WASHINGTON METROPOLITAN AREA TRANSIT COMMISSION

WASHINGTON, D. C.

ORDER NO. 880

IN THE MATTER OF: Served October 18, 1968

Application of D. C. Transit System, Inc., for Authority to Increase Fares.	)	Application No. 505 Docket No. 186

APPEARANCES:

HARVEY M. SPEAR, LEON SPOLIANSKY, and SAMUEL LANGERMAN, Attorneys for D. C. Transit System, Inc., applicant.

JOHN W. KARR, Attorney for D. C. Democratic Central Committee, protestant.

PAUL R. WEBBER III, Attorney for D. C. City-Wide Consumer Council; Northwest United Community Corporation Organization; Concerned Citizens of Congress Heights, A Chase, Inc. affiliate; and the Welfare Alliance of the District of Columbia, protestants.

ALFRED S. TRASK, for the Federation of Citizens Association of the District of Columbia, protestant.

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

BEFORE GEORGE A. AVERY, CHAIRMAN, WILLIAM O. DOUB, VICE CHAIRMAN, AND H. LESTER HOOKER, COMMISSIONER.

I

THE PROCEDURAL BACKGROUND

On July 17, 1968, D. C. Transit System, Inc., ("Transit") filed an application seeking authority to increase certain of its fares for the transportation of passengers within the District of Columbia and Maryland, and between points in those two areas.

Transit's application, accompanied by appropriate tariffs, testimony, and exhibits requests authority to establish the following fares:

1. Cash fare of 30¢ for regular route service within the District of Columbia (presently 27¢ cash).

2. Four tokens for $1.20 for regular route service within the District of Columbia (presently 4 for $1.00).

3. Cash fare of 65¢ for the Capitol Hill Express (presently 60¢).

4. Interline ticket plus 10¢ cash (presently a ticket plus 5¢).

5. Maryland - D. C. Interstate fares:

(a) Local: a 5¢ increase in zones 4 through 12.

(b) Express: a 5¢ increase in first stop only.

6. Maryland intrastate local service: 30¢ cash fare for first two zones (presently 27¢ cash). A 5¢ increase in zone three.

7. Cash fare of 75¢ for stadium special service (presently 60¢ cash).

On August 15, 1968, Order No. 854 was issued in which the Commission suspended the proposed tariffs until October 1, 1968, pending investigation and hearing, and deferred the use of the fares stated in the tariffs until decision herein.

Notice of the proposed fares and hearing thereon was given in accordance with the Commission's Rules and Regulations. Hearings began on August 26, 1968. Three formal parties were admitted to the proceeding, and the Commission received 23 letters in opposition to the fare proposals. One evening session was held to afford interested persons, other than formal parties, an opportunity to express their views. Thirty-three persons made statements for themselves or on behalf of organizations. These statements comprise 950 pages of transcript.

Four sessions of formal hearing were held, concluding on September 13, 1968. The record comprises 32 exhibits and a transcript of testimony and argument of 1,025 pages.

Transit proffered the testimony of its Senior Vice President, J. Godfrey Butler; its Vice President and Comptroller, Samuel O. Hatfield; Mr. John F. Curtin of Simpson and Curtin, independent consultants; and Mr. Robert R. Nathan, of Robert R. Nathan Associates, consulting economists.

The Commission's Staff presented the testimony of Mr. Charles W. Overhouse, Chief Engineer; Mr. Richard Kirtley, Senior Accountant; and Mr. David A. Kosh of Kosh-Glassman Associates, an independent rate of return consultant.

Protestants D. C. Democratic Central Committee and the City-Wide Consumer Council, et al., coalition jointly presented the testimony of Mrs. Rochelle Huckaby, corresponding secretary of the Council, and Mr. Phillip D. Patterson, Jr., research associate with the Washington Center for Metropolitan Studies.

On September 30, 1968, Order No. 876 was issued further suspending the tariffs until October 14, 1968.

II

BROAD ISSUES RAISED IN THIS PROCEEDING

Before discussing the specific factual issues before us in this proceeding, we wish to address ourselves to certain broad and vexing questions which are of concern to us and to all of those in the community who are involved in any way with the mass transit system and its problems.

The Commission, by this Order, authorizes increases in D. C. Transit's fares. As will be discussed in detail, both the facts and the law fully justify this action. Indeed, for the first time in our experience, the formal parties (i.e., the company, the Commission Staff and the three protestants) are all in substantial agreement on the revenue and expense projections. These projections show beyond question that under the present fare structure, the company will not receive sufficient revenues during the year ending July 31,1969,to pay the operating expenses and interest charges which it will incur. These facts, and the legal standards which we must apply to them, provide an ample basis for our action.

We begin with these introductory remarks, however, because we are deeply concerned with the broader economic and social implications of the action we take. We are greatly concerned about the impact of this fare increase upon already acute social problems in this community. First, we are concerned about its counter-productive impact upon the entire urban transportation problem. It is axiomatic by now that the burden imposed upon our cities by the automotive age cannot be dealt with effectively unless we maximize the usage of mass transit facilities. However, the undoubted impact of increasing fares is to reduce the number of persons riding buses, driving them to other means of transportation -- in most cases, to the automobile. Second, it is beyond question that those most dependent upon public transportation are the low income groups. Increasing bus fares thus poses an additional burden on an already overburdened economic strata.

We fully recognize those consequences of our present action, and we deplore those consequences. We take this opportunity to discuss the reasons which bring them about and the actions which should be taken to dispel them. Finally, while recognizing the undesirable aspects of our present action, we shall address ourselves to certain misconceptions which have been aired on the subject before us in the hope that, by identifying the real problems, effective action can be taken to deal with them.

We point out here, as we did in Order No. 773, that the basic reason for this present rise in the fares is the increase in the cost of operating the bus system. In Order No. 773, we found that D. C. Transit's labor costs would rise by $1,571,657 in the year following issuance of our order. That finding was based upon the facts as known to us when we entered our order. Increases in the cost of living index call for certain wage increases under the company's union contract. The size of cost of living index increases after our order was entered actually caused labor expenses to increase by 4¢ per hour on 4/28/68; another 6¢ per hour on 6/30/68; and 6-1/2¢ per hour on 9/29/68 for the period projected by Order No. 773, ending

10/31/68. This occasioned an increase in wages of $268,521 more than we had allowed in Order No. 773. Now, projecting ahead for the twelve months ending July 31, 1969, we find that there will be an increase in labor expense of $2,376,919 over the historical year, before giving effect to an increase of 6-1/2¢ per hour on 9/27/68. In addition, our revenue projections in Order No. 773 were based in part upon an assumption of an increasing trend in ridership -- a trend which has not in fact developed.

