20.00	$16.67	$3.33
ONT-SJC/OAK	20.00	16.67	3.33
PSP[2]-SFO/SJC/OAK	24.00	22.68	1.32
SMF-SNA/ONT	20.37	19.44	.93
SMF/PSP	26.16	23.15	3.01
SNA/PSP	8.33	7.41	.92
SJC-SMF	7.87	7.41	.46

1 Excluding tax.
2 Palm Springs Airport.

These reductions are estimated to save the public $1.92 million during 1973 under the current fare structure, including taxes, and $2.03 million if the fare increases sought by both carriers are granted in full (Exh. No. 9, pp. 9-11).

The opponents downgrade these reductions with the assertion that they may soon evaporate through future fare increases. Although this may occur in the mid-to-long term future, the fact remains that any fare reductions in these inflationary times is a significant public benefit entitled to substantial weight. Specifically, the reduced fares in the Ontario and Santa Ana markets provide a 16 percent decrease. The Commission also takes note that it has recently denied a rate increase application by PSA (Decision No. 80322 dated August 1, 1972 in Application No. 52970), and that PSA's break-even load factor of 50-52 percent is considerably less than Air Cal's. Despite the fact that PSA will be acquiring some poor routes in terms of traffic production, it should be able to operate them for several years with lower fares than Air Cal. In short, this is clearly the most important benefit provided to the traveling public by the proposed merger.

SERVICE IMPROVEMENTS

PSA proposes to achieve some operating efficiencies and to upgrade service in several markets. First, it will eliminate four daily uneconomic flights now operated by Air Cal between San Diego-Santa Ana and two daily flights now operated by PSA between San Diego-Burbank. These flights are presently provided as "entry mileage" for longer flights to San Jose and Oakland (Exh. No. 27, p. 10). Second, one daily one-stop Santa Ana-Oakland flight will be upgraded to a nonstop flight (Tr. 555). Two daily nonstop flights will be commenced between San Diego-Oakland. San Diego-San Jose will receive four daily nonstops instead of two, but ten one-stop flights will be reduced to four (Exh. No. 32). Santa Ana-San Jose daily flights will be increased from 15 to 17 (Exh. No. 32).

The opponents criticize these schedule improvements on the ground that they could be provided at the present time if they are needed, and that if they prove to be unprofitable, they will be terminated. In particular, Oakland fears that the loss of Air Cal's service will mean fewer flights at its airport, which will result in higher load factors and public inconvenience (Oakland R. Br., p. 4).

On balance, the service improvements are not outstanding, but they may prove helpful to the public. Air Cal currently provides daily Santa Ana-Oakland service in the summer because it does not have the financial ability to offer such flights all year (Tr. 1131). PSA has long held San Diego-Oakland nonstop authority, but provided it only on the weekends. And Air Cal has not achieved good operating results with its San Diego-San Jose nonstop flights. In each of these cases the expanded nonstop service will aid the public's convenience even though there is presently a large amount of seat capacity available in the San Diego-San Jose/Oakland markets (Tr. 579-80).

In order to be assured that these schedule improvements will be provided, the Commission staff recommends that the proposed nonstop flights be established as a minimum daily flight requirement in PSA's certificate. This recommendation is reasonable and will be adopted.

OPERATING ECONOMIES

PSA's vice president for finance presented a study respecting the economies which are expected to be achieved under the merger (Exhs. Nos. 37 and 9). The study is in the form of a forecast of combined operating results for 1973. It is based upon present fare levels and operations during a "normalized" year; i.e., that all the resulting costs and disruptions which will accompany the merger have taken place (Tr. 651). For such a year it shows airline revenues will be increased by $22.8 million, and net income by $816,000. Working capital at the end of 1973 is forecast to be $20.2 million.

PSA would achieve savings through reduced unit costs. The witness estimated that the cost of flight operations would be increased because PSA flight crews receive higher wages than Air Cal's, and that maintenance expenses would be greater for the same reason. On the other hand, savings should be realized in the areas of insurance premiums ($210,000), refueling costs ($360,000), passenger supplies, terminal operations after duplicate facilities are eliminated, reservations, sales, and general expenses resulting from economies of size, and in depreciation and lease expense from achieving higher aircraft fleet utilization levels. These savings are projected to be $1.59 million a year (Exhibit No. 37, Chart 4).

After the merger PSA plans to sell one Boeing 727-100 aircraft and one Boeing 737-200, and to return one leased 727-100 to the lessor. One Boeing 737-200 it leases will be recalled and operated by PSA. The carrier's fleet will then consist of 33 aircraft, 17 Boeing 727-200 and 16 Boeing 737-200 aircraft. No capital improvements are planned as a result of the acquisition.

Firm known costs of integrating Air Cal into PSA are estimated at $538,000. This figure covers retraining for pilots, aircraft reconfiguration, and relocation of equipment and inventories (Exh. No. 37, p. 13, Chart 5). In addition, the cost of employee relocation is forecast to be a maximum of $145,400.

There are several potential costs which could not be estimated, including employee movements caused by the integration of seniority lists, possible termination of Air Cal's reservation system contract, severance pay to Air Cal employees who refuse employment with PSA, cancellation costs for terminal space leases, which require negotiation, and the cost of legal services. Also not calculated is the cost of excess employees because PSA estimates that normal turnover and growth will eliminate the possibility of excess employees prior to the end of the first year of the merger.

The opponents did not challenge these projections other than by cross-examination. Since the estimates are based on a normalized year, they must be considered as somewhat a mid-term projection at best rather than an immediate one. Optimistic assumptions are included, particularly the expectation that the integration of all employees, including different labor organizations, will occur without any disputes or delays. At the time of the hearing, discussions between the different labor organizations had not taken place (Tr. 658). It also appears that legal expenses will be considerably greater than PSA estimates since the U. S. Justice Department has commenced an action in federal court to enjoin the combination of the two carriers.

Nevertheless, it is reasonable to conclude that economies will be achieved under the merger. PSA's witness testified that in general and administrative operations it would be able to handle the increased work load created by the merger with only 20 percent of Air Cal's personnel (Tr. 654). Viewing the situation cautiously, it seems likely that the acquisition will produce additional net income for PSA in the range of $300,000 to $400,000 during 1975, assuming that the merger transaction is consummated by mid-1973.

MONOPOLY AND RESTRAINT OF COMPETITION

A. Introduction

The opponents' primary contention is that the proposed merger conflicts with Section 2758. This section prohibits a merger that would create a monopoly and thereby restrain competition or jeopardize another carrier not involved in the merger. All the parties agree that Section 2758 is patterned on Section 408(b) of the Federal Aviation Act of 1958, 49 U.S.C.A. 1378(b).[3] This language in Section 408(b) has been interpreted to mean that "the creation of a monopoly is not enough unless it would restrain competition or jeopardize a non-party air carrier". (Butler Aviation Co. v CAB (2d Cir. 1968) 389 F 2d 517, 519.) Consequently, there are two requirements which must be found before a proposed merger is prohibited under this provision; namely, that it creates a monopoly and thereby restrains competition, or that it jeopardizes a nonparty carrier.

Furthermore, with respect to transactions under the authority of the CAB, the Butler decision establishes the principle that if there are anti-competitive effects which are not as extreme as this language requires, they must still be considered in determining if the transaction is in the public interest. (Butler Aviation Co. v CAB, supra, 389 F 2d at 519.) In other words, the CAB cannot

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3 The relevant portion of Section 408(b) provides:

"(b) Any person seeking approval of a consolidation, merger, purchase, lease, operating contract, or acquisition of control, specified in subsection (a) of this section, shall present an application to the Board, ...

"Provided, That the Board shall not approve any consolidation, merger, purchase, lease, operating contract, or acquisition of control which would result in creating a monopoly or monopolies and thereby restrain competition or jeopardize another air carrier not a party to the consolidation, merger, ..."

approve a merger if its effects will be so extreme as to violate the statute but it "must approve others if, but only if, it finds the disadvantage of any curtailment of competition to be outweighed by the 'advantages of improved service'...." (389 F 2d at 519; McLean Drucking Co. v United States (1944) 321 US 67, 87. This principle has been amplified in North Nat. Gas Co. v F.P.C. (DC Cir. 1968) 399 F 2d 953, in which the Court of Appeals stated that federal administrative agencies must consider the policies underlying the antitrust laws, make findings related to them, draw conclusions from the findings, and weigh these conclusions against whatever "other important public interest considerations" are present. The agencies may approve a merger which conflicts with antitrust policies to some extent "where other economic, social and political considerations are found to be of overriding importance". (399 F 2d at 960-1, emphasis added.)

Recently, the California Supreme Court has held that when the Commission determines public convenience and necessity, it must consider antitrust questions along with the other factors involved, and make appropriate findings on these questions, as follows:

> "By our decision herein we do not intend to intimate any view on the merits of NCPA's claim that PG&E's steam supply contracts violate the antitrust laws. Nor do we hold that the Commission must deny PG&E's application if it determines that the contracts violate those laws. The Commission may conclude that the public interest as a whole is better served by the construction of units 7 and 8 under the present contracts than under other possible conditions, even if it finds that the contracts do adversely affect the public interest in free trade. We merely hold that the Commission must consider all of these questions and must express its findings and conclusions specifically as to each of the material issues raised." (North. Calif. Power Agency v PUC (1971) 5 Cal 3d at 381.)

