

BEFORE THE  
WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION  
WASHINGTON, D. C.  
ORDER NO. 703

IN THE MATTER OF:

Served April 14, 1967

Application of Alexandria, )  
Barcroft and Washington )  
Transit Company for Author- )  
ity to Increase Fares. )

Application No. 411

Docket No. 137

APPEARANCES:

S. HARRISON KAHN, Attorney for Alexandria, Barcroft and Washington Transit Company, Applicant.

JAMES M. HENDERSON, appearing for the Mount Vernon Council of Citizens Associations, and the Fairfax County Federation of Citizens Associations, Intervenor.

JERRY EMRICH, Attorney for the Board of Supervisors, Arlington County, Intervenor.

RUSSELL W. CUNNINGHAM, General Counsel, Washington Metropolitan Area Transit Commission.

JOHN O'NEILL, Pro se

WALTER SCHWARTZ, Pro se

BEFORE EDWARD D. STORM, CHAIRMAN; H. LESTER HOOKER, VICE-CHAIRMAN; GEORGE A. AVERY, COMMISSIONER

On January 13, 1967, Alexandria, Barcroft and Washington Transit Company ("A. B. & W.") filed an application with the Washington Metropolitan Area Transit Commission ("Commission") seeking authority to increase certain of its fares for the transportation of passengers interstate between points in Northern Virginia, on the one hand, and points within the District of Columbia, on the other.

A. B. & W.'s application was accompanied by appropriate prepared testimony and exhibits as well as the following tariffs setting forth new and increased fares.

- (A) Supplement No. 5 to WMATC No. 2 (Tariff of A. B. & W.)  
Generally, this supplement seeks to increase interline passenger fares by five cents (5¢) each between all interstate zones of A. B. & W. and the routes of D. C. Transit System, Inc.
- (B) Supplement No. 5 to WMATC No. 5 (Tariff of A. B. & W.)  
Generally, this supplement seeks to increase interline passenger fares by five cents (5¢) each between all interstate zones of A. B. & W. and the routes of WMA Transit Company.
- (C) WMATC No. 23 (Tariff of A. B. & W.)  
Generally, this tariff seeks to increase interstate adult fares by five cents (5¢) each in Zones 1 through 8, to increase interstate children's fares by five cents (5¢) each in Zones 1, 3, 5, and 7 and to increase the token rate from four (4) for eighty-five cents (85¢) to four (4) for one dollar and five cents (\$1.05).

The tariffs were issued January 13, 1967, and stated an effective date of February 13, 1967. By Order No. 662, served January 24, 1967, the Commission scheduled the matter for public hearing, made provision for the availability of A. B. & W.'s proposed testimony and exhibits, and directed applicant to post on its buses, and publish in a newspaper,

notice of the scheduled hearing. Order No. 675, served February 10, 1967, suspended the above mentioned tariffs, pending investigation and hearing, until May 14, 1967.

Upon due notice, a pre-hearing conference was held on February 17, 1967, to formulate and consider the issues and other related matters as suggested by Commission Rule 17-01.

Notice having been duly given in accordance with the Commission's Rules and Regulations, the public hearing commenced on March 9, 1967. Two formal parties were admitted to the proceeding, and two A. B. & W. patrons representing themselves as users of the service, Mr. John O'Neill and Mr. Walter Schwartz, appeared and were granted permission to participate in the proceedings.

The Commission processed approximately ten informal protests in connection with the proposed fare increases. The public hearing held on March 9, 1967, produced a transcript of 196 pages and 45 exhibits.

A. B. & W. presented the testimony of its Executive Vice-President and General Manager, Robert T. Mitchell; its Operations Manager, Richard F. Lawson; and its auditor, George R. Snyder, C.P.A. The Commission staff presented the testimony of its Chief Engineer, Charles W. Overhouse, and of its Chief Accountant, Melvin E. Lewis. Mr. John O'Neill and Mr. Walter Schwartz appeared and gave testimony, each in his own behalf. James M. Henderson submitted a written brief on behalf of the Mount Vernon Council of Citizens Associations, and the Fairfax County Federation of Citizens Associations, after the close of the hearing.

#### PROJECTED OPERATING RESULTS

Both the Commission and A. B. & W. used a historical year ended October 31, 1966, and a rate year ending March 31, 1968.

The Commission staff and company witnesses were in substantial agreement on their projections of revenue and expense estimates for the future rate year under the present fares.

The Commission staff's projections of both operating revenues and operating expenses under the proposed fare structure were more than \$70,000 higher than those projected by the company. These increases are primarily due to the Commission's forecast that both passengers carried and miles operated will be higher in the rate year with increased fares than those forecast by the company. These increases tend to offset one another and the resulting net operating income under the Commission's projections closely parallel that projected by the applicant.