These facts reveal the nature of the problem we face. The company's cost of operation is steadily pressing upward, principally due to increases in labor expense. These increased expenses must be met, and essentially the only source of revenue to meet them is the farebox. These facts are pushing fares to levels which produce socially undesirable consequences and impose social costs upon the entire community.

~~A more rational means of dealing with this problem of~~ increasing costs must be found. One means is readily apparent and we will do our utmost to achieve its accomplishment. Simply, it must be recognized that it is unwise public policy to impose the entire cost burden of the mass transportation system upon the users of the system. Rather, some portion of that cost should be borne by the community at large which unquestionably benefits from the existence of the system whether any given individual uses it or not. The network provided by the public transportation system is so inherently essential to the economic and social life of the entire community that all should share in its cost. Particularly, the system benefits the automobile user, who would find traffic conditions intolerable without the load assumed by public transportation. It is perhaps wise policy to impose the cost of the public transportation system entirely upon its users when that can be done at fare levels consistent with maximum utilization of the system. But when the cost becomes so high that fare increases drive substantial numbers of riders from the system and adversely affect its maximum utilization, then the wise course of policy is to shift at least a portion of the cost burden to those others who benefit from the existence of the system but contribute nothing to its cost.

We feel strongly that this point has come with D. C. Transit, and we call upon the community and its leaders to seek the necessary legislative changes to relieve the transit rider of a portion of the cost burden. Specifically, we suggest legislation which will peg the transit fare at a socially desirable level and provide the remaining revenue necessary to support the system out of public funds. This revenue could be provided from general tax sources or a special levy could be created. For instance, a tax on parking fees would raise the needed revenues from motorists who benefit from the transit system whether they use it or not. In an effort to obtain the necessary action, we are writing to appropriate officials of the District of Columbia Government, and of the Congress, asking that the requisite legislation be enacted.

Many erroneous allegations and misconceptions have been aired in our hearings and in public discussions of this application and it would be well to discuss some of them so that the record is clear. First, it cannot be emphasized strongly enough that our present action is based upon a showing -- an essentially undisputed showing -- that the company's operating expenses, principally labor, will increase substantially in the coming year. The amount of profit we project is essentially the same as that we have allowed in the previous two rate cases. It is worth noting, in passing, that through circumstances beyond the control of this Commission or the company, in the calendar year 1967, and in 1968 to date, the company has not earned any profit, much less the amount we have allowed for in our rate case projections. We do not point this out with pride, but simply to emphasize that this fare increase, like past fare increases, is not granted so that the company owners will obtain more profit than in the past. Rather, it is granted to cover increased operating expenses.

Nor is this fare increase granted to make up the losses incurred by the company this year due to the civil disturbance, the Poor People's Campaign, the work stoppage over driver robberies, and other adverse factors which have occurred in the past. There is no doubt that these losses have occurred and have been substantial. The unaudited monthly reports indicate an operating loss in the first seven months of this year of $129,211.03. In addition, interest payments totalling $753,440.55 in the same period were not recovered from revenues, making a total loss of $882,651.58 . However, those losses are behind us and, under the "water over the dam" theory, they cannot be made up. A brief explanation of the rate-making equation should make it clear they play no part in the present increase. The company's revenue requirements are computed by starting with actual figures for a historical year -- in this case, the twelve months ending April 30, 1968. However, the actual figures for April, 1968 have been adjusted to eliminate the impact thereon of the civil disturbance. The revenue and expense figures for April, 1967, an essentially normal month, were substituted for those of April, 1968. Thus, the basic revenue and expense figures from which we start reflect nothing of the adverse events which begin in April, 1968.

These historical year figures were then adjusted to create projected revenue and expense figures for the twelve months ending July 31, 1969. The revenue projections were based on the assumption that the trend of ridership experienced in the adjusted historical year would remain level, the only adverse factor being a resistance factor for the proposed increase. Thus, the actual loss in ridership during the past spring and summer plays no part in the projected revenue results. Similarly, the increases in expenses projected for the future annual period are only those normally expected in due course ~~and are not affected by the adverse events recently experienced~~ by the company. It is these figures which demonstrate that present fares will not produce adequate revenues during the future annual period and this conclusion is in no way based on the company's losses during the months since April, 1968.

We have seen, therefore, that the present increase is granted, not to allow more profit than we have permitted in the past, nor to make up for losses already suffered, but to cover substantial increases in expenses which will occur in the future.

It would perhaps be well to face directly at this point the image which was expressed by some of those most vehemently opposed to a fare increase. That image briefly was this: the present fare increase is simply a continuation of the company's effort to exploit its customers; it was approved by the Commission from the very outset of the proceeding because we are not diligent in our protection of the public. It need hardly be said that this view of our action is not one with which we can agree. We should, however, address the issues it raises directly.

The contention that D. C. Transit riders have been, and are being, "exploited" must be taken to mean that they are paying fares significantly higher than would otherwise be necessary, simply to pay exorbitant profits to the company's owners.

The facts simply do not bear out this point of view. Taking, first, the profit element we would allow in this Order, except for certain developments we discuss, it would provide approximately $746,682 for the company's owners. (The total return allowed is $2,092,682, of which $1,346,000 will be paid out in interest on debt, principally debt incurred for new bus purchases.) The total annual revenues which would be necessary to cover operating expenses, debt service and return on equity would be $40,079,851. Thus, the $746,682 return to the company's owners would be only 1.9% of total revenues. Putting this another way, if all profit were eliminated and the company operated on a straight break-even basis, the amount of revenues needed by the company would be reduced by only 1.9%. Applying this percentage to the typical fare of 25¢, we see that the amount included in that fare to cover the profit element is less than one cent.

A similar analysis can be made of the historical record of the company. From August 15, 1956, when the present owners took control, until April 30, 1968, the bus riding public has provided the company with a total of $353,506,280 in gross operating revenues. From those revenues, a total of $341,110,432 has been incurred in operating revenue deductions. Thus, the amount which has flowed through to the company's owners totals $12,395,848. From this amount, however, $7,738,174 has been paid out in interest on debt, principally debt incurred in the purchase of new buses. The owners have actually received, therefore, a total of $4,657,674. This amounts to 1.32% of the total operating revenues paid in by riders. Thus, if all profit had been eliminated in the company's entire history under its present ownership, the amount of revenue required by the company would have been reduced by only 1.32%. Again, applying this percentage to a typical fare, the amount of such fare required to provide a profit to the owners has been less than one cent.