Turning to the relevant antitrust laws which should be considered in this proceeding, Section 7 of the Clayton Act, 15 U.S.C.A. 18,[4] forbids any merger which may have the effect of substantially lessening competition, or which tends to create a monopoly. Under this section the critical questions are whether the merging companies deal in the same product line; what is the relevant geographic market; and what is the resultant size of the merged company in relation to the number of competitors that will remain. (Brown Shoe Co. v U.S., 370 U.S. 294 (1962).) The U. S. Supreme Court has emphasized that the purpose of Section 7 is to arrest the tendency to monopoly. (U.S. v Phil. Bank, 374 U.S. 321 (1962).) However, the question under Section 7 is not resolved by merely looking at percentages of market control before and after the merger takes place. In Brown Shoe, supra, the U. S. Supreme Court stated:

> "[W]hile providing no definitive, quantitative or qualitative tests by which enforcement agencies could gauge the effects of a given merger to determine whether it may 'substantially' lessen competition or tend toward monopoly, Congress indicated plainly that a merger had to be functionally viewed, in the context of its particular industry." (370 U.S. at 321-322 (1962).) (Emphasis added, footnote omitted.)

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4 The relevant part of Section 7 provides:

"No corporation engaged in commerce shall acquire, directly or indirectly, the whole or any part of the stock or other share capital and no corporation subject to the jurisdiction of the Federal Trade Commission shall acquire the whole or any part of the assets of another corporation engaged also in commerce, where in any line of commerce in any section of the country, the effect of such acquisition may be substantially to lessen competition, or to tend to create a monopoly. . . ."

B. Discussion

With respect to Section 2758, none of the opponents claims that the merger would jeopardize a non-party air carrier. There are no facts in the record which would support such a conclusion, since neither Western or Air West presented any evidence showing that it would suffer traffic diversion as a result of the transaction. Therefore, the Commission need only consider whether the merger creates a monopoly which would restrain competition. If we conclude that the merger does have these two effects, the application must be denied. If the merger does not have both these effects, then the Commission, under the North. Calif. Power decision, must still weigh whatever anti-competitive effects are involved against the public benefits and determine if the latter outweigh the former.

PSA maintains that a monopoly will not result because it faces actual and potential competition by the larger CAB carriers on most of its routes. These carriers include UAL, Western, Air West, Trans-World Airlines, American Airlines, Continental Airlines, Delta Airlines, and National Airlines. It further argues that Western, UAL, and Air West could easily acquire additional authority between California intrastate points from the CAB (Exh. No. 27, pp. 13-16).

Second, PSA denies that the transaction will cause any unreasonable restraint on competition as proscribed by either Section 2758 or the Clayton Act. It relies upon a city-pair market analysis as the relevant geographic market.[5] Under its view the only direct competition between it and Air Cal which would be eliminated by the merger is in four small markets - San Diego-San Jose; San Diego-Oakland; San Diego-Sacramento; Ontario-Sacramento. In fiscal year 1971 these four markets produced less than 6 percent of each carrier's

5 There is no doubt that the applicants are engaged in the same line of commerce - scheduled intrastate passenger air transportation.

total traffic (Exh. No. 27, pp. 13-14); and Air Cal carried a significant percent of the total traffic in only the first two - 19 percent of total San Diego-San Jose traffic and 12 percent of San Diego-Oakland total traffic. It emphasizes that Western dominates the Ontario-Sacramento market, having carried 75 percent of the total 1971 traffic, and the Palm Springs-San Francisco market, in which Western carried 65 percent of the total traffic. It also asserts that this lack of competition has been designed by the Commission in several past decisions which attempted to limit competition between the two carriers by dividing the intrastate markets between them.

The opponents position is that a monopoly results because there is only one intrastate market. They maintain that the relevant market is not the particular city-pair markets which would be affected by the merger, but intrastate air transportation between the Los Angeles-San Francisco metropolitan areas, including the satellite airports in each area. Under this view, the staff's traffic figures show that for the year ending June 30, 1971 PSA carried 70 percent of the total intrastate origin and destination (O&D) traffic. Air Cal was the second largest carrier with 11 percent of the O&D traffic. After the merger PSA's share would rise to 81 percent, leaving UAL with 9 percent and Western with 7 percent (Exh.No. 29, p. 19). They conclude that PSA's control of 81 percent of this single intrastate market would constitute monopoly power which would restrain competition by destroying any chance for a balanced, competitive intrastate transportation system.

Furthermore, they claim that Air Cal is presently engaged in competition with PSA, not only in four small markets, but between Orange County and Long Beach for traffic to San Francisco even though Air Cal's Santa Ana-San Francisco fare is significantly higher. They dismiss PSA's contention that the CAB carriers are serious competitors by denying that these carriers could easily establish operations at PSA's satellite points, such as Burbank, Santa Ana, and Long Beach, because hearings would be required before the CAB.

The Commission agrees with the applicants that the proposed merger does not violate Section 2758. Specifically, we reject the opponents' contention that the relevant geographic market is one single California intrastate market consisting of the principal and all the satellite airports in the two major metropolitan areas. In our decision authorizing PSA to operate at Ontario, we concluded that there is a separate and distinguishable market area for the Ontario Airport. We have discussed separate airport markets in other decisions as well. (Apps. Pacific Southwest Airlines and Air California to serve Orange County-San Jose/Oakland (1967) 67 CPUC 567, 570-73; App. Pacific Southwest Airlines to serve Ontario, Decision No. 74144 dated May 14, 1968 in Application No. 49512, pp. 21-28, 35-6; see also Apps. Pacific Southwest Airlines, Air California and Pacific Air Transport to serve Long Beach (1969) 70 CPUC 122 and Examiner's Proposed Report, unprinted, at pp. 55-8.) In both the Ontario and Long Beach proceedings, not only the applicant carriers, but also Western maintained that the satellite airports involved had distinguishable service or market areas.

Similarly, in the Pacific Northwest-California Investigation, CAB Order No. 70-5-52 dated May 12, 1972, the CAB recognized that with the great dispersion of population and commerce in the two vast metropolitan areas, separate communities within those areas should be served by a satellite specialist air carrier. Consequently, it authorized Continental Airlines to operate to the Pacific Northwest and to carry local passengers between Santa Ana/Long Beach/Ontario/Burbank and San Jose/Oakland. (Order No. 70-5-52, pp.6-7.)[6]

6 See also Novo Corporation and the Estate of Edward L. Richter, CAB Order No. 71-4-41 dated April 8, 1971, in which the CAB adopted city-pair air freight forwarder markets as the relevant geographic market for considering Section 7 policies.

After the merger PSA will inherit Air Cal's position in the Santa Ana-San Francisco/Oakland/San Jose markets and the Ontario-San Jose/Oakland markets, as well as Air Cal's small shares in the San Diego-San Jose/Oakland and the Palm Springs markets. However, Western will remain the dominate carrier in the Palm Springs-San Francisco and Ontario-Sacramento markets, and in the major corridor market, between Los Angeles and San Francisco, UAL has increased its level of competition by scheduling flights on the hour at the same departure times as PSA's flights.

Assuming arguendo, that after the merger PSA will have monopoly power the question remains, insofar as Section 2758 is concerned, whether this monopoly "thereby restrains competition". Air Cal competes with PSA in only four small markets - San Diego-San Jose/Oakland/Sacramento, and Ontario-Sacramento. The loss of competition in these four markets is negligible and does not constitute a restraint of competition within the meaning of Section 2758 for the following reasons. First, PSA and Air Cal generally do not compete with each other. The share of each carrier's total traffic made up by the traffic each carrier has captured in the four small markets set out above is only 5.2 percent for Air Cal and 5.7 percent for PSA (Exhibit No. 27, p. 13). Air Cal was not able to compete effectively with PSA in the Burbank-San Jose/Oakland markets when it did offer the same fares, and had to abandon this service. Thus, Air Cal does not now and has never provided effective competition to PSA.

Second, even before the Burbank experience it has been Commission policy not to allow direct competition between the two carriers, but rather to attempt to equitably divide the intrastate markets between them. This is demonstrated by our decisions twice denying PSA proposals to serve the Santa Ana-Bay Area markets, as well as denying PSA the Ontario-San Jose/Oakland markets. (App. Pacific Southwest Airlines to serve Santa Ana (1968) 68 CPUC 410; Apps. Air California and Pacific Southwest Airlines to serve Sacramento, Decision No. 79085 dated August 24, 1971 in Applications

Nos. 51007 and 51058, pp. 16-17; App. Pacific Southwest Airlines to serve San Diego-Santa Ana-Bay Area, Decision No. 80318 dated July 25, 1972 in Applications Nos. 52165 and 51080 (Phase I).)[7]

This policy was based on our conclusion in PSA's first Santa Ana application that direct competition should not be permitted by a financially strong carrier against a fledgling carrier, and in its second application on the further conclusion that after the Burbank experience direct competition would undoubtedly result in Air Cal's collapse as a going concern because of its weak financial condition and its heavy dependence upon the traffic at that market. In PSA's second application, it was proposing not only direct competition, but also price competition by means of a lower fare structure than Air Cal's. PSA's proposed fares were the same as its fares charged on its LAX-Bay Area routes, despite the slightly greater distance present on the Santa Ana-Bay Area routes. This would have required Air Cal to reduce its fares in order to compete with PSA, and thereby sustain larger overall operating losses, as well as face substantial diversion of its Santa Ana traffic which provides 70 percent of its systemwide traffic. (See 68 CPUC 411; and Decision No. 79085, pp. 12-13, supra.)

Third, and most important is the presence of actual and potential competition by the larger CAB carriers. For example, Western Air Lines is the dominant carrier in the Ontario-Sacramento market; this proves that CAB certificated carriers hold latent authority to enter Air Cal's markets at will and presumably will do so when such markets are mature enough to support real competition. These CAB carriers, with the possible exception of Air West, have far greater revenues, assets, annual traffic, number of employees, and number of aircraft than PSA or Air Cal (Exhibit No. 27, pp. 3,

7 See also Air California v Pacific Southwest Airlines (1969) 70 CPUC 89, 91-92; and Air California v Pacific Southwest Airlines, Decision No. 78619 dated April 27, 1971 in Case No. 9160.

6, and App. 2).[8] As far as PSA's major routes, San Diego-Los Angeles-San Francisco and Los Angeles-Sacramento are concerned, there is presently actual competition provided by Western and UAL, and by several other CAB carriers to a lesser degree.