The Commission, after careful analysis, accepts the staff estimates as more accurate and will use them in computing the operating results of the applicant for the rate year.

The following tabulation indicates the results which would be obtained under present and proposed fares during the rate year (Exhibit S-2).

	<u>PRESENT FARES</u>	<u>PROPOSED FARES</u>
Operating Revenue	\$6,156,936	\$6,656,759
Operating Expense	<u>5,868,183</u>	<u>5,884,937</u>
Net Income Before Income Taxes	288,753	771,822
Income Taxes	<u>115,280</u>	<u>359,713</u>
Net Income After Income Taxes	<u>\$ 173,473</u>	<u>\$ 412,109</u>
Operating Ratio	97.18%	93.81%
Return % on Gross Operating Revenue	2.82%	6.19%

In keeping with the Commission's ruling in its Order No. 369, served June 22, 1964, applicant was permitted to use normalized taxes in projecting its operating costs.

The relevant part of that Order, p. 4, is quoted herein:

The Commission is of the opinion that the public interest is protected under either of these methods as long as the carrier, under normalization, sets up and maintains a Reserve for Deferred Taxes to permanently record the relationship between income taxes actually paid and normalized income taxes charged, and as long as such Reserve is kept in proper adjustment; thus, should deferred taxes be changed in amount due to changes in tax legislation, such change must be reflected in the Reserve for Deferred Taxes and passed on directly to the ratepayers. Under this procedure, the incidence of income taxes upon the ratepayer is the same in amount under either method -- the only difference being in the timing of such incidence. The Commission finds that the timing of the tax charge, indeed the basic determination as to how to file its tax return (whether to use straight-line depreciation or accelerated depreciation, for example), is within the discretion of management. This carrier opts the normalization method; as long as it carries out its accounting correctly so that the public is protected, the Commission will not interfere.

It should also be noted that all projections used were based on the assumption that the adjustment in intrastate fares applied for before the Virginia State Corporation Commission would be granted. Our Commission has now been advised by the State Corporation Commission that it has reached an affirmative decision to grant the fare adjustments applied for by A. B. & W.

### FAIR RETURN

We now have before us, with little or no dispute, the applicant's projected operating results under the present fare structure and under the proposed fare structure.

For guidance on the applicable law governing the determination of what constitutes a fair return, we look generally to our Compact and to the decision of the U. S. Court of Appeals for the District of Columbia Circuit in D. C. Transit System, Inc. v. WMATC, 350 F. 2d 753 (1965).

The latter case spelled out the rate-making objective as involving, among other considerations, the task of assuring

"that all the enterprise's legitimate expenses will be met, and ... cover interest on its debt, pay dividends sufficient to continue to attract investors, and retain a sufficient surplus to permit it to finance down payments on new equipment and generally to provide both the form and substance of financial strength and stability." (D. C. Transit System, Inc., v. WMATC, supra, 350 F. 2d 778)

We are still governed by the constraints spelled out in the Washington Metropolitan Area Transit Regulation Compact (Article XII, Sec. 6(a)(4), quoted below:

(4) It is hereby declared as a matter of legislative policy that in order to assure the Washington Metropolitan District of an adequate transportation system operating as private enterprises the carriers therein, in accordance with standards and rules prescribed by the Commission, should be afforded the opportunity of earning such return as to make the carriers attractive investments to private investors. As

an incident thereto, the opportunity to earn a return of at least 6-1/2 per centum net after all taxes properly chargeable to transportation operations, including but not limited to income taxes, on gross operating revenues, shall not be considered unreasonable.

This commits the Commission to a primary reliance on the operating ratio method, which relates operating expenses (and incidentally net operating income) to gross operating revenues.

This Commission is aware of the peculiar value of the operating-ratio approach to rate-making in the motor carrier industry, as differentiated from the rate-base and return-on-investment techniques. The latter techniques are well suited to a high-cost, long-lived investment base where fixed costs are the major financial considerations. In the motor carrier industry, however, the basic plant devoted to public use is relatively short-lived, and the strategic financial problem turns upon the current operating costs and their delicate relationship to operating revenues.

In the specific case of this applicant, the book value of its land and buildings was 6.6% of its total tangible operating property, and only 5.3% of its total assets (Exh. 21). Thus the great bulk of its operating assets resides in its buses, with their relatively short life of twelve years.