In light of these facts it simply cannot be fairly said that the company has been permitted to "exploit" its riders by charging inflated fares in order to provide its owners with profits. Nor can it be said that we permit such "exploitation" in the present Order.

We might note, at this point, that our decision in this case is based entirely on the facts of record as developed at the hearing. The charge was made that we had made up our minds on the issues prior to the hearings. It would be well to set the record straight on that point. Under the Compact, the company initiates a rate case by filing a proposed tariff with the Commission. The tariff automatically goes into effect thirty days after filing unless the Commission takes action to suspend it. Thus, the law itself requires us to make a preliminary assessment of the financial situation facing the company. In the present case, we reviewed the material supplied by the company with its application, as well as other financial data available to us, and concluded that we should indeed suspend the proposed tariff and hold a hearing. However, our preliminary review of the data presented to us also indicated that, if the facts as initially presented were eventually borne out, the company faced a serious financial situation. For this reason, we determined to schedule the hearings on a more expedited basis than had been our practice in the past. In so doing, we made it clear that our final determination would be based upon the facts elicited on the record at the hearings. It was our announcement of the expedited hearing and the reason therefor which formed the basis for the charge that we had already determined the issues in the case. In fact, we had simply made the preliminary analysis we are required by the Compact to make and announced the results of that analysis. We then considered the evidence presented at the hearing without pre-formed judgments on the facts.

While discussing allegations about D. C. Transit's fares, it might be useful to examine two other propositions often urged. First, it has been stated that fares have climbed at a rapid rate out of proportion to need. Let us look at this claim. Today, the basic fare is 25¢, if tokens are purchased in multiples of four. This is the fare paid by about two-thirds of D. C. Transit's riders.1/ The 25¢ fare has been a basic element of D. C. Transit's fare structure since 1960, i.e., for about 8-1/2 years. For most of that time, this was the fare paid by at least about 1/3 of D. C. Transit's riders. Thus, a substantial proportion of the fares collected by D. C. Transit has been unchanged for over 8-1/2 years. For those who have consistently chosen to pay the lowest fare available, there has been a 5¢ increase in fares in the past 8-1/2 years.

1/ With the advent of the Exact Fare Requirement on a 24-hour basis effective August 4, 1968, more passengers shifted to the cash fares. The week ended September 14, 1968, the latest data available, showed 50.8% of D. C. local riders paid cash fares rather than token.

There are 21 cities2/ in the United States, including Washington, D. C., with a population of 500,000 or more (1960 Census). In 13 of these 21 cities, the lowest basic fare available has increased by at least 5¢ since 1960.3/ In all but one4/ of the remaining eight cities, there have been increases in fares, ranging from a 2¢ increase5/ to an increase of 3.75¢ in the fare <u>plus</u> the imposition of a 5¢ charge for transfers.6/ The cost of living index has increased by 23.1% since 1960.

We regret the fact that there has been any need for an increase in bus fares since 1960, but the size of the increase, when considered in the light of experience in other cities, and in light of the inflationary trend of the last eight years, cannot be considered disproportionate.

It has also been alleged that fares here are already higher than in most similar cities. The facts once again do not bear out this contention. There are presently 15 remaining privately owned companies, other than D. C. Transit, serving Metropolitan areas with population of 500,000 or more. Seven of them have cash fares of 30¢ or 35¢.7/ Five of them have a cash fare of 25¢;8/ but of these five companies, four charge 5¢ for a transfer.9/ There is a

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2/ New York, Chicago, Los Angeles, Philadelphia, Detroit, Baltimore, Houston, Cleveland, Washington, St. Louis, Milwaukee, San Francisco, Boston, Dallas, New Orleans, Pittsburgh, San Antonio, San Diego, Seattle, Buffalo, Cincinnati.

3/ New York, Chicago, Los Angeles, Philadelphia, Detroit, Cleveland, Washington, St. Louis, Milwaukee, San Diego, Seattle, Buffalo, Cincinnati.

4/ San Francisco

5/ Boston and San Antonio

6/ Pittsburgh

7/ Cincinnati, Milwaukee, Houston, Kansas City, Indianapolis, Columbus, Denver.

8/ Baltimore, Buffalo, Philadelphia, Twin Cities, Atlanta.

9/ Baltimore, Buffalo, Philadelphia, Atlanta.

total of seven of these cities in which a ride can be obtained for 25¢, whether due to a straight fare of this amount or the availability of tokens.10/ Four out of these seven cities charge 5¢ for a transfer.11/ The maximum fare within the District of Columbia is presently 27¢, with free transfers. In eleven of the fifteen other companies, the maximum fare within the city exceeds 27¢,12/ and in six out of those eleven, there is also a charge for a transfer.13/ The fare in New Orleans is 10¢, but this operation is conducted by the New Orleans Public Service, Inc., and the losses of the bus operations are subsidized by other services of the company. Only two other companies, both in the New York City area, have a fare lower than 25¢ (i.e., 20¢). Both have zones within their service areas and fares can be as high as 40¢. In light of these facts, it would have to be recognized that the fares which D. C. Transit riders have been paying compare very favorably with fares of other private companies in cities of similar size.

Even a 30¢ cash fare, if that should become necessary at any time, would be the same as, or lower than, the cash fare of seven14/ of the fifteen similarly situated companies. The maximum basic fare within eleven15/ of the fifteen cities discussed above is 30¢ or more. There are eleven similarly situated companies which have available basic fares lower than 30¢16/, but four of these 11 charge 5¢ for transfers.17/

10/ Baltimore, Buffalo, Philadelphia, Milwaukee, Houston Twin Cities, Atlanta.

11/ Baltimore, Buffalo, Philadelphia, Atlanta.

12/ Cincinnati, Philadelphia, Milwaukee, Houston, New York (2 companies), Kansas City, Indianapolis, Columbus, Denver, Atlanta.

13/ Cincinnati, Philadelphia, Kansas City, Indianapolis, Denver, Atlanta.

14/ Cincinnati, Milwaukee, Houston, Kansas City, Indianapolis, Columbus, Denver.

15/ Cincinnati, Philadelphia, Milwaukee, Houston, New York (2 companies), Kansas City, Indianapolis, Columbus, Denver, Atlanta.

16/ Baltimore, Buffalo, Philadelphia, Milwaukee, Houston, New York (2 companies), Twin Cities, Atlanta, Columbus.

17/ Baltimore, Buffalo, Philadelphia, Atlanta.