In addition, these carriers are serious potential competitors of PSA. For instance, Air West is established at Santa Ana, and Continental has authority to serve between there and San Jose/Oakland; Western is established at Long Beach, Ontario, and Palm Springs; Continental is established at Ontario, and has authority to operate at Long Beach; Air West and Continental are presently serving Burbank; and Western and UAL either are serving or hold authority to serve Oakland and San Jose from Los Angeles (Exh. No. 59, WA-9). Although Western and Air West correctly point out that in some of the above city-pair markets the particular interstate carrier would have to acquire CAB approval for removal of restrictions in order to provide service identical to that provided by PSA, these carriers are fully capable of seeking such approval and providing competition if they are disposed to do so.[9]

It seems clear, therefore, that despite the restraint on intrastate competition which results from the elimination of Air Cal, the actual and potential intrastate competition of the CAB carriers will remain unrestrained. Since on a comparative basis, only a small amount of competition, and none of it effective, will be lessened by the merger, the Commission concludes that the restraint is not unreasonable, and that it does not violate Section 2758.

8 Air West did not introduce any of this data in this proceeding.

9 According to Western's exhibit, Air West would have to acquire CAB authority to operate nonstop between Burbank-San Francisco. It should also be noted that Continental's satellite service is subject to a long-haul restriction requiring that its flights serve the Pacific Northwest.

For the same reasons we doubt that the merger violates the Clayton Act because competition does not appear to be substantially decreased, nor does it seem to create a monopoly because the CAB carriers will still remain in the markets.[10] This does not mean that the merger does not contain some anti-competitive effects. We recognize that it does, as discussed above, and it is even possible that it could be in conflict with the Clayton Act, since the U. S. Justice Department has commenced such an action. (United States v Pacific Southwest Airlines, et al., USDC, CD Cal Civil Action No. 72-2901-DWW.) Even so, the likelihood that the merger does conflict with antitrust policies is only one factor to be weighed in determining the overall public interest. In balancing all the interests involved, we will consider the possible conflict with antitrust policies as one of the anti-competitive effects.

Having concluded that the merger does not have anti-competitive effects which are so extreme as to violate the prohibition in Section 2758, the final issue is whether these effects are outweighed by the benefits of the merger so as to make it consistent with the public interest. If these effects do not outweigh the benefits, then under Section 2758 we are required to approve the transaction.

10 Even if the broader statewide intrastate market is accepted as the relevant market for Clayton Act purposes, as the opponents advocate, we reject the conclusion that PSA must be considered to hold monopoly power simply because its market share would be increased from 70 to 81 percent. As pointed out in Brown Shoe, supra, mergers are to be functionally viewed in the context of their particular industries. In this particular line of commerce the fact remains that PSA faces serious actual and potential competition from the CAB carriers. Moreover, there is even some possibility that another intrastate carrier, Holiday Airlines, will be entering the market because it has an application under submission for permission to carry local passengers between Los Angeles/Burbank and San Jose/Oakland on its flights to Lake Tahoe. Holiday operates two Lockheed Electra aircraft. Its application is opposed by Air Cal, PSA, Western, and Air West. (Application No. 53266 filed April 14, 1972.)

In balancing the factors involved, the fare reduction is entitled to substantial weight. It will benefit the public immediately and significantly. If the transaction takes place without difficulties PSA's unit costs should be reduced through economies of size, which in turn will benefit the public by possibly delaying future fare increases. There will be savings in maintenance, reservations, and in general and administrative expenses. The service improvements will aid public convenience. The transaction will permit full year, daily nonstop service between Santa Ana and Oakland which Air Cal lacks the capital to provide.

Although Air Cal's financial condition is no longer critical, it remains weak. The carrier has excess aircraft and capacity. With the exception of the Santa Ana-Bay Area routes, it is saddled with unprofitable routes and operating costs which are higher than PSA's. In order to achieve sustained profitable results it requires additional capital to undertake expansion into markets not served by PSA. The number of such markets justifying service with large aircraft is very limited, and Westgate is not willing to provide expansion capital. If required to modify its aircraft engines to reduce noise levels, it would clearly have difficulty in covering this expense (Tr. 42).

Despite the fact that the loss of Air Cal in the California markets is a serious matter, it has not been able to compete effectively with PSA. Once completed the merger will provide lower fares, upgraded service, and operating efficiencies, but PSA will continue to be faced with actual and potential intrastate competition from larger CAB carriers. It will still be limited to California markets unless it applies for and receives CAB authority for interstate operations. After weighing the various factors, the Commission's opinion is that the public benefits are substantial enough to outweigh the loss in competition and any possible violation of the Clayton Act.

Finally, we should point out that we are not unmindful of our obligations to regulate air transportation within the State of California "in order that an orderly, efficient, economical, and healthy intrastate passenger network may be established to the benefit of the people of this state, its communities, and the state itself." (Public Utilities Code, Section 2739.) This merger, with the conditions we have imposed, is consistent with our statutory responsibility and duty to see that the benefits resulting from the merger will be realized by the public.

EMPLOYEE PROTECTION

The merger agreement provides that none of the employees of both carriers will be terminated as a result of the transaction for one year following its closing (Exh. No. 22, p. 31). The employees of both carriers will not suffer any reduction in compensation, fringe benefits, or vacation and sick leave accrued prior to the closing date. Provisions are to be made for integration of seniority rights, apparently either by negotiation or collective bargaining. If PSA requests that an employee change his location of employment as a result of the merger, it agrees to pay "reasonable moving expenses". If such an employee refuses to continue employment because his job location has been changed, PSA will pay the employee a "reasonable termination allowance" based upon years of service and salary.

PSA's executive vice-president, who is responsible for labor relations, testified and presented data indicating that normal attrition, projected additional flight hours, and traffic growth will require that PSA add employees by the end of 1973. Only in the sales and administrative departments does he foresee the possibility that normal attrition and expansion might fail to require the services of all Air Cal's employees. He stated that PSA would use its best efforts to secure comparable employment for these excess personnel in the carrier's consolidated operations (Exh. No. 43).

Four labor unions intervened to be heard on the question of employee protection. They are the Southwest Flight Crew Association (SFCA) and the Southwest Independent Stewardesses Association (SISA), which represent the PSA flight crews and flight attendants, respectively; the International Brotherhood of Teamsters, Local Union No. 2707 (Teamsters), which represents the maintenance, station and ramp employees of PSA, and the pilots of Air Cal; and the Transport Workers Union of America, AFL-CIO (TWU), which represents the stewardesses, inspectors, mechanics, ramp service agents, mechanic's helpers, and aircraft cleaners of Air Cal, and the aircraft dispatchers and assistant dispatchers of PSA.

The unions request that the Commission require as a condition in its order approving the merger that PSA enter into negotiations with them to establish specific protective conditions and seniority rights. Neither carrier has been willing to commence such negotiations. PSA maintains that there are jurisdictional issues involving different unions which cannot be resolved by negotiations or collective bargaining at this time. Apparently there will have to be an election under National Labor Relations Board rules to determine which unions will survive as collective bargaining agents with PSA. In this situation it does not appear that ordering negotiations on terms of employee protection would be productive.

The unions also seek greater protective arrangements than provided in the merger agreement if the Commission grants approval. In general, they seek a longer guarantee of employment than one year, particularly for those employees who are required by PSA to move their residences; protection against any loss resulting from the sale of their homes, and detailed separation standards, and guaranteed full seniority rights. TWU has submitted a draft proposal which would create a special class of employees called "protected employees", and provide detailed standards on all these matters, including moving expenses, integration of seniority rosters, wages, training, extra board, and provisions for resolving disputes. The proposed agreement would apparently run in perpetuity. TWU urges that the Commission establish similar terms as a condition of approval.

In past instances the Commission has held that employee protection is a part of the public interest to be considered when a utility abandons operations, particularly with respect to severance pay, or when mergers or consolidations are involved. (Richmond and San Rafael Ferry and Transportation Co. (1953) 52 CPUC 420; Metropolitan Coach Lines (1957) 55 CPUC 500; Glendale City Lines, Inc. (1963) 61 CPUC 772, 774.)

The terms set forth in the merger agreement for employee protection appear to be satisfactory, except that they are vague with respect to moving expenses and termination allowances. The Commission will provide minimum standards for these two items. PSA will be required to pay not only the relocated employee's actual cost of moving his personal property, furniture, etc., to the new job location, but also to provide for such employees a minimum per diem allowance of at least $25 per day for each employee for up to 30 days in the locality to which he is moving for the purpose of finding and acquiring a new residence. We will also require that PSA guarantee each relocated employee one year's employment after the date of actual relocation. We will not require, however, that any relocated employee be compensated for any loss sustained in the sale of his personal residence.

With respect to termination or severance pay, we will require the same standard as was applied in Glendale City Lines, supra. PSA will be required to pay at least one-half month's average salary or wages earned for the twelve-month period prior to termination for each year's service with Air Cal and PSA as severance pay for any employee whose employment is terminated as the result of the merger.

These minimum standards should not prove onerous to PSA since it forecasts that normal attrition and future growth will minimize the termination of employees. For the same reason we reject the elaborate standards and requirements requested by TWU.

PURCHASE PRICE

Western charges that the excess price over net assets acquired, totaling $17.4 million, which PSA has agreed to pay Westgate is sufficient ground for denial of the application (Western Open. Br., p. 22). The applicants respond by asserting that there is nothing improper or illegal in earning a profit on the sale of an airline's stock, particularly when the block of stock sold carries control with it.

The Commission agrees with the applicants on this matter. Western has not shown that any fraud is involved. The purchase price was apparently the result of arms-length bargaining over a period of time from late 1971 through June 1972, and which was negotiated by experienced businessmen. There has not been any opposition by minority shareholders.

