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ORIGINAL

Decision No. 85629

BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Application of AIR CALIFORNIA for  
an ex parte order to increase its  
intrastate passenger fares and  
cargo rates.

Application No. 55784  
(Filed July 2, 1975;  
amended August 1, 1975,  
August 18, 1975, and  
January 15, 1976)

(Appearances are shown in Decision No. 85340.)

Additional Appearance

Lawrence A. Guske, for Pacific Southwest Airlines,  
Interested party.

FINAL OPINION

Air California, a passenger air carrier operating wholly within California, seeks authority to increase its air fares and freight rates.<sup>1/</sup>

Air California's last general fare increase was authorized by Decision No. 82687 dated April 2, 1974 in Application No. 54546. Since that time Air California has received fare increases to offset the increased cost of fuel. Air California assertedly has experienced other increased operating expenses, such as labor costs, repair and maintenance costs, and terminal rentals and landing fees for which it seeks increases in this proceeding.

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<sup>1/</sup> Interim fares and final fares proposed in the fourth amendment to Application No. 55784 are shown in Appendix A.

Interim Decision No. 84821 dated August 26, 1975 granted the request in the second amendment to the application to increase air fares by 18 cents per passenger (before tax) and 20 cents per passenger (after tax) to offset increased fuel costs occurring prior to the date of the filing of that amendment on August 18, 1975.

Second Interim Decision No. 85340 dated January 13, 1976 granted the request in the third amendment to the application to further increase air fares by 47 cents per passenger (before tax) and 50 cents per passenger (after tax) to offset increased fuel costs and labor cost increases occurring since August 1, 1975, and to increase air freight rates. Final decision on applicant's request was deferred to permit the Commission staff to complete its studies.

Public hearing on the requested fare increases set forth in the fourth amendment to the application was held before Examiner Mallory at San Francisco on January 28, 1976 and the matter was submitted for final decision. Evidence in this phase of the proceeding was presented by applicant's chief financial officer and by a transportation engineer and a financial examiner from the Commission's Transportation Division and Finance and Accounts Division, respectively.

A senior transportation engineer presented Exhibit 10, which contains the results of the study made by the Transportation Division. That exhibit sets forth the staff's estimated results of operation for a future rate year ended March 31, 1977. The estimated results of operation contain no estimated federal and state income taxes, inasmuch as the necessary background information was not made available before the commencement of the hearing. The staff's financial examiner sponsored Exhibit 11, which contains the staff's calculations of income taxes applicable to the test year net operating income under present and proposed fares set forth in Exhibit 10. Cross-examination of the

staff engineer developed that a change was required in the estimated test year expense for direct maintenance, which changed his estimated test year net operating income. The financial examiner testified that the method of tax calculations described in Exhibit 11 was proper in connection with the revised net operating income resulting from the revision of Exhibit 10, although those calculations were not made for the record.

Exhibits 8 and 9 were offered by applicant. Exhibit 8 encompasses the data set forth in the fourth amendment to the application. Exhibit 9 contains Air California's actual operating revenues and expenses (unaudited) for the calendar year 1975, and also sets forth its estimates of operating revenues and expenses for the test year ended March 31, 1977 used in the staff's Exhibit 10. Air California's witness explained that the airline's projections resulted in greater expenses, in some instances, than the staff because such projections were developed from actual data for a later base period (year 1975) than the staff year ended September 30, 1975.

Exhibit 9 contains no calculations of estimated federal and state income taxes for the test year. Air California's witness pointed out that Westgate California owns 80 percent of Air California's capital stock, permitting Westgate and Air California to file a joint federal return. Westgate is in bankruptcy; the profits of airline operations offset, in part, losses from other phases of Westgate's operations. In the past, an agreement was reached under which a fixed percent of the California state tax was paid to Westgate, computed as if Air California had filed a separate return. That agreement has expired. It was agreed by the principal financial examiner appearing for the staff and applicant that if such an agreement was renewed it should have no effect on the reasonable level of taxes to be included in test year estimates used herein for ratemaking purposes.

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The following table sets forth the actual results of operations for the year ended September 30, 1975 (Exhibit 10) and for the calendar year 1975 (Exhibit 9) compared with the staff's estimate of operating results under present fares for a test year ended March 31, 1977 (Exhibit 10). These comparisons make no provision for income taxes.