Even a comparison with a larger universe indicates that present fares are not disproportionate. D. C. Transit Exhibit 13 sets out the fares in the forty-six largest cities in the United States and Canada. This includes systems both publicly and privately owned. The list includes a total of forty-nine operators since some cities have more than one system. Twenty-three of these forty-nine operators have already found it necessary to raise their basic cash fare to 30¢ or higher.18/ There are nine of these twenty-three which offer token fares under 30¢,19/ but four of these nine also charge for transfers.20/ In forty-two out of the forty-six cities, the maximum fare including transfers is 30¢ or higher. In twenty-five out of forty-nine operations listed, the minimum fare, including the right to transfer, is 30¢ or more.21/ In fourteen out of the forty-nine instances listed, i.e., about 1/3 of the total, the bare minimum fare available is 30¢ or more.22/ It is

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18/ Akron, Toledo, Kansas City, Cincinnati, Portland, Los Angeles, Houston, Oklahoma City, Long Beach, Fort Worth, Chicago, Detroit, Cleveland, St. Louis, Pittsburgh, Denver, Indianapolis, Omaha, San Diego, Montreal, Milwaukee, Columbus, Louisville.

19/ Houston, Fort Worth, Detroit, Cleveland, San Diego, Montreal, Milwaukee, Columbus, Louisville.

20/ Fort Worth, Detroit, Cleveland, Louisville.

21/ Akron, Toledo, Kansas City, Cincinnati, Portland, Los Angeles, Oklahoma City, Long Beach, Chicago, Detroit, Cleveland, St. Louis, Pittsburgh, Denver, Indianapolis, Omaha, Louisville, Philadelphia, Atlanta, Phoenix, Memphis, Birmingham, Baltimore, Buffalo, Newark.

22/ Akron, Toledo, Kansas City, Cincinnati, Portland, Los Angeles, Oklahoma City, Long Beach, Chicago, St. Louis, Pittsburgh, Denver, Indianapolis, Omaha.

clear, therefore, that there is a well-established upward trend in fares which has already led a substantial number of the larger cities in the United States to establish higher fares than now exist in the District of Columbia.

Before leaving this subject, we should emphasize once again that in making these comparisons we are not condoning the necessity of raising fares. We are convinced that doing so is counter-productive to sound transportation planning and imposes social costs which are intensely undesirable. We re-affirm our intention to seek those changes in the law which will open the way to avoiding these undesirable results by bringing fares back to lower levels.

Returning to our central theme, our ruling on the need for additional revenues is based upon the increase in operating expenses which will occur in the future annual period. Without additional revenues, the company will suffer further substantial losses. Two further propositions urged in opposition to our action should be discussed. First, it is claimed that the supposed losses are illusory and are the product of manipulation of the company's accounts. This simply is not the fact. We are not naive in our approach to review of the company's books. Our instructions to the staff are to give them a thorough, searching, and continuous review. A significant amount of staff effort is devoted to the task. It absorbs all the time of one accountant, and the great majority of the time of the Commission's three other accountants, including the Chief Accountant. It was testified at this hearing that every expense which is reflected on the company's books is examined by these auditors to ensure that the bus rider is asked to pay nothing other than the costs properly attributable to the operation of buses. These efforts bear fruit since there are expenses of significant amounts which, on the staff's recommendation, are not imposed on the fare paying public. In light of these facts, we cannot accept unsupported general allegations that accounts have been manipulated to produce an illusory loss.

The second proposition contends that the additional revenues required by the company can be produced simply by lowering the fares. This will, it is said, produce sufficient additional riders to raise revenues up to the required levels. We fervently wish that the solution were this simple. If we thought it were, we would adopt it without hesitation. Unfortunately, however, there is not a shred of evidence or theoretical support for the conclusion that this solution would work.

Indeed, when the factual implications of adopting this approach are considered, some startling conclusions are reached. Our analysis of the financial data in this case indicates that at its present level of operations, the company requires a total of $40,000,000 in revenues. With a 30¢ fare in the District of Columbia, the company could expect 99,551,000 D. C. riders annually, producing $29,865,000 of the total revenue required. To obtain that same $29,865,000 with a 20¢ fare, it would be necessary to have 149,325,000 D. C. riders. This is 50% more riders than would be needed at a 30¢ fare and would be an increase of 44 % over existing D. C. ridership. This would be an enormous increase, of course, but it is not the end of the story. It would be unrealistic in the extreme to assume that ridership could increase 44% without some increase in cost. On the conservative assumption that a 44% increase in ridership would increase costs by only 22%,23/ an additional $8,357,177 in expenses would be incurred. To meet these expenses, an additional 41,785,885 riders at 20¢ each would be required. This is an additional 28 % increase in ridership that would be necessary. An increase of this magnitude would also lead to increased expenses and the cycle would have to be repeated again. According to our computations, the company would not meet its expenses and earn a fair return at a 20¢ fare unless it had a total of 191,110,885 D. C. riders paying that fare. This would require an increase of 85% over existing ridership levels! There is not the slightest shred of support for thinking that such price elasticity exists.

Indeed, studies of the problem indicate just how unrealistic it would be to expect any such results. A study was done in Chicago in an effort to determine just what kinds of fare reductions would be necessary to induce automobile users to switch to public transit. The conclusion reached was that, even to

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23/ This is truly a conservative estimate since a substantial portion of any overall increase of this magnitude would inevitably occur during the period of peak demand, when the incremental cost of adding new riders is very high.

achieve an increase in transit ridership as little as 33%, the amount of "price" differential which would be required to induce auto users to make this switch would exceed current transit fare levels. In other words, this study found that to achieve a 30% increase in ridership through diversions from auto use it would actually be necessary to pay automobile users to make the switch. See Moses, "Economics of Consumer Choice in Urban Transportation", *Proceedings - The Dynamics of Urban Transportation* (Automobile Manufacturers Association, 1962). While we need not give full acceptance to that startling conclusion to support our point, it certainly casts a considerable cloud over the proposition that a 5¢ decrease in fares would increase ridership 100%.

We do know the degree of price elasticity which prevails in the case of fare *increases*. There is a loss of .25% of riders for each 1% increase in fares. This is a relatively inelastic demand. If this same elasticity factor applies to rate decreases, the dimensions of the problem are apparent. Assume the company requires revenues of $30,000,000 from D. C. riders. It presently has 100,000,000 such riders. At a 25¢ fare, they would produce a total of $25,000,000. A reduction in fare to 20¢ would be a 20% reduction. Apply the .25% factor for each 1% decrease in fare, a 5% increase in ridership would result. Thus, we would have 105,000,000 D. C. riders at 20¢ each, producing total revenue of $21,000,000, $4,000,000 less revenue than at the 25¢ fare. Thus, if the same elasticity of demand applies to decreases as undeniably exists for increases, a fare reduction simply cannot solve the problem. To justify the fare reduction approach to the revenue problem, we would have to be able to say that in the case of fare *decreases* there would be an increase in riders of almost 5% for each 1% decrease in fares. A disparity of this magnitude between elasticity in response to price decreases and elasticity to price increases cannot reasonably be expected.