Western cites <u>Acquisition of Marquette by TWA</u> (1940) 2 CAB 1. That case is not applicable, however, since it involved a payment of more than fifteen times the value of the tangible property acquired. The purchased carrier lacked modern equipment and frequent schedules. Furthermore, the CAB has approved acquisitions with a purchase price substantially in excess of book value or market value. (<u>Acquisition of Byers Airways by Wien Alaska Airlines</u> (1956) 23 CAB 428, 436.)

The Commission also agrees with the staff, however, that because the amount of excess cost over net assets acquired is material, our order will be conditioned to protect the fare-paying public in future rate cases by providing that only the original cost of the property acquired will be recognized for rate-making purposes.

No other issues require discussion.

Findings of Fact

1. Air Cal's financial position is weak. It has never shown a calendar year profit. It has incurred net losses of $6.7 million as of December 31, 1971 and a further net loss of $105,000 for the first six months of 1972. It had a negative stockholders' equity of $1.57 million at the end of 1971. A small net profit of about $250,000 is forecast for the full year 1972, but this profit is less than previously forecast and is largely derived from the subleases of two jet aircraft.

2. Air Cal had total debt of $700,000 at the time of the hearing. A recent lender required that its loan to Air Cal be guaranteed by Westgate. Air Cal's subordinated convertible debentures are subject to annual sinking fund payments of about $300,000 commencing in 1977. It is under-capitalized and has always had difficulty maintaining adequate working capital.

3. Air Cal has an unbalanced route structure in that 70 percent of its total traffic is derived at Santa Ana. All its other routes are unprofitable. It has a break-even load factor of at least 60 percent. It received a freight rate increase in 1972, and has a passenger fare increase application on file.

4. Under the merger PSA will introduce fare reductions on 13 of Air Cal's routes which are estimated to save the public $1.92 million during 1973 under the current fare structure. In the Ontario and Santa Ana markets, these reductions represent a 16 percent decrease. These reductions in an inflationary period constitute a substantial public benefit.

5. As a result of the merger, PSA will upgrade service by establishing one daily nonstop round-trip flight between Santa Ana-Oakland, two daily nonstop round trips between San Diego-San Jose and between San Diego-Oakland. PSA will also increase its Santa Ana-San Jose daily flights from 15 to 17. In addition, PSA will be able to eliminate some uneconomic flights now provided by it and Air Cal as entry mileage for longer flights. These improvements will add to the public convenience.

6. On a normalized year basis, PSA should achieve savings from reduced unit costs in the amount of $1.58 million in operating the large combined PSA-Air Cal system. Savings will be achieved in insurance premiums, refueling costs, passenger supplies, terminal operations, reservations, sales and general expense, and in depreciation and lease expense. Wage expense for flight crews and maintenance personnel will be increased. PSA estimates that it will derive additional net income of $816,000 during the first normalized year of operations.

Although it is not possible to precisely quantify all these savings, or to estimate exactly PSA's additional net income because there are possible unknown expenses involved, it is reasonable to find that PSA will achieve additional net income in the range of $300,000 to $400,000 during 1975, assuming that the acquisition is consummated by mid-1973.

7. The Commission has recognized in past decisions involving PSA and Air Cal that separate market areas exist for the different airports in the major metropolitan areas of Los Angeles and San Francisco. The CAB has also recognized this situation. The relevant geographic market for considering the question of anti-competitive effects involved in the proposed merger, therefore, is the various city-pair markets in the California corridor.

8. PSA is the strongest intrastate carrier in the California market.

9. There is presently little direct competition between PSA and Air Cal because Air Cal has not been able to compete effectively against PSA, and because the Commission has followed a policy of dividing the various city-pair markets between the two carriers in light of the destructive competition which occurred in the Burbank-San Jose/Oakland markets.

On the other hand, PSA will continue to face actual and potential competition from the larger CAB carriers after the merger. These carriers have greater revenues, assets, and the necessary authority to compete aggressively with PSA if they desire to do so. They have the advantage of carrying long-haul interstate passengers to assist their load factor results in the local California markets.

10. A small amount of direct competition which presently exists between Air Cal and PSA in four small markets in which each airline carries less than 6 percent of its total traffic will be eliminated by the merger. This competition has not been effective, and would not be effective if the merger were denied. A small amount of indirect competition for traffic from the Orange County area to San Francisco will also be eliminated.

While this small amount of intrastate competition will be restrained by the merger, the larger, combined amount of actual and potential competition by the CAB carriers will remain unrestrained. This small degree of restraint on competition is not so great as to be considered unreasonable and does not fall within the prohibition set forth in Section 2758 because the far greater actual and potential competition presented by the CAB carriers will remain unrestrained.

11. PSA will strengthen its position in most of the city-pair intrastate markets; however, there will be no diminution of the competitive position of the CAB carriers. PSA will continue to be limited to California markets. This possible antitrust conflict is only one anti-competitive effect to be weighed against the public benefits involved in the transaction.

12. Because the significant fare reduction is a substantial and immediate public benefit; because PSA's unit costs will undoubtedly be reduced through the economies of size; because service improvements will be instituted which will aid public convenience by providing daily nonstop flights between San Diego-San Jose, San Diego-Oakland, and Santa Ana-Oakland; because it will be possible to eliminate some uneconomic flights over entry mileage segments; and because Air Cal's financial condition is weak, as set forth above in Finding of Fact No. 1, it is reasonable to conclude that the loss in competition, or the anti-competitive effects present in the proposed merger, including the possibility that it conflicts with the Clayton Act, are outweighed by the above-described public benefits. Therefore, the proposed merger is consistent with the public interest.

13. The employee protection provisions agreed to by the parties to the merger are generally satisfactory, except that they are vague on the subject of moving expenses if employment relocation is required, and on termination or severance pay. Since PSA expects employment terminations to be minimized because of normal attrition and future growth, it is reasonable that minimum standards for moving allowances and severance pay be prescribed by the Commission in our order herein.

14. The excess price over net assets acquired which PSA will pay to Westgate is $17.4 million. The purchase price appears to be reasonable considering that it is for the purchase of a controlling block of stock, that the record is devoid of any showing of fraud, that the price was reached by arm's length bargaining, and that there is no opposition by Air Cal's minority shareholders. However, to protect the interests of the fare-paying public we will condition our order to the effect that the excess price of $17.4 million will not be recognized for rate-making purposes.

Conclusions of Law

1. The proposed acquisition of Air Cal by PSA does not violate Section 2758 of the Public Utilities Code.

2. The application should be granted subject to the terms and conditions set forth in the order which follows.

ORDER

IT IS ORDERED that:

1. Pacific Southwest Airlines is authorized to acquire a controlling interest in Air California by purchasing all the common stock held by Westgate-California Corporation in accordance with the terms set forth in the agreement executed on July 26, 1972, subject to the following terms and conditions:

a. Pacific Southwest Airlines shall file within thirty days of the effective date hereof tariffs for the routes formerly operated by Air California which include the fare reductions set forth in Exhibit No. 9, page 9 of 12.

b. Pacific Southwest Airlines shall establish the following service improvements within ninety days after the effective date hereof:

(1) Two daily nonstop round trip flights between San Diego and Oakland.

(2) Two daily nonstop round trip flights between San Diego and San Jose.

(3) One daily nonstop round trip flight between Santa Ana and Oakland.

c. Pacific Southwest Airlines shall within thirty days of the effective date hereof accept in writing the condition that the excess cost over net assets acquired, in the amount computed by the Commission staff, $17,369,880 (Exh. No. 55, p. 2), shall not be recognized by the Commission for rate-making purposes in the future.

d. Pacific Southwest Airlines, Inc., Pacific Southwest Airlines, Air California, and Westgate-California Corporation shall accept in writing within thirty days after the effective date hereof the following employee protection provisions:

(1) Moving expenses to be paid by Pacific Southwest Airlines for any employee of Air California whose employment is relocated shall include not only the actual costs of moving said employee's personal property, etc., but also a per diem allowance of at least $25 per day for up to 30 days in the locality to which the employee is moving for the purpose of finding and acquiring a new residence. Each relocated employee shall also be guaranteed one year's employment at the new location after the date of actual relocation.

(2) Any person terminated as a result of this merger shall receive termination pay which shall include as a minimum at least one half month's average salary or wages earned for the twelve-month period prior to termination for each year's service with Air Cal and PSA.

2. This authorization shall expire one hundred and eighty days after the effective date of this order, unless extended by further order of the Commission.

3. A revised certificate of public convenience and necessity is granted to Pacific Southwest Airlines as set forth in Appendix A attached hereto.

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

Dated at San Francisco, California, this 23rd day of FEBRUARY, 1973.

Vernon L. Sturgeon
President
William Symons Jr.
Thomas Moran
Commissioners

I will file a concurring opinion
Thomas Moran Commissioner

I dissent:
J. P. Vukasin Jr., Commissioner

I dissent:
D. W. Holmes,
Commissioner

JM

The authority stated herein to Pacific Southwest Airlines supersedes all previous certificates of public convenience and necessity granted to Pacific Southwest Airlines and granted to Air California.

Pacific Southwest Airlines is authorized to operate as a passenger air carrier over the routes and between the points listed below:

Symbol	Airport
BUR	Hollywood/Burbank
FAT	Fresno Air Terminal
LAX	Los Angeles International
LGB	Long Beach
OAK	Oakland International
ONT	Ontario International
PSP	Palm Springs Municipal
SAN	San Diego International
SCK	Stockton Metropolitan
SFO	San Francisco International
SJC	San Jose Municipal
SMF	Sacramento Metropolitan
SNA	Orange County

ROUTE 1. LOS ANGELES - SAN FRANCISCO

Between BUR/LAX/LGB/ONT/SNA and OAK/SFO/SJC.

NOTE: Authority to operate between LGB and OAK/SJC is set aside and will be subject to further order of the Commission (Decision No. 78848).