This Commission must consider the specific relationship between projected revenues and projected costs, and try to leave a spread between projected revenue and projected costs. This spread represents the carrier's margin, which will have to provide the funds to (1) enable applicant to meet its inherent requirements; (2) pay reasonable dividends; (3) permit retention of a reasonable amount in the business to provide for contingencies; and (4) attract the necessary funds to meet future capital needs.

The Commission finds that the net operating income forecast for the rate period at present fares, in the amount of

\$173,000 (Exh. #S-2), will not provide sufficient margin (2.82%) to satisfy the requirements of the Compact, nor will it supply the funds, financial strength, or incentive to support needed expansion and growth of the bus system.

The \$173,000 forecast will represent a return of 6.14% on the projected average rate base of \$2,826,000 developed in Exhibit S-7; if the \$173,000 here forecast is reduced by the \$48,000 of required interest expense in the rate year, the remaining \$125,000, related to the resulting book equity as developed following the procedure illustrated in Exhibit S-8, would show that the amount available to the investors, without fare relief in the rate year, will be only 5.85% of their book-value equity. These percentages are low for the transit industry, but of particular concern is the conversion of the \$173,000 projection to a cash-oriented base, as was done in Exhibit S-9, where results under the proposed fares were analyzed. The same analysis, applied to the rate year with no change in fares would leave an excess of cash inflow over cash needs of some \$78,000; this would leave -- assuming no substantial economic aberrations as experienced in some of the years from 1960 forward -- barely enough for a continuation of applicant's conservative dividend policy. The Commission finds the return forecast for the rate period, without fare relief, to be manifestly inadequate.

The Commission now addresses itself to the projected results of operations for the rate period and finds that the fares requested, after providing for the new fares to be granted by the State Corporation Commission of Virginia, will produce a net operating income of \$412,000 (Exh. #S-2), or a margin of 6.19% of projected gross operating revenue. The net operating income here considered was found to equate to a return on projected average rate base, as calculated in staff Exhibit #S-7, of 14.57%; income available to investors, per staff Exhibit #S-8 would be 15.28% of book equity. Each of these percentages fall within the range of reasonableness, in the judgment of the Commission, for a company as conservatively-financed (Tr. p. 175) as is this applicant. The 80 : 20

relationship of equity to debt and the careful dividend policy of applicant (Tr. p. 180) have helped maintain a sound fiscal structure for this applicant despite the wide fluctuations in its net operating income since 1960. Staff Exhibit #S-12 shows one year with net operating income up to \$324,000 and the very next year down to \$46,000 (less than 1% margin). This demonstrates the extreme sensitivity of applicant's net income to the economic hazards to which it is exposed.

The Commission again turns to the decision of the U. S. Court of Appeals for the District of Columbia Circuit in D. C. Transit System, Inc. v. WMATC 350 F. 2d 753 (1965), p. 9 for a succinct evaluation of the operating ratio of rate-making as related to the determination of fair return in a case such as this one:

This method (operating ratio) was thought to provide a fairer test of revenue needs in an industry in which, characteristically, a carrier's capital investment is small in comparison to his total costs. Among motor carriers, annual operating expenses are often three or four times as great as investment in property.<sup>1/</sup>  
The principal risk in such operations inheres in the cost of operation, not in the investment. (Underscoring added by the Commission)

With this risk in mind, and in view of the fluctuations the company has faced in the past, we feel that the return on gross revenues provided by this fare increase is within the range of reasonableness.

#### THE RATE STRUCTURE

Mr. Schwartz and Mr. O'Neill raised questions at the hearing as to the equity of the fare and zone structure of the company.

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<sup>1/</sup> Applicant's operating expenses (Exh. #S-2 are more than double its forecasted average rate base (Exh. #S-7).

The Commission recognizes that short-distance riders pay more per mile for a ride than long-distance riders. The basis for this is that fixed costs are evenly distributed among all riders, and variable costs, geared to miles operated, are distributed in accordance with distance traveled. Since the area served by A.B. & W. is a growing one, it is necessary periodically to review fare zone boundaries to see whether changes in population, riding habits and routes require boundary changes. However, the record does not include information on which the Commission could order changes in fare zone boundaries. In this connection, A. B. & W.'s zone structure is receiving the attention of the Commission's Engineering Department, and recommendations concerning fare zone boundaries will be made in the future. There is no basis in this record for changing boundaries at this time, and the existing zone structure provides an equitable basis for a fare structure until we have the recommendations of our Engineering Department in hand.