In any event, competition between mass transit and other forms of urban transportation (principally the automobile) does not appear to be based on price considerations. It is already more expensive in most cases to use one's car than to take public transportation. The motivating factors appear to be comfort, convenience, and time consumed. See, *e.g.*, Garfield & Lovejoy, *Public Utility Economics*, 241-42 (1st Ed. 1964). There is little ground for hope that increasing the price differential would have a significant impact.

We have diligently searched the literature of urban transportation economics and we have never found the suggestion that the problem of increasing costs could be solved by the simple means of reducing fares. When this solution was suggested by counsel for a protestant, we asked if he could cite to us any study which supported this theory. He was unable to do so even after we had given him additional time to research the question.

To our great regret, we are unable to conclude that the vexing and difficult problems of spiralling costs of urban transportation can be dealt with by the happy solution of reducing fares. Our task would be much easier and more pleasant if we could only so decide. We must face up to the problems in the cold light of reality, however, and recognize that the additional revenues needed can come only through increases in fares or through shifting a portion of the cost burden off the transit rider and onto the community at large.

This brings up one final point with which we will conclude this introductory discussion -- one other solution to the problem which has been heard in this proceeding, and on other occasions. Again it is a simple one. We should simply refuse to grant an increase and let the company operate at a loss. This is a course we cannot and will not pursue. We cannot pursue it because it would be legally impossible for us to do so. We operate under a specific statutory directive to establish a fare structure which will produce revenues sufficient to cover the company's expenses and provide it with a fair return. Compact, Article XII, § 6(a)(4). Moreover, to force the company to operate at a loss would be to deprive it of its property without due process, a Constitutional violation.24/ It would, in any event, be shortsighted policy. The company's ability to provide an acceptable standard of service, to improve its fleet, and to extend its routes and operations would quickly be destroyed. The story is familiar to anyone acquainted with the history of such commuter services as those provided by the New Haven Railroad. We would not be a party to such a deterioration of quality in this essential community service.

24/ Bluefield Water Works & Improvement Co. v. West Virginia Public Service Commission, 262 U.S. 679, 690 (1923).

With this, we will conclude the general discussion of some of the issues raised by those who expressed general opposition to a rate increase. Additional discussion of issues raised will be found in the following sections of this Order. We hope that this review of the issues brought up at the hearings will help the community to identify the real nature of the urban transportation problem and take effective action to deal with it.

III

PROJECTED FINANCIAL RESULTS

A. Revenues and Expenses - Present Fares

The company chose for its historical year, the twelve months ending April 30, 1968. Two sets of adjustments must be made to these figures. First, the civil disturbance in Washington during early April, 1968, resulted in drastically curtailed service and riding. Using the actual operating results for that month would have distorted the annual figures. Accordingly, the company substituted the revenue and expense figures for the month of April, 1967, for the corresponding 1968 period.

Second, the staff recommended certain adjustments after auditing the company's figures. These adjustments are set out in detail in Staff Exhibit 4, Schedule 2. They have been accepted by both the company and the protestants and they need not be discussed in detail. Accordingly, we find that the company had the following adjusted results during the historical period:

TABLE I

D. C. TRANSIT SYSTEM, INC.
OPERATING STATEMENT FOR 12 MONTHS
ENDED APRIL 30, 1968, AS ADJUSTED
BY WMATC STAFF

1.	Operating revenues:	
2.	Passenger	$33,669,608
3.	Charter bus	2,104,578
4.	Government contracts	125,305
5.	Station and vehicle	156,304
6.	Other	68,411
7.	Total	$36,124,206
8.	Operating revenue deductions:	
9.	Operating expenses	$30,873,624
10.	Taxes, other than income taxes	1,019,928
11.	Income taxes	37,356
12.	Depreciation	2,835,987
13.	Amortization of acquisition adjustment	(194,516)
14.	Total operating revenue deductions	$ 34,572,379
15.	Net operating income	$ 1,551,827
16.	Operating ratio	95.70%
17.	Rate of return on operating revenues	4.30%

These historical year figures provide the basis upon which we can project results for the future annual period. First, we consider the future results which can be expected under the present fare structure during the twelve month period ending July 31, 1969.

The company projected that, under present fares, revenues would increase by $384,124 and expenses would increase by $3,057,815. In this case, unlike the past case decided by Order No. 773, there is little dispute between the parties as to these projected results, essentially because the company accepted in advance all but one of the adjustments recommended by the staff. The only item in dispute is an additional reduction in depreciation in the amount of $61,501. The company is on an annual bus replacement program and claims that it will lose $61,501 on the sale of old buses next year. However, its 1968 acquisitions were not made on the June 1 date as required. Anticipating that the 1968 buses would be purchased in the late summer, that figure was included in the company's future annual period projections. In short, it amounts to a doubling up in one year of this expense item, which we clearly feel to be improper. Accordingly, we will disallow this item.

Finally, there is one special item relating to wage expenses. It has been our consistent practice to project wage expenses for the future annual period on the basis of the facts as they appear as of the date of our decision. See Order No. 656, p. 8 and Order No. 773, pp. 14-15. We refer in this regard specifically to the impact of wage increases brought about by the cost of living index clause in the company's labor contract. Under this clause, the company is required to increase wages on the basis of the level of the official cost of living index on certain fixed dates. On September 26, 1968, the latest index figure was published, and it stood at 123.1.

Under the terms of the labor contract, this fact called for a wage increase of 6-1/2 cents per hour beginning September 29, 1968. This hourly increase will cause a rise in labor expense, including pension increases, during the future annual period, totalling $345,458. In accordance with our past practice of recognizing wage expenses as of the date of our order, we will adjust operating expense projections to recognize this increase.

Thus, the increase in expenses during the future annual period will total $ 3,379,545 .

It is worth noting once again the precise nature of the problem we face. We have just stated that the company's expenses will increase by about $3,400,000 in the future annual period. Approximately $3,250,000 of this increase falls into the category of labor expense. Hourly wages alone will increase by $2,377,000 and other fringe benefits account for the remainder. Here, then, is the crux of the problem -- a substantial increase in the company's labor cost; an increase about which there can be no question; an increase which calls for additional revenue, which, under present law, must be produced almost entirely through the farebox.