ROUTE 2. LOS ANGELES - SAN DIEGO

Between BUR/LAX/LGB/ONT/SNA and SAN

ROUTE 3. LOS ANGELES - SACRAMENTO

Between BUR/LAX/SNA and SMF.

ROUTE 4. LOS ANGELES - FRESNO/STOCKTON - SAN FRANCISCO

Between LAX and FAT/SCK and SFO.

ROUTE 5. SAN FRANCSICO - SAN DIEGO

Between OAK/SFO/SJC and SAN.

ROUTE 6. SAN FRANCISCO - SACRAMENTO

Between OAK/SFO/SJC and SMF.

ROUTE 7. SAN FRANCISCO - PALM SPRINGS

Between OAK/SFO/SJC and ONT/SNA and PSP.

ROUTE 8. SAN DIEGO - SACRAMENTO

Between SAN and SMF.

JM

CONDITIONS

1. Authority granted herein is limited to passenger air carrier operations over the specific routes described above and between airport pairs listed.

2. On each route each airport shall be served with a minimum of one flight in each direction on each of seven days a week.

3. Operations between an airport on one route and an airport on any other route shall not be provided except through a terminal point common to the routes.

4. BUR/LAX/LGB/ONT/SNA points may be either terminal or intermediate points for ROUTES 1, 2, and 3. No passenger shall be transported solely between these points, except a passenger may be transported between ONT and SNA.

5. OAK/SFO/SJC points may be either terminal or intermediate points for ROUTES 1, 5, 6, and 7. No passenger shall be transported solely between these points.

6. Either or both FAT/SCK shall be an intermediate point for ROUTE 4.

7. Either ONT or SNA may be an intermediate point for ROUTE 7, but service between PSP-OAK/SFO/SJC via ONT and SNA on the same flight is not authorized.

JM

CONDITIONS - (Continued)

8. The minimum number of scheduled daily round trips to be provided between the specific airports described below are:

BUR - OAK/SJC	4 round trips
BUR - SMF	2 " "
LAX - FAT - SFO	2 " "
LAX - FAT - SCK - SFO	2 " "
OAK - SAN	2 " "
OAK/SJC - ONT	2 " "
OAK/SFO/SJC - PSP	1 " "
OAK/SJC - SNA - SAN	2 " "
OAK - SNA	3 " "
ONT - SAN	2 " "
ONT - SFO	4 " "
SAN - SJC	2 " "
SFO - SMF	4 " "
SFO - SNA	5 " "
SJC - SNA	3 " "

Airports joined by "/" shall be either a terminal or an intermediate point; "-" indicates nonstop portion of the required trip.

NOTE: BUR - SMF minimum has been reduced to one round trip until August 1, 1973 (Decision No. 80353).

9. No local passengers shall be carried between PSP - ONT.

COMMISSIONER J. P. VUKASIN, JR., DISSENTING.

I dissent.

The majority opinion grants authority to Pacific Southwest Airlines (PSA), the largest intrastate air carrier, to acquire Air California (Air Cal), the second largest carrier, with the result that the surviving corporation will control 81 percent of the intrastate air transportation. The opinion is in error. It ignores relevant facts and misinterprets the applicable law.

The issues are simple:

1. Is the acquisition of Air Cal by PSA in the public interest?
2. Will the acquisition result in creating a monopoly and thereby restrain competition?

The law is clear. Section 2758 of the Public Utilities Code[1/] provides that the Commission shall authorize acquisition of control of an airline if such acquisition "is in the public interest." It further provides that "The commission shall not authorize . . . any . . . acquisition of control which would result in creating a monopoly . . . and thereby restrain competition . . . ."

In other words, the Commission can authorize an acquisition only if it is in the public interest, and if such public interest is not established by a preponderance of the evidence, the acquisition must be denied. If the acquisition would create a monopoly and thereby restrain competition, it must be denied. This application fails on both counts.

1/ All statutory references are to the Public Utilities Code unless otherwise stated.

At the threshold we should note that although these two issues arise from the same Code section, they are different in nature and require different treatment by the Commission. The "public interest" issue involves a balancing of the benefits and detriments to the public and thus a discretionary judgment by the Commission.

The "monopoly" issue requires this regulatory agency to apply the facts of this case against the anti-monopoly State and Federal statutes and arrive at a legal decision. Because the error of the majority is more obvious on the monopoly issue, I will direct my attention to this subject first.

THE APPLICATION SHOULD BE DENIED BECAUSE
THE ACQUISITION WOULD CREATE A MONOPOLY
WHICH WOULD RESTRAIN COMPETITION

This case is one of first impression for the Commission. It is the first case calling for interpretation and application of the Passenger Air Carriers Act, Public Utilities Code Sections 2739 et seq., in the context of a merger of major air carriers subject to that Act.

The decision in this case is governed by the terms of Section 2758 of the Public Utilities Code which, insofar as pertinent here, reads:

> "The commission shall . . . authorize such . . . acquisition of control . . . if the acquisition . . . is in the public interest. The commission shall not authorize, however, any . . . acquisition . . . which would result in creating a monopoly . . . and thereby restrain competition, ..."2/

2/ The quoted language in Sec. 2758 was adopted from Sec. 408(b) of the Federal Aviation Act of 1958, 49 U.S.C. §1378(b).

It is apparent from the quoted language that the anti-monopoly provision does not leave the Commission any discretion where it applies. It is a mandatory prohibition.

At this juncture it is appropriate to point out a fatal error in the majority opinion. That opinion contains the seeds of its own destruction. While paying lip service to the provisions of Section 2758, the majority cavalierly ignore the clear, plain meaning of its terms. We have already noted the mandatory language which states that the Commission shall not authorize any acquisition which would result in creating a monopoly ". . . and thereby restrain competition. . . ." Note there is no reference to the degree to which competition may be restrained. It does not refer to "substantial" restraint, "unreasonable" restraint, "extreme" restraint, or other measures of restraint. Any resulting restraint on competition is fatal to an acquisition or merger. Yet the majority acknowledge existence of such restraint while in the process of granting their blessing, saying ". . . despite the restraint on intrastate competition which results from the elimination of Air Cal, ..." ". . . the Commission concludes that the restraint is not unreasonable, ..." (Mimeo. Opinion p. 25.) ". . . competition does not appear to be substantially decreased, ..." "We recognize that it does . . ." (contain some anti-competitive effects), and "Having concluded that the merger does not have anti-competitive effects which are so extreme as to violate the prohibition in Section 2758, ..." (Mimeo. Opinion p. 26.) (Emphasis added.) Thus we see the majority opinion citing Section 2758 and then disregarding its plain, clear meaning. I find no reason to tinker with the Code mandate. It is not surprising that no authority is cited by the majority for their startling distortion of legislative intent.

In order for the prohibition in Section 2758 to apply, two effects must result from approval of a proposed merger:

(1) A monopoly would be created; and
(2) Competition would thereby be restrained.

The first element of this prohibition will be analyzed now.

Neither Section 2758 nor any other section of the Air Carriers Act or Public Utilities Code defines the term "monopoly." There is, however, no dearth of California authority on the subject in general. Indeed, the California decisions hold that cases decided under the Federal Sherman Act, Clayton Act, and the common law policy against restraint of trade are applicable to problems arising under California statutes. Chicago Title Ins. Co. v. Great Western Financial Corp., 69 Cal.2d 305 (1968); Wilton v. Hudson Sales Corp., 152 C.A. 2d 418 (1957); Widdows v. Koch, 263 C.A. 2d 228 (1968); Swenson v. Braun, 272 C.A. 2d 366 (1969). See also Northern California Power Agency v. Public Util. Comm., 5 Cal.3d 370 (1971), where the California Supreme Court, at page 377, cites a number of Federal antitrust cases as being persuasive authority in California.

Under California law a monopoly is said to exist where all or nearly all of a commodity or article of trade or commerce within an area is brought within the control of an agency or set of agencies as practically to exclude competition or free traffic therein. Herriman v. Menzies, 115 C. 16 (1896); Grogan v. Chaffee, 156 C. 611 (1909). In Pacific Factor Co. v. Adler, 90 C. 110 (1891), the court rejected a situation where a retailer controlled as much as 75 percent of a product in the state. See United States Steel Corp. v. Federal Trade Commission, 426 F.2d 592 (1970), where the court approved an order of divestiture where the market share was less than 75 percent, and for a general discussion of the evils of monopoly. I have been unable to find any authority which approved an acquisition or merger where the surviving entity controlled 81 percent of the market, as is the case here.

In any case in which the question of monopoly is raised, the basic starting point is: What market are you talking about? -- or, in the parlance of antitrust law, What is the "relevant market?"[3/] It is obvious that a "monopoly" may or may not result, depending upon how broadly or how narrowly the market is defined. In the instant case, the parties have argued that there are two possible alternative definitions of relevant market.

(1) Each individual city-pair route served by the two airlines; or

(2) The so-called "California air corridor," which is defined generally as the intrastate air transportation system between the Los Angeles and San Francisco areas, including the satellite airports in each area.

Applicants advocate the city-pair approach, while opponents argue that the air corridor is the true relevant market. It really makes no difference which is selected because PSA ends up in a monopoly position in both.

3/ In this case, the term refers only to geographic market, since there is no question that the same "product line" is involved as between the merger partners.

In discussing the city-pair markets, it is acknowledged by everyone that PSA and Air Cal do compete directly in four small city-pair markets.4/ The merger, therefore, would result in creating a monopoly in each of these city-pair markets. Moreover, in all but two5/ of the other major city-pair markets within the California air corridor, either PSA or Air Cal is at the present time essentially in a monopoly position.6/ This fact means, of course, that if you look only at the individual city-pair routes as individual "relevant markets," PSA would wind up with a virtual monopoly in all but two comparatively minor routes, as a result of the merger. Thus, even if the Commission adopts the narrow approach which sees the relevant market as merely the individual certificated routes, it does not avoid the monopoly question.