TABLE 1

## AIR CALIFORNIA

Estimated Results of Operation  
Year Ending March 31, 1977 (Present Fares)  
And Actual Results for Years Ended  
September 30, 1975 and December 31, 1975

	<u>Historical Year</u> <u>Ended 12-31-75</u> <u>(Exhibit 9)</u>	<u>Historical Year</u> <u>Ended 9-30-75</u> <u>(Exhibit 10)</u>	<u>Rate Year</u> <u>Ended 3-31-77</u> <u>(Exhibit 10)<sup>1/</sup></u>
<u>Statistics</u>			
Passenger	1,555,140	1,498,568	1,728,000
Flight Hours	20,878	20,061	23,440
<u>Revenue</u>			
Scheduled Passengers	\$35,251,000	\$33,397,983	\$39,641,300
Charter	736,000	782,807	782,800
Freight and Baggage	555,000	553,153	641,700
Beverages	219,000	207,355	239,100
Miscellaneous	795,000	765,854	105,600
Total Revenue	<u>\$37,556,000</u>	<u>\$35,707,152</u>	<u>\$41,410,500</u>
<u>Expenses</u>			
Flying Operations	\$10,973,000	\$10,402,050	\$13,108,400
Direct Maintenance	2,858,000	2,609,208	3,118,900
Aircraft Lease Cost	4,238,000	4,238,400	4,238,400
Depreciation	482,000	449,812	522,400
Maintenance Burden	1,429,000	1,382,989	1,470,300
Passenger Services	2,416,000	2,260,384	2,936,100
Aircraft Services	1,987,000	1,894,718	2,262,200
Traffic Services	4,750,000	4,424,030	4,808,500
Sales and Promotion	4,389,000	4,188,005	4,810,000
General Administration	1,678,000	1,505,086	1,550,500
Total Oper. Expenses	<u>\$35,200,000</u>	<u>\$33,354,682</u>	<u>\$38,825,700</u>
Operating Income	\$ 2,356,000	\$ 2,352,470	\$ 2,584,800
Operating Ratio (Assuming no Income Tax)	93.73%	93.41%	93.76%

<sup>1/</sup> Based on fares authorized in Decision No. 85340.

The following table sets forth estimates of operating results for a test year ended March 31, 1977 under the fares proposed in the fourth amendment to the application. Income taxes included therein for both applicant and staff have been estimated based on methods set forth in the staff's Exhibit 11. No specific method of calculating test year income taxes was furnished by applicant.<sup>2/</sup>

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<sup>2/</sup> Cross-examination of applicant's witness by the principal financial examiner indicated that some tax factors used in Exhibit 11 may be different than estimated therein; however, applicant did not dispute the staff showing.

TABLE 2

## AIR CALIFORNIA

Estimated Results of Operation  
Year Ended March 31, 1977 at Proposed Fares

	<u>Applicant</u> (Exhibit 9)	<u>Staff</u> (Exhibit 10)
<u>Statistics</u>		
Passenger	1,728,000	1,728,000
Flight Hours	23,400	23,440
<u>Revenue</u>		
Scheduled Passengers	\$41,900,000	\$41,900,000
Charter	680,000	782,800
Freight and Baggage	586,000	641,700
Beverages	242,000	239,100
Miscellaneous	108,000	105,600
Total Revenue	<u>\$43,516,000</u>	<u>\$43,669,200</u>
<u>Expenses</u>		
Flying Operations	\$13,237,000	\$13,108,400
Direct Maintenance	3,289,000	3,118,900
Aircraft Lease Cost	4,238,000	4,238,400
Depreciation	530,000	522,400
Maintenance Burden	1,556,000	1,470,300
Passenger Services	3,085,000	2,936,100
Aircraft Services	2,358,000	2,262,200
Traffic Services	5,319,000	4,808,500
Sales and Promotion	4,790,000	4,892,000
General Administration	1,598,000	1,550,500
Total Operating Expenses	<u>\$40,000,000</u>	<u>\$38,907,700</u>
Operating Income	\$ 3,516,000	\$ 4,761,500
Provision for Income Tax	\$ 1,598,200	\$ 2,254,300
Net Income	\$ 1,917,800	\$ 2,507,200
<u>Operating Ratio</u>		
Before Taxes	91.92%	89.10%
After Taxes	95.59%	94.25%

The Commission staff engineer recommended that the increased fares proposed in the fourth amendment to the application be granted, based on the following considerations:

1. In the last proceeding involving a general increase in Air California's fare (Decision No. 82687 dated April 2, 1974 in Application No. 55308) Air California was authorized to establish increased fares based on estimated net operating income which resulted in an operating ratio of 86.1 percent (before income taxes) and an operating ratio of 92.7 percent (after income taxes).