The brief filed by James M. Henderson on behalf of the Mount Vernon Council of Citizens Associations, and the Fairfax County Federation of Citizens Associations, stated in part:

The basic concern of the Federation and the Council is whether the proposed fare increase contributes toward the solution of critical transportation problems in Fairfax County and the Mt. Vernon District or tends to aggravate those problems. It is the position of the Federation and Council that the proposed increase tends to compound relevant transportation problems and should be approved only in conjunction with remedial measures designed to mitigate the deleterious consequences of such an increase. More specifically, it is the position of these groups that any fare increase should be accompanied by Commission and carrier action designed to insure that "fare resistance" to such increase will be offset by improved service, added convenience and augmented equipment, to the end of greater

public acceptance of the transportation offered by the carrier.

The Commission agrees wholeheartedly with this eloquently stated position.

The Commission is aware that fare increases cause some bus passengers to turn to the automobile for transportation. However, all requests for fare increases processed by this Commission since it was created have been generated by increased operating costs, not by reductions in passenger volume. This case now before the Commission was initiated mainly because of increased costs provided in the November, 1966, labor contract entered into between the company and the employees' union.

The Commission cannot ignore the language in its Compact (Title II, Article XII, Sec. 6 (a) (3)) which points to "adequate and efficient transportation services by such carriers at the lowest cost consistent with the furnishing of such service"--the latter part of the phrase is a necessary concomitant of the first part. The Commission in this Order, as in all of its rate orders, addresses itself to the task of arriving at the exact point of balance that will achieve the former goal without violating the constitutional and practical constraints implicit in the latter.

Mr. Henderson's brief also emphasizes the need for new buses and in the process increasing the number of air-conditioned buses in its fleet. Mr. Henderson believes that the present condition of the company's bus fleet is a major factor in the company's inability to attract an increasing share of the riding population in the area served. The Commission has found that the average age of the fleet is becoming lower, therefore, offering the public an increasingly modern service. The percentage of air-conditioned buses in the company's fleet has grown steadily from 9.01% in October of 1960 to 53.45% of its fleet on March 31, 1967, per applicant's Exhibit No. 9.

The Commission is of the opinion that the applicant is actively striving to develop a more modern fleet. It is noted that applicant acquired two air-conditioned 1962 model buses in February, 1967, and has put 22 new air-conditioned buses into service in late March of 1967.

Mr. Henderson suggested that a portion of the increased revenues be allocated "to research and development as to overall demand for public transportation, and possible methods to improve rider acceptance thereof." We believe this to be an excellent suggestion and will adopt it in our order.

In this connection, the Commission takes especial note of the projected cash flow of applicant for the rate period, as presented in staff Exhibit #S-9, showing a net cash inflow of some \$340,000, "available for improving working capital position, new equipment, etc." (Exhibit #S-9).

Upon the evidence adduced, the Commission further finds and concludes:

1. That the present fares of applicant are unjust and unreasonable, and will not generate sufficient revenues to maintain applicant in a sound financial condition, and consequently, will not enable applicant to render adequate and satisfactory service to the public in the future.

2. That the fares proposed by applicant are just and reasonable and are not unduly preferential or unduly discriminatory either between riders or sections of the Metropolitan District.

3. That the fares authorized by this Order (together with those now to be authorized by the Virginia State Corporation Commission) will produce sufficient net earnings to allow applicant to service its debt, pay reasonable dividends, retain a reasonable amount of earnings in its business, and will enable applicant to render proper, adequate and satisfactory service to the public.

THEREFORE, IT IS ORDERED:

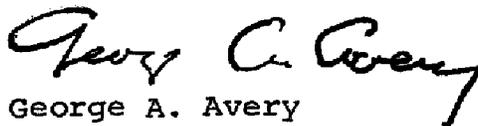
1. That, effective 5:00 A.M., April 16, 1967, A. B. & W. Transit Company be, and it is hereby, authorized to establish the rates of fare as shown in proposed Supplement No. 5 to WMATC Tariff No. 5, proposed Supplement No. 5 to WMATC Tariff No. 2, and proposed WMATC Tariff No. 23.

2. That applicant file with this Commission, forthwith, appropriate tariffs pursuant to the authority herein granted.

3. That applicant post in all of its buses, forthwith, appropriate notices indicating all such fare changes pursuant to the authority herein granted.

4. That applicant undertake an active program of research and development, hiring the necessary personnel and engaging the necessary equipment, to revise its schedules, its routes, and its standard of service so that riding on this carrier is an attractive choice for its patrons and for the residents and workers in its service area. Applicant is further ordered to report to the staff of the Commission as to details of its work in this matter and as to progress being made, within sixty (60) days of the date of issuance of this Order.

BY ORDER OF THE COMMISSION:



George A. Avery  
Commissioner