However, I do not accept this unduly restrictive view of the relevant market for antitrust purposes.

The majority ignore the fact that the quality of service at individual satellite airports, such as we have in California, has a substantial competitive impact at both the primary and other secondary

4/ San Diego-San Jose, San Diego-Oakland, San Diego-Sacramento, and Ontario-Sacramento.

5/ The Palm Springs-San Francisco and Ontario-Sacramento routes are apparently dominated at present by Western Airlines.

6/ Even on the most important LAX to San Francisco route, PSA's share of the traffic is well in excess of all the other carriers combined and may be as much as 70 percent, according to evidence of record.

airports in their general area. The opinion summarily dismisses the contention that the relevant geographic market is one single California intrastate market consisting of both the main and all the satellite airports in the two major metropolitan areas, thereby ignoring the vast bulk of the intrastate passenger air network which the Commission is charged to protect and promote. (Section 2739.) The majority not only have lost sight of the responsibilities of this regulatory agency, but they have even ignored the broader and sounder view of the competitive situation set forth in recent opinions of this same Commission. For example, in Decision No. 70657 (65 P.U.C. 497, (1966)) the Commission certificates PSA to serve the San Jose-LAX route based on a finding that "there is sufficient passenger air traffic available [for the route] . . . to allow both Pacific Air Lines, Inc. and Pacific Southwest Airlines to operate said route economically, provided equipment and rates comparable to those available at San Francisco International Airport and Oakland International Airport are offered." (65 P.U.C. at 498 (1966).) (Emphasis added.) Even as between Orange County Airport and LAX, the Commission has recognized the broader impact and interdependence of the routes; in Decision No. 73172 (67 P.U.C. 567 (1967)), in authorizing Air Cal to serve San Jose and Oakland from Orange County, it stated that "we can safely conclude that some passengers now utilizing the existing service to or from Los Angeles or San Francisco would avail themselves of the proposed service, if offered." (67 P.U.C. at 570 (1967).) In certificating both PSA and Air Cal to serve Hollywood-Burbank to San Jose and Oakland, the Commission found that "it is expected that operations between these corridors will contribute greatly towards reducing congestion at the

Los Angeles and San Francisco Airports." (Decision No. 74248, 68 P.U.C. 382 (1968).) Finally, even as recently as last summer, in allowing Air Cal to operate between San Diego and Orange County over PSA's protests, the Commission specifically termed PSA's authority to operate between Long Beach and San Francisco as "indirect competition" for Air Cal on its Orange County to San Francisco route. (Decision No. 80318, issued July 25, 1972 (Mimeo. Opinion p. 26.)).)

The relevant market for measuring PSA's control of intra-California passenger air transportation before and after the proposed merger is the Los Angeles Metroplitan Area - San Francisco Bay Area Market, including in the case of the Los Angeles area the satellite airports, Hollywood-Burbank, Long Beach Municipal, Ontario International and Orange County, and in the case of the San Francisco area the satellite airports, Oakland International and San Jose Municipal. This is the heaviest traveled air corridor in the world.

Based on traffic for the calendar year 1971, PSA controls 68.3 percent of this market and if the merger is consummated, PSA will control 82.6 percent of this market, or a 20 percent relative increase in PSA's market share. Air California's market share (14.3 percent) alone exceeds the market share of any other carrier (other than PSA) serving this market. (Ex. 59: WA-3.) 7/

7/ Adding San Diego and Sacramento the market would only highlight PSA's predominance before and after the merger. Based on traffic for the calendar year 1971, the comparable market shares in such expanded market are:

PSA	71.8%
Air California	10.9%
Combined	82.7%

Again, Air California's market share exceeds the market share of any other carrier (other than PSA) serving the market. (Ex. 59: WA-4.)

By any standard 82.6 percent of a market is a monopoly. Under the Clayton Act such concentration of market control would be per se invalid. See e.g., United States v. Philadelphia Nat'l Bank, 374 U.S. 321 (1963). Under any standard, to allow one carrier to obtain control of passenger air transportation within California so far in excess of that possessed by competitors would as a practical matter destroy any possibility of having a properly balanced, competitive intrastate passenger air transportation system.

It should be pointed out that even if the anti-competitive effects of this merger did not fall within the prohibitory guidelines of Section 2758, the Commission would still be obligated to deny the application because the acquisition will violate Federal antitrust laws. The correct reasoning here is as follows.

Section 2758 is patterned after Section 408(b) of the Federal Aviation Act of 1958, 49 U.S.C. §1378(b).[8/] However, the tests established in Section 408(b) are not the only anti-competitive considerations which the Federal regulatory agencies must consider. In Butler Aviation Co. v. CAB, 389 F.2nd 517, 519 (2d Cir. 1968), the Second Circuit established the principle that where anti-competitive effects are not as extreme as the Section 408(b) language requires, they still must be considered in deciding whether or not the transaction is in the public interest. In other words, the Civil Aeronautics Board (CAB) cannot approve a transaction which violates

8/ The relevant portion of Section 408(b) provides: "(b) Any person seeking approval of a consolidation, merger, purchase, . . . or acquisition of control, . . . shall present an application to the Board, ...
"Provided, That the Board shall not approve any consolidation, merger, purchase, . . . or acquisition of control which would result in creating a monopoly . . . and thereby restrain competition . . . ."

Section 408(b). However, if the transaction is not so extreme as to violate Section 408(b), the CAB still must consider the anti-competitive effects in determining public interest. And it can approve the transaction ". . . if, but <u>only</u> if, it finds the disadvantage of any curtailment of competition to be outweighed by the 'advantages of improved service' . . . ." <u>Butler Aviation Co.</u> v. <u>CAB</u>, <u>supra</u>, 389 F.2d (1968) at 519; <u>McLean Trucking Co.</u> v. <u>U.S.</u>, 321 U.S. 67, 87 (1944). (Emphasis added.)

The merger proposal violates two basic provisions of the antitrust laws because its effect "may be substantially to lessen [both existing and potential] competition, or to tend to create a monopoly" (prohibited by Section 7 of the Clayton Act, 15 U.S.C. §18) and because it represents an "attempt to monopolize" (prohibited by Section 2 of the Sherman Act, 15 U.S.C. §2).

This merger is a bold effort by PSA to capture greater monopolistic control over intra-California passenger air transportation. PSA would dominate and control every major air transportation market within California, if the merger were approved. (See Ex. 59: WA-2, WA-3 and WA-4.) As stated in <u>Santa Fe Transportation Company</u>, 41 C.R.C. 239, 281 (1938), "In the case of transportation . . . public interest is preponderant in favor of regulated competition," not "regulated monopoly."

This conclusion brings us to the second part of the prohibition in Section 2758, namely, whether the creaton of the monopoly would give rise to a restraint on competition. At first glance, it would appear that the two concepts would be synonymous -- <u>i.e.</u>, allowing the monopoly automatically restrains competition -- however, that does not necessarily follow. For example, if it could be shown that Air California was clearly a company headed for bankruptcy and business failure, it might be argued successfully that approval of a merger would not create any anti-competitive effect, because no viable competitor would be eliminated thereby. This principle is the "failing company" doctrine, which is well-established in antitrust law. See Citizens Publishing Co. v. United States, 394 U.S. 131 (1969). In such a case, the argument that the prohibition in Section 2758 does not apply would be much stronger.

The difficulty in the instant case, of course, is that Air Cal cannot be said to be a "failing company" for purposes of the antitrust laws.

Attempts to portray Air Cal as beset with economic problems which cannot be overcome and as to which the only realistic solution is the proposed merger are contrary to the record. All forecasts at the time of the hearing indicated that 1972 would be Air Cal's first profitable year. (Ex. 1, p. 1; Ex. 2, pp. 2-3; Ex. 55, p. 6.) The Commission's own Transportation Division forecasts that Air Cal's operations in 1973 at present fares would result in net earnings of $1,279,000. (Ex. 29, p. 10.)

Air Cal's financial prospects are far from bleak. They augur that given full operation under normal conditions Air Cal will prove to be an economically sound component of the intra-California air transportation system, one which should be continued in the public interest.

If Air Cal's future potential is so dire, and its financial condition so bleak, it is anomalous that:

1. PSA is willing to pay a price ($20,000,000) in 1972 which is more than three times the price it offered in 1970 for Air Cal. (Tr. 407-408; Ex. 10 p. 4.)

2. Westgate stands to profit handsomely from the proposed merger, more than doubling its investment in less than three years. (Tr. 192-194; Ex. 25; Ex. 37 p. 17.)

3. The price offered by PSA for Air Cal in this proceeding is more than 6-1/2 times the per share book value of Air Cal after adjustment to account for conversion of all its debentures and more than 2-1/4 times the market value of Air Cal's shares prior to announcement of the proposed merger. (Ex. 37 p. 17.)

Most important, however, is the fact that without exception the witnesses in this proceeding stated that Air Cal is presently in its best financial position since its inception. It would certainly be a pity to waste even this degree of financial success, not to mention the operational expertise, derived from the several years of development of Air Cal, particularly in light of the rather apparent difficulty or, more likely, impossibility of development of another major intrastate carrier in California in the foreseeable future.

The "failing company" defense requires a showing that (a) the company to be acquired faces the grave possibility of imminent business failure, (b) there are no other prospective purchasers, and (c) there would be little or no chance that the company to be acquired could successfully emerge from reorganization as a competitive unit. See Citizens Public Company v. United States, supra; Brown Shoe Company v. United States, 370 U.S. 294 (1961); United States Steel Corp. v. Federal Trade Comm., supra. Applicants have failed to establish the grounds for the application of these principles on all three counts. The evidence is clear that Air Cal's future has never looked brighter. There has been no showing of imminent business failure. There has been no showing that other purchasers cannot be found. In fact, Mr. Philip A. Toft, an officer and member of the Board of Directors of Air Cal, testified that no attempt had been made to find any other purchaser (Tr. p. 154). Finally, no evidence whatever appears in the record concerning Air Cal's prospects as to successful emergence from a possible reorganization.