We conclude, therefore, that in the future annual period ending July 31, 1969, the company can expect the following results, if there is no change in fares:

TABLE II

INCOME STATEMENT
FUTURE ANNUAL PERIOD
ENDING JULY 31, 1969 AT PRESENT FARES

1.	Operating revenues:		
2.	Passenger		$34,047,169
3.	Charter bus		2,104,578
4.	Government contracts		125,305
5.	Station and vehicle privileges		171,904
6.	Other		68,412
7.	Total		$36,517,368
8.	Operating revenue deductions:		
9.	Operating expense	$34,022,126	
	Add: Effect of new wage rates 9/29/68	345,458	$34,367,584
10.	Taxes, other than income taxes		1,303,702
11.	Income taxes		-
12.	Depreciation		2,475,154
13.	Amortization of acquisition adjustment		(194,516)
14.	Total operating revenue deductions		$37,951,924
15.	Net operating income (Loss)		$(1,434,556)
16.	Operating ratio		103.93%
17.	Rate of return on operating revenues		(3.93)%

It is quite obvious that if the present fare structure is maintained, the company will be operating at a substantial loss. It must be emphasized that $1,434,556 is only the net <u>operating</u> loss. The company must also meet interest payments on debt obligations for the future annual period totalling $1,346,000. Thus, under present fares, the company would lose almost $2,800,000 during the future annual period. It is an inescapable conclusion that the existing fares are unjust and unreasonable, in that they will not produce revenues sufficient to enable the company even to meet its expenses.

We note, at this point, the testimony of Mr. Phillip Patterson, Jr., a research associate with the Washington Center for Metropolitan Studies, who was called by protestants25/. The witness stated that the thrust of his testimony went to the concept of "an optimal transportation system for the entire D. C. area." However, his testimony called for several measures. First, that the community should subsidize the transit operation. Our own strong views on the need for the subsidy are spelled out elsewhere in this opinion.

Second, Transit had failed to give recognition to savings which would emanate from the reduction in service, made possible by those passengers resisting the fare increase. When pressed as to what specific variable costs he had in mind, he replied that he was not familiar enough with the industry or this particular company to pin-point them precisely. However, he did reveal that he thought maintenance costs could be reduced and that some trips could be eliminated.

25/ Protestants also called Mrs. Huckaby, the recording secretary of one of the protestant groups, and a bus rider. Her comments may be summarized as a critical, but general, commentary upon the caliber of applicant's service, especially in the area of scheduling. This witness felt service should be expanded, coordinated, and better maintained.

Unfortunately, neither is correct. Reducing the level of maintenance will only result in a lessening of the caliber of vehicle on the streets. We are in constant surveillance of transit's maintenance program and are aware of the costs involved therein. Moreover, this particular subject has been explored more than once in hearings before this Commission in prior cases. We feel that Transit's maintenance efforts in the future should be expanded, not restricted. Moreover, the reason for our position is dictated by the demands of the public witnesses who appeared before us in this case. Indeed, as noted above, one of the areas of criticism of Mr. Patterson's co-witness was that the maintenance of the vehicles should be improved not lessened.

As to the second point, fare resistance does not show up in one particular trip or even one particular line. Such resistance is general in nature and in practically every instance takes place throughout the system rather than on a particular trip or line. In short, we welcome Mr. Patterson's affirmation of our efforts to secure subsidies for the carrier, but must reject his contentions on operating expenses.

Since the existing fares will not produce revenues sufficient to meet the expenses of the company and provide it with a fair return, we must establish a new fare structure. We will first determine what the total revenue requirements will be, and then turn to the fare structure required to produce those revenues.

In Table II, we have determined the amount of expenses to be incurred in the future annual period. To this must be added the amount we should allow as a fair return, plus the appropriate income taxes, if any, on that return.

B. The Return To Be Allowed

We turn, therefore, to a determination of the return to be allowed the company.

Since we have discussed the guiding principles in this area in two recent orders (Nos. 684 and 773), we will not repeat those principles fully here. Generally, however, the return must be one that "enables it to 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, 350 F. 2d 753 at 778 (D.C. Cir. 1965). In making this determination, we must inquire into such matters

> . . . as the capital programs in prospect, what such programs entail in terms of downpayments as well as financing, the cost of borrowing money, working capital needs, the desirable ratio of debt to equity, the incentives required by a stockholder to keep his money in the business and the dividends and growth rates requisite to supply these incentives, the opportunities in these respects provided in comparable businesses, and [the] related matters. . . . D. C. Transit System, Inc. v. WMATC, supra, 350 F 2d at 779.

In the last fare case, concluded just eight months ago, we heard testimony from two witnesses on the subject of rate of return. The company called Mr. John F. Curtin of Simpson and Curtin, a transportation consultant with long and distinguished experience in the field. The staff presented testimony by Mr. David A. Kosh, a utilities expert and rate of return analyst who also brought to us the benefit of a long and distinguished career in the field.

In this case, the company again called Mr. Curtin to present rate of return data. Upon motion by the staff, all parties stipulated that Mr. Kosh's testimony and exhibits, both on direct and on cross-examination, in the last case

(Docket No. 156) was relevant, and should become part of record in this proceeding. That stipulation was accepted by the Commission. We shall begin our consideration of the rate of return problem with a brief description and summary of the testimony of each of those witnesses.

Testimony of John F. Curtin

Mr. Curtin recommended a return of $2,700,000 to Transit. He stated that in arriving at that sum, he was guided by the concept that a fair rate of return requires consideration of the amound needed by Transit to safeguard its service, to attract capital and to provide sufficient income, over and above operating expenses, to insure the financial soundness of the company, after giving due consideration to the inherent differences between this business and others -- other utilities, as well as other industries generally.

He then discussed various factors which he felt distinguished the transit industry from other utilities and from unregulated industries, insofar as its risk attributes and its attractiveness to investors are concerned. He included such factors as automobile competition, labor costs, absence of natural growth, inelasticity of costs, and the absence of labor savings opportunities. He concluded that these factors make the transit industry more risky than other industries, thereby causing transit securities to be more speculative.