2. Finding 2 of that decision stated that return on rate base would not provide a reasonable test of applicant's earnings, inasmuch as the major components of applicant's property used to produce the services rendered to the public are leased, rather than owned.

3. The proposed fares in the rate year ended March 31, 1977 are estimated by the staff to yield an operating ratio of 89.10 percent before taxes, which is less favorable than that allowed in Decision No. 82687.

#### Discussion

The Commission staff recommends that the sought increases in fares be granted. The differences in estimates of test year operating expenses between applicant and staff need not be resolved, in view of the staff recommendations. Applicant's operating ratio before income taxes, as estimated by the staff (Table 2), is less favorable than that found reasonable in the last general fare increase proceeding. In the circumstances, the fourth amendment to the application will be granted.

At the impetus of the Commission, PSA and United have established reduced corridor air fares applicable after 8:00 p.m. Air California is requested to investigate the feasibility of establishing similar fares in its exclusive markets and to advise the Commission.

#### Findings

1. Air California seeks a permanent increase in air fares as set forth in the fourth amendment to Application No. 55784

2. Table 2 sets forth the estimated results of operations under such proposed fares for a test year ended March 31, 1977, as developed by applicant and the staff.

3. The staff estimates of operating revenues, operating expenses, income taxes, net operating income, and operating ratios as set forth in Table 2 are reasonable for the purposes of this proceeding.

4. The operating ratio method provides a reasonable test of earnings in the rate year. As found in Decision No. 82687, return on rate base is an inappropriate method, inasmuch as the major components of applicant's property used to provide its passenger air carrier service to the public will be leased rather than owned in the test year.

5. The estimated operating ratio of 89.10 percent (before income taxes) and 94.25 percent (after taxes) applicable to test year operations under proposed fares are less favorable than those authorized in the last proceeding in which a general fare increase for Air California was considered (Decision No. 82687). Those operating ratios are reasonable for Air California's operations and will not result in excessive earnings in the test year.

6. The increased air fares proposed in the fourth amendment to the application are justified.

7. Fares will be increased by approximately \$2,258,700 over the amount authorized in Interim Decision No. 85340. Interim Decision No. 85340 authorized an annual revenue increase of \$748,800, and Interim Decision No. 84821 authorized \$268,000. The total revenue increase authorized in this application is \$3,275,500.

#### Conclusions

1. The increased fares sought in the fourth amendment to the application should be authorized as permanent fares.

2. The Commission concludes that the effective date of this order should be the date on which it is signed because there is no known opposition and there is no reason to delay granting the relief requested.

FINAL ORDER

IT IS ORDERED that:

1. Air California is authorized to establish the increased air fares proposed in the fourth amendment to Application No. 55784 filed January 15, 1976.

2. Tariff publications authorized to be made as a result of this order may be made effective not earlier than five days after the effective date of this order on not less than five days' notice to the Commission and to the public.

3. The authority granted herein shall expire unless exercised within ninety days after the date hereof.

The effective date of this order is the date hereof.

Dated at San Francisco, California, this 30<sup>th</sup> day of MARCH, 1976.

*I abstain*  
*Leonard Ross*  
Commissioner

*[Signature]*  
President  
*William J. ...*  
*Vernon L. Sturgeon*  
*Robert Buchanan*  
Commissioners

APPENDIX A

Air California Fares  
(Excluding Tax)

Market	Interim Fares			Proposed Fares Fourth Amendment
	Decision 84138	Decision 84821	Decision 85340	
Effective Date	3-28-75	9-5-75	1-21-76	
SNA - SFO/SJC/OAK	\$24.31	\$24.49	\$24.96	\$26.62
ONT - SJC/OAK	24.31	24.49	24.96	25.69
SMF - SNA/ONT	24.77	24.95	25.42	27.08
SAN - SJC/OAK	26.67	26.85	27.32	29.17
PSP - SFO/SJC/OAK	29.63	29.82	30.29	32.41
PSP - SNA/ONT	12.22	12.41	12.88	13.43
SJC - OAK	8.33	8.52	8.99	9.03
SNA - SAN	11.48	11.67	12.14	12.78
SMF - SJC	11.48	11.67	12.14	12.78
SMF - SAN	26.85	27.04	27.51	29.40
SMF - PSP	30.09	30.28	30.75	32.87
TVL - SNA/ONT	29.63	29.63	29.63	29.63
TVL - SFO/OAK/SJC	17.59	17.59	17.59	17.59