The decision finds that Air Cal's financial position must be considered "weak" (Mimeo. Opinion p. 27) and that its ". . . 1973 prospects are marginal at best. They can be fairly summarized as unclear and uncertain." (Mimeo. Opinion p. 12.) But this finding is simply not enough from an anti-trust standpoint to support a conclusion that the elimination of Air Cal would not be anti-competitive. As the U.S. Supreme Court recently stated in the Citizens Publishing case, supra, the prospects of the acquired company emerging from reorganization as a competitive unit must be "dim or non-existent." (394 U.S. at 138.) (Emphasis added.)

In summary, it should be noted that the Commission is here faced with a far more restrictive requirement than the simple "public interest" hurdle discussed by the California Supreme Court in Northern California Power Agency v. Public Util. Comm., 5 Cal.3rd 370 at 381 (1971). The Commission must be able to find that authorization of the proposed acquisition, even if it be in the public interest, will not create a monopoly which will restrain competition. It is submitted that such a finding is not possible on the record presented. The policy enunciated by Section 2758 is one of competition, and the law requires an interpretation of that statute which will promote rather than defeat such policy. Department of Motor Vehicles v. Industrial Accident Commission, 14 Cal.2d 189 (1939); People v. Centr-O-Mart, 34 Cal.2d 702 (1950); In Re Lynwood Herald American, 152 C.A. 2d 901 (1957).

The majority accept another of applicants' contentions, namely, that ". . . this acquisition would not restrain competition due to the presence of actual and potential competition by the larger CAB carriers." Absurd! As stated in the Western Air Lines opening brief, "This is sophistry."

This argument appears so baseless in view of PSA's substantial control of its markets, it is only with some reluctance that a portion of this dissenting opinion is devoted to it. It is somewhat surprising that the majority have not either rejected or at least ignored this argument, as the proposition is so far removed from reality it raises a question as to the credulity of their other arguments. Even the applicants should readily admit that the argument has no present basis in fact and it appears to be based primarily on some speculative possibility of future action by PSA's rather distant competitors.

PSA's ability to achieve its present predominance in the market belies its own contention. PSA's operating results show it to be a strong carrier in relation to the CAB carriers. Based on available 1970 and 1971 financial statistics, PSA's operating margin ranks ahead of all CAB carriers (Ex. 59: WA-5) and in terms of earnings it ranks between third and seventh compared with all CAB carriers (Id.: WA-6). Based on 1971 traffic statistics, PSA carries more passengers than nine CAB carriers (Id.: WA-7). On a nationwide basis the merger would create the eighth largest carrier in terms of earnings during 1971 and ninth in terms of systemwide passengers (Ex. 59: WA-6, 7).

The possibility of increased intra-California competition by CAB carriers poses no real threat to PSA or Air Cal. (See discussion in Ex. 59: WA-9.) The greater capital and expense commitments of the CAB carriers, their drastically higher cost levels, their obligation to adequately serve all communities on their systems, the low per mile fare level of intra-California commuter operations and the CAB carriers' heavy losses in their California operations demonstrate that PSA's alleged fear of intensified competition by the CAB carriers is a pretense. (Tr.1052-4; see Ex. 59: WA-8.)

PSA has the cost and equipment advantages of a system designed for short haul, high volume turnaround service. Economically the CAB carriers cannot match PSA's service. Not only are the fares per mile too low but also without new equipment the CAB carriers could not do so and maintain required interstate schedules. Moreover, their interstate flights cannot be timed to meet intrastate-market requirements.

Despite sporadic attempts by certificated carriers to penetrate the California corridor markets, PSA has retained its overwhelming dominance. Witness Mitchell described the unsuccessful attempts of both United and Western to gain a larger market share in the SFO-LAX market in 1963-1964 (Ex. 27, p. 7, Tr. 427). The record shows, however, that PSA continued to dominate its markets despite these special efforts by the trunkline carriers (Tr. 426ff).

It is also important to note that United outscheduled PSA in the SFO-LAX market in 1970 in the ratio of 42:30 without lessening PSA's dominance (Ex. 58, RW-2, p. 2). Continental has instituted service between Ontario/

Burbank and San Jose. In neither market has Continental achieved greater than a 12 percent market share after more than two years of service (Ex. 58, RW-2, p. 3). If we look at the way PSA and Air Cal have been affected by the recent CAB competition, the facts are clear.

On the other side of the coin, PSA began service in Stockton and Fresno against the competition of both United and Hughes Airwest in July, 1972. While operating only 20 days during July, 1972, PSA carried 44.8 percent of the total traffic for the whole month. In September PSA carried 61.8 percent of all traffic, both local and interstate connecting, and 82 percent of the local traffic in the markets it serves to and from Stockton. In its Fresno markets it captured almost 30 percent of the local traffic in its third month of service.

If we compare PSA's performance in Stockton and Fresno to Continental's performance between Ontario/Burbank-San Jose, it is obvious that PSA is relatively invulnerable to new competition from CAB carriers.

Likewise, Air Cal has not been affected by Continental's new service (Ex. 58, RW-2, p. 3). The allegation that competition at Orange County is "virtually certain" (Ex. 27, p. 18) has already been rejected by the Commission (Decision No. 80318, p. 12 (1972)). In summary, the record shows that past competition by CAB carriers has not adversely affected either PSA or Air Cal. Future competition is speculative at best, and there is clearly no threat to Air Cal's Orange County operation. The plain fact is that PSA has been able to compete most effectively in every market it has entered and has been able to beat off the best competitive shots of the very carriers which it now points to as the possible source of increased competition in the future.

The competition which should in fact be encouraged and nurtured is the competition which Air Cal with 11 percent of the market provides to PSA with 70 percent of the market. The majority opinion correctly states ". . . it has been Commission policy not to allow direct competition between the two carriers, but rather to attempt to equitably divide the intrastate markets between them." (Mimeo. Opinion p. 23.) That is an accurate statement of Commission policy, a policy specifically and intentionally used to protect the fledgling Air Cal in its formative years, as previously indicated, a policy followed by this Commission for more than 30 years, ever since it said "In the case of transportation . . . public interest is preponderant in favor of regulated competition", not "regulated monopoly". Santa Fe Transportation Company, 41 C.R.C. 239 (1938), a policy designed to furnish the citizens of this State the benefits which hue from the atmosphere of competition.

And now in one fell swoop, it casts aside long-standing, sound policy and ignores and distorts the law in its headlong rush to give the carrier which already has 70 percent of the intrastate passenger transportation control over the only other carrier with more than 10 percent of the intrastate business.

The conclusion is clear. This acquisition will result in a monopoly which will restrain competition. The acquiring entity will control 11 of 13 of the major city-pair markets. It will control 81 percent of the intrastate passenger transportation. It has effectively shown that it needs no help in competing with CAB carriers. Just now when Air Cal appears to have turned the financial corner, it is a travesty to bless its demise.

Having disposed of the monopoly issue, it should not be necessary to comment on the public interest issue. Nevertheless, in order not to be deemed acquiescent in the majority views on the merits of this issue, I continue on to discuss it.

THE APPLICATION SHOULD BE DENIED BECAUSE
IT IS NOT IN THE PUBLIC INTEREST

This issue involves a balancing of the benefits and detriments to the public resulting from the proposed transaction. Section 2739 defines the public interest as an orderly, efficient, economical, and healthy intrastate passenger air network.

In this proceeding applicants contended that the acquisition is in the public interest because:

(1) Air Cal's financial condition is weak and its future prospects are poor.

(2) Operating efficiencies and economies will be achieved which will strengthen PSA.

(3) Service will be upgraded.

(4) Fare reductions will be introduced on some of Air Cal's routes.

Let us quickly examine these contentions.

In connection with their first claim, the following observations are appropriate, in addition to the arguments set forth above regarding Air Cal's financial position. An important consideration is the growth in traffic and income of Air Cal. Air Cal has expanded and diversified into new markets with excellent potential while the Orange County-Bay Area traffic continues to grow at a substantial rate. The economic climate is improving, and the outlook for Air Cal has never been better.

Air Cal has sufficient aircraft to meet its needs in the foreseeable future. Of the eight aircraft leased by Air Cal, six are being fully utilized in passenger operations and two are subleased profitably on short term agreements. Air Cal has a good level of aircraft utilization. In 1971 Air Cal had 5.9 hours per day utilization for its 737's compared to 5.7 hours per day for PSA (Ex. 16).

Finally, the most important aspect of Air Cal's viability is its achievement of profitable operations. Mr. Van Dordrecht testified that Air Cal had been operating profitably since early in the year and a profit for the year was expected.[9/] Indeed, the \$200,000 - \$250,000 figure certainly seems conservative in light of a net profit in August of \$260,638 and \$39,896 in September. This brings Air Cal's net profit (including non-operating items) to approximately \$244,000 for the first nine months.[10/]

I assume applicants' contention is (although never clearly set forth) that a financially weak airline is undesirable and therefore not in the public interest. In the abstract that may be true, but a financially struggling airline is better than no airline, and financially thin competition to an already existing monopoly is better than no competition at all.

9/ Van Dordrecht Tr. 231.

10/ Monthly financials submitted to California P.U.C. pursuanttto General Order 65A.

Applicants contend, and the majority agree (Mimeo. Opinion, p. 16), that the public interest will be served because operating efficiencies can be expected to result from this acquisition. Of course they will. Does that justify removing the only viable competition from the scene? I think not. There is not one scintilla of evidence in the record that the paying passenger will enjoy one cent of rate reduction as a result of this greater operating efficiency.