Mr. Curtin's data included tabulations showing the operating ratios of (a) public utilities serving the Washington Metropolitan Area, (b) railroads serving the entire country, and (c) a group of nine privately-owned transit systems. The witness testified that Transit is a typical transit utility because its characteristics are quite similar to most other transit companies; the similarity includes trend of patronage, population density, and in the relative degree of use of transit by the community. He emphasized the narrow degree of margin between revenues and expenses of Transit as compared to other utilities, by portraying the operating ratio of D. C. Transit for corresponding years. He emphasized that this comparison illustrates how little margin Transit has to withstand various economic impacts, such as a 5% increase in expenses, in comparison with other utilities.

Much of Mr. Curtin's presentation conformed to his approach in the previous case. For example, he discussed the risks inherent in the transit business from the long-term viewpoint, and discussed the long-term growth of public utilities. He stated that while the company's passenger volume trend had increased in the past few years, the trend broke last year, and the level of patronage actually declined. He contrasted this with what he noted was a strong growth trend existing among other major utilities of the metropolitan area.

The witness once again made a comparative analysis of the quality of public utility bonds and notes, comparing Transit with other utilities. Mr. Curtin also presented a comparative analysis of the company with other transit systems insofar as their basic market characteristics were concerned. He reaffirmed his previous conclusion that Washington is reasonably representative of the major metropolitan areas in this country, both in terms of city and urban population density.

As before, the witness presented a comparative analysis of operating revenues, operating costs, wages and salaries, and miles of service for the company since 1961 updating it through 1967. In arriving at his conclusion, Mr. Curtin commingled what is known as the "comparable earnings" standard and the "attraction of capital" standard. To this end, Mr. Curtin presented the capitalization of various public utility groups in 1967, including electric, gas, telephone, water and transit. He tabulated the comparative price and debt capital among those public utility groups, again in 1967, and then gave his analysis of the tabulation. Correspondingly, he presented a comparison and analysis of the price of equity capital among that same group for the same year. That was followed by a comparison of the price of debt and equity capital among the same group, which was followed by a synopsis of the total return on capital, on a comparable basis for the same groups of utilities. Mr. Curtin concluded from this analysis that whereas the money market was willing to invest in other utilities which return yields between 5.5% and 6.7%, investors in the transit industry required a return of 8.1% on market value of debt and equity securities combined.

In deriving a rate of return, Mr. Curtin used several approaches. The first related to historical cost rate base. The witness selected nine transit companies26/ which he deemed were representative of the industry. In 1967, these companies had an average return on historical rate base of 11.27%; the low was 3.99% and the high was 21.56%. He noted that Transit's proposed fares would earn $2,186,514, or, on an average rate base of $26,730,779, a return of 8.18%, which was less than the rate earned by seven of the nine companies in 1967. His recommended return -- $2,700,000 -- would equate to 10.10%.

He made a similar analysis of the operating ratios of the nine companies over the past eight years. He concluded that Transit has had, between 1960 and 1967, a return on operating revenue much lower than the other companies.

Mr. Curtin studied the earnings, yield, and price-earnings ratios of the common stock of the nine transit companies, as well as of Transit, for 1967. The witness also computed the percentage of bonds and notes to total capitalization, for 1967, of each of the companies; also, he showed the dividend pay-out ratios, 1960-1967. While the average pay-out ratio was 65.1%, Transit's was 37.1%.

Mr. Curtin arrived at his final recommendation in light of three conditions: (1) A rate of return of 9-1/2 to 10% on

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26/ This witness selected the same companies studied by Mr. Kosh.

the fair value of the system. Such a return, he claimed, was warranted by the higher risks prevailing in the transit industry. (2) An operating ratio of 92.0 to 92.5, which was justified by the short-term risk exposure of the company. (3) The debt service requirement of the company.

Mr. Curtin noted that Transit's aggregate outstanding debt on April 30, 1968, was $20,736,164; the weighted average interest rate was 6.06% (previously, 5.95% as of May 31, 1967). He further noted that recent financing was at a 7% rate.

Unlike the last case, the witness did not provide a return on equity capital, although he acknowledged that a return on the book value of equity could be computed. He indicated, however, that return on book value of equity has no significance because, in his opinion, the book value of equity of the company bears no meaningful relationship to the market value of the company. Accordingly, the actual return on <u>market</u> value of equity would be lower than return on book value.

Mr. Curtin summarized his recommended return as fully meeting the return standards laid down by the court of appeals. He stated that it would provide the four essential elements as follows: interest on debt - $1,352,500; dividends on stock - $500,000; down payment on new buses and balance of return on equity as retained earnings - $847,500.

<u>Testimony of David A. Kosh</u>

We have stated, <u>supra</u>, the stipulation of Mr. Kosh's testimony and exhibits into this record. In order to maintain the continuity of this opinion, we shall repeat here our comments from Order No. 773.

Mr. Kosh approached his problem from two points of view -- the classic rate of return on rate base, and the operating ratio. In laying the foundation for his recommendations, Mr. Kosh noted that prices in general were set by the forces of price competition; where businesses vested with the public interest exist without competition, the substitute for competition is regulation. He noted, however, that regulation must make it possible for the utility to compete in the capital markets for the funds it needs. The utility's earnings, both historical and prospective, must be sufficient to maintain existing capital and attract the required additional capital on reasonable terms. Mr. Kosh concluded that the fair return should be identified with the price a utility must pay, that is, the earnings it must hold out to attract capital. He concluded that the basic ingredient of a fair rate of return is the cost of capital. He declared that the cost of capital is determined by considering the pure rate of interest and the compensation for subjecting one's capital to uncertainty, <u>i.e.</u>, the degree of risk.

Mr. Kosh stated that where a company's securities are actively traded, the terms on which it is traded provide evidence of the cost of that particular type of capital to that company; accordingly, the yields of a company's bonds reflect cost of debt, and the earnings/price ratios indicate the cost of equity.

In effect, Mr. Kosh stated that the fair rate of return is basically equal to the cost of capital, and that the cost of capital is determined in the investment markets. Contrary to the position taken by Mr. Curtin, Mr. Kosh declared that the capital structure of a company affects both the cost of debt and the cost of equity.

Since the securities of D. C. Transit are not traded, Mr. Kosh obtained evidence as to the cost of capital to D. C. Transit by relying upon an analysis of a group of transit companies whose securities were traded and, in his opinion, very similar to Transit.