Applicants claim they will upgrade service in several markets. Actually this "upgrading" will consist of eliminating 13 daily flights on one hand, and commencing seven other daily flights, primarily affecting San Diego, Hollywood-Burbank, Santa Ana, San Jose and Oakland. Do these so-called "service improvements" justify removing the only viable competition from the scene? I think not. Even the majority opinion concedes that "On balance, the service improvements are <u>not outstanding</u>, but they <u>may</u> prove helpful to the public." (Emphasis added.) (Mimeo. Opinion, p. 14.)

Applicants proudly point to service improvements which will be introduced. Actually, PSA and Air Cal respectively could, without merger, institute the proposed increases in service if the demand exists. Such proposals afford no justification for the merger.

I concur with the opening brief of the City of Oakland where it says, at page 6:

> "Each of these improvements is possibly temporary in nature and it is also interesting to note that the proposed nonstop improvement in quality of service could be implemented by PSA without the merger. PSA's witnesses indicated that this improvement, the institution of additional

nonstop service between Oakland and San Diego, would stimulate a fairly substantial traffic growth, a stimulation particularly needed at Oakland at the present time. It is difficult to understand why this obviously available and needed service improvement is offered only as an apparent bait to gain public support for the merger."

Applicants cite certain fare reductions which will result from the acquisition. Air Cal presently charges from $.46 to $3.33 more than PSA per flight on some of its routes. In order to bring these rates into conformity with its general rate schedules PSA proposes introducing lower fares.

The fare reduction which is alleged by the majority to be the principal benefit is for all practical purposes offset by the presently pending application (A. 53525) of PSA requesting a rate increase of over $4,500,000. The Commission Staff argument on this issue (Commission Staff reply brief, p. 5) is convincing and therefore repeated here in toto.

"A cursory examination of the proposed acquisition raises the obvious question of why PSA would be willing to pay a price which exceeds asset value by an amount in excess of $17,000,000 for an airline which it claims provides no significant competition. The answer, of course, is that Air Cal does provide significant competition, as has been shown, and that PSA does not intend to pay the price, but intends to collect it from the intrastate airline passenger. This intention includes the $17,000,000 excess described above (see Witness Barkley's prepared testimony, pp. 4-8). A look at recent proceedings involving PSA will reveal where a substantial part of the $5,442,664 down payment will be extracted. On August 1, 1972, the Commission issued Decision No. 80322 in Application No. 52970 with regard to a requested rate increase of $4,547,102. The Commission found as follows:

'6. The fares and freight rates proposed in the application will provide an estimated rate of return of 15.5 percent, and an operating ratio (after taxes) of 83.4 percent. Said rate of return on depreciated rate base exceeds that heretofore granted to PSA in recent fare proceedings (Decision No. 75899, 69 Cal. P.U.C. 739 (1969), Decision No. 76447, 70 Cal. P.U.C. 419 (1969), and Decision No. 77991, unreported (1970).) Said rate of return is in excess of the rates of return of 12.0 percent and 12.5 percent found reasonable for trunkline and regional air carriers by the Federal Civil Aeronautics Board in its Docket 21866. Said rate of return also exceeds the maximum recommended herein as reasonable by the staff witness. The estimated rate of return of 15.5 percent resulting from PSA's fare and freight rate proposal in the application herein produces excessive earnings and, therefore, is unreasonable.'

"Before the ink was cold, let alone dry, on Decision No. 80322, and before it even became effective, PSA filed Application No. 53525 requesting a rate increase in an amount equal to that which had just been found unreasonable. If PSA should succeed in its most recent fare application and also in the present proceeding, its competition will be eliminated, the ratepayer will pick up substantially all of the tab and PSA will be home free."

In conclusion, this acquisition is not in the public interest on any of the four grounds relied on by applicants and the majority. Applicants have failed to sustain the burden of proof.

CONCLUSION

For years this Commission has protected Air Cal from the ravages of uncontrolled and cut-throat competition so that the citizens, communities, and the State itself would realize the benefits of competition in intrastate air transportation. Now, just when the only real competition to the monopoly carrier appears to have "made it" financially, the majority brush it away with a cursory sweep of the hand.

The significance and importance of this competition is convincingly set forth by the City of Oakland in its opening brief, pp. 3-5, where it cites numerous examples to support its contention that PSA "responds effectively to competition." Indeed, the testimony of Mr. Fred Dubois, Oakland's Director of Air Traffic Development, was so convincing on this issue that the Commission Staff's opening brief devotes more than three pages to repeating its highlights (pp. 4-8) because, as staff puts it, it ". . . so forcefully and clearly demonstrates the value of competition."

This proposed acquisition creates a monopoly which will restrain competition. It is against the public interest. It violates Section 2758 of the California Public Utilities Code. It should be denied summarily.

The California Public Utilities Commission, which presided at the birth of Air Cal, carefully nurtured it and watched it develop from a sickly fledgling into a viable and dependable carrier, should not so quickly deliver the coup de grace while its progeny is still breathing.

J. P. Vukasin, Jr.
J. P. Vukasin, Jr.
Commissioner

San Francisco, California
February 23, 1973

D. W. HOLMES, Commissioner, Dissenting:

The application for merger authority filed herein by the largest, and by far the most viable, of the California intrastate airlines has presented far-reaching and difficult issues. It is with regret that I must dissent from the decision reached on those issues by the majority of my fellow Commissioners.

My thorough analysis of the evidence and the law applicable thereto indicates that under present conditions the authority granted cannot be legally upheld.

Approval of this transaction requires compliance with Section 2758 of the Public Utilities Code. This section imposes mandatory restrictions upon the exercise by the Commission of any authority granted for the merger of two passenger air carriers. After providing that the merger may be authorized if it is found to be "in the public interest", the section states:

> " . . . The commission shall not authorize, however, any consolidation, merger, purchase, lease, operating contract, or acquisition of control which would <u>result in creating a monopoly or monopolies and thereby restrain competition</u>, or jeopardize another passenger air carrier not a party to the consolidation, merger, purchase, lease, operating contract, or acquisition of control . . . ." (Emphasis supplied)

There is no question in the instant case of jeopardy to a non-party carrier; thus, we are left with two issues:

(1) Does the merger authorized result in the creation of a monopoly; and

(2) Does the merger result in a restraint on competition?

In determining whether a monopoly is created, it is necessary to determine the "relevant market" since the breadth of this market may result in different effects. In the instant case, however, there are extreme similarities whether the market is defined as either (1) the individual city-pair routes served by the two airlines; or (2) the "California air corridor" (the intrastate air transportation system between the Los Angeles and San Francisco areas, including the satellite airports in each area). It is acknowledged that the parties compete directly in four small city-pair markets,[1/] and the merger will result in a monopoly in each. Further, in all but two[2/] of the other city-pair markets within the California air corridor, either PSA or Air Cal is in essentially a monopoly position. Thus, as a result of the merger, PSA will hold a monopolistic position on all but two relatively minor routes.

Although it is established anti-trust law (Brown Shoe Co. v.

1/ San Diego-San Jose, San Diego-Oakland, San Diego-Sacramento, and Ontario-Sacramento.

2/ The Long Beach and Ontario routes to San Francisco are apparently dominated at present by Western Airlines.

U.S., 370 U.S. 294 (1962)) that the share of the relevant market remaining to the surviving company is not controlling, it is certainly a significant factor. I am compelled to give weight in my analysis to the fact that definition of the relevant market as the "California air corridor" will show that PSA's share of the total traffic in the market will increase from 70% to 81%. This will leave the CAB certificated carriers, United Airlines and Western Airlines, with approximately 7% and 9%, respectively. I cannot view permitting this situation to obtain as compliance with the mandate of Section 2739 of the Public Utilities Code which requires " . . . regulation of the transportation of passengers by air in common carriage within the State of California in order that an orderly, efficient, economical, and healthy intrastate passenger air network may be established to the benefit of the people of this State, its communities, and the State itself." (Emphasis supplied)

Having established by definition, that the merger will create a monopoly, we must still determine whether the monopoly will, in fact, constitute a restraint on competition since the two concepts are not necessarily synonymous. Where there is no viable competitor to be eliminated by a merger, such merger cannot be held to be anti-competitive. This "failing company" doctrine is a well-established principle in anti-trust law. (Citizens Publishing Co. v. United States, 394 U.S. 131 (1969)). However, it is also clear that in order to meet this test the prospects of Air California would have to be "dim or non-existent", and I do not feel that the record in this case can support such a conclusion. While it is obvious that Air California is in a financially weak position, it is not established to my satisfaction that it cannot continue to grow and improve. Under the circumstances, I find that authorizing the creation of a monopoly will result in a definite restraint of competition.

I feel that the appropriate resolution of this matter would have been a dismissal without prejudice so that in the event the fears concerning Air California's viability as a competitive entity come to fruition, the matter might again be considered by this Commission.

Commissioner

Dated at San Francisco, California,
February 23, 1973.

COMMISSIONER MORAN, CONCURRING.

I concur with my colleagues in this Decision but on somewhat different grounds.

The representation by PSA that it will introduce lower fares on certain of Air California's routes is almost meaningless inasmuch as PSA can charge no more and no less than this Commission from time to time may authorize. The only significance of the representation is that it indicates that PSA is of the opinion that it will be able to achieve economies which may make such reductions possible.

To me the most significant fact is that the competition between PSA and Air California in the transportation of passengers between Northern and Southern California is largely theoretical rather than real. The history of Air California and its operating results make it clear that it has survived this long only because this Commission has consistently prohibited PSA from competing with Air California for the transportation of passengers between heavily populated Orange County and the Bay Area.

It is my conclusion therefore that the public does not presently benefit from the independent operation of Air California and is not likely to benefit from such operations. It is my further conclusion that in view of this situation, the economies of operation which cannot fail to result from the integration of the two companies, must in the long run result in lower fares and better service for the people of California.

Dated: February 23, 1973
San Francisco, California

Thomas Moran
Commissioner