Mr. Kosh then developed his second approach, that is a determination of the operating ratio or revenue margin. He explained that the operating ratio is the ratio of all expenses, including depreciation and all taxes, to revenue. The reciprocal of that ratio equals the margin of return or revenue margin. It is Mr. Kosh's opinion that it is improper to compare the operating ratios of non-transit industries with the transit industry. He noted that the so-called standard utilities require a heavier investment per dollar of revenue than do transit companies. Accordingly, the margin between revenues and expenses is much greater than it is for transit companies. It is the greater variability of earnings, combined with low-profit margin, stated the witness, which makes the revenue margin a matter of much greater import in the transportation utilities than in the standard utilities. Mr. Kosh concluded that the equity holder in transit companies then is much more concerned with the fluctuations in revenue margin than in the return on investment. In seeking to determine the capital requirements of a transit company, then the regulator should seek a relationship for the transit industry against which it could measure the fluctuations in earnings of a given company.

After laying down those general rules, Mr. Kosh attempted to measure the cost of equity in general. He did so by determining earnings/price ratios for a general group of utilities, over an extended period of years. Mr. Kosh stated that an evaluation of earnings/price ratios must be made over an extended period of time during which abnormal short run pressures tend to balance out. In his opinion, the years 1958 to 1966 provided such a period. He noted that because the stock of D. C. Transit was not traded he was unable to determine earnings/price ratios for that company. Therefore, in order to get a base for his estimate of the cost of equity to D. C. Transit, he selected a group of transit companies which he felt were representative of the industry and comparable to D. C. Transit at the same time. He also explained the basis for eliminating certain companies. For example, he stated he had eliminated all holding companies, all interstate long haul companies, and all wholly owned subsidiaries which had no stock traded. He also eliminated companies with a relatively small number of stockholders and also those companies that did not pay dividends during each year of the period 1958 to 1966, inclusive. After selecting nine companies, he developed comparisons among them and with Transit, noting their general operating characteristics, density of population, employees per bus, and revenue passengers per bus per day.

He further presented a summary of his analysis of the nine-company transit group and applicant herein, showing for each its operating ratio, revenue margin, and the standard deviation of the margin (that is, a measure of the scatter or disperson of the individual annual values around the average). Also, he showed the net plant turnover, the rate earned on net plant, the average earnings/price ratio, the dividend payout ratio, the equity ratio, and the ratio of market price of the stock to its book value. Mr. Kosh stated that it was his opinion that the nine companies he selected reflect an investment opportunity similar to that of D. C. Transit, if the companies are considered as a group and not on an individual basis.

Mr. Kosh then made a study to determine to what extent the earnings/price ratios reacted to different degrees of fluctuations in the revenue margin. He did this to test the hypothesis that investors would require a higher return for transit companies whose revenue margins or earnings fluctuated greatly, than for those whose revenue margins were more stable. The test was made by developing an index or measure of variability by establishing a ratio of the standard deviation divided by the average revenue margin. (Exh. 42, pp.7-9.) His test revealed that the computed earnings/price ratio was 12.62%. Having established a 13% return on equity based on the above earnings/price ratio analysis, the witness increased the cost of equity to 15%, based on an additional allowance for the cost of financing and other factors involved in raising equity capital. The witness then developed D. C. Transit's cost of debt, which, based on his analysis, was 5.98% as of December 31, 1966, and which would be increased in 1967. The witness stated that the cost of anticipated new debt would be 7.5%; accordingly, the cost of debt to the company as of December 31, 1967, would average out to 6.32%.

Having derived the cost of debt and the cost of equity, the witness developed two capital structures. The first was the actual capital structure as of December 31, 1966, and the second was a pro forma capital structure as of December 31, 1967. He noted that the actual capital structure as of December 31, 1966, consisted of 87% debt at a cost of 5.98% and 13% common equity, for which he used a cost of 15%. The total cost of capital for the actual period was 7.15%. Using the pro forma capital structure, he established debt at 86% at a cost of 6.32%. He then derived 14% of common equity at a cost of 15%. As a total cost, he computed the figure of 7.54%. These two percentages he stated were the cost of capital. Based on those costs, it was his opinion that a fair rate of return on rate base for the company at this time was 7-3/4%.

Mr. Kosh's approach to forming an opinion as to the proper earnings to be allowed under the operating ratio method was derived through an analysis of the variability or fluctuations of the revenue margin of Transit as well as the group of the nine transit companies previously discussed. Mr. Kosh found that the average margin for the group of transit companies was 4.12%. The standard deviation developed was 1.16%.

A parallel computation for D. C. Transit was derived and showed an average revenue margin for the nine year period of 4.15% with a standard deviation of 1.18%. Mr. Kosh then related that had the company earned a revenue margin of 4.15% (its 1958-1966 average) in 1966, its revenue margin would have been $1,434,000. At the end of 1966, interest requirements were $1,294,000; earnings thereby covered interest 1.1 times, which Mr. Kosh considered barely sufficient.

He noted, however, that there is a 1 in 3 chance that earnings would decline to a 2.97% revenue margin, that is, a deduction by one standard deviation of 1.18%. At this level earnings would clearly be insufficient. Mr. Kosh then recommended that Transit be allowed a revenue margin of one standard deviation above its average, that is a margin of 5.3%. Such a margin, he stated, provides a sufficient safety factor against chance occurrences.

We have, then, Mr. Curtin's recommendation that the proper return for Transit should be $2,700,000 or 6.74% on gross operating revenues and Mr. Kosh's recommendation of 5.33% of gross operating revenues. These are basically the same figures presented to us in the last case. There, we allowed net operating income of $2,024,414 -- and a resulting rate of return on gross operating revenues of 5.34%.

We reached this conclusion in Order No. 773 only after a detailed discussion and analysis of the evidence presented by both Mr. Curtin and Mr. Kosh. See the discussion in Order No. 773 at pp. 44-54. We believe that our analysis is fully applicable to the evidence presently before us. In Mr. Kosh's case, of course, the evidence is identical. Mr. Curtin's theory and approach in the present proceeding are substantially the same as in the last case although the data he uses is, in some instances, different here. Our analysis of the principles involved in Mr. Curtin's testimony is unchanged, however. We believe, therefore, that the return we could allow here would be in the same general range as that we permitted in Order No. 773.27/

We note, in this connection, that the applicant itself asked only for a return of 5.2% in this proceeding. D. C. Transit Exh. 4A.

Accordingly, we would allow a return of about $2,100,000, i.e., a rate of return of 5.2% on gross operating revenues.

In terms of return on rate base, a net operating income of $2,100,000 would represent a return of about 7.85%. The average rate base of the company in the future annual period will be $26,730,779, which is very close to the historical average rate base of $26,307,314, as of April 30, 1968.

The net operating income, as related to Transit's capitalization of $33,577,500 equals 6.25%; net income available to equity holders, after interest, would be 30.93% of equity as of April 30, 1968.

27/ For the ultimate disposition of the return question, see the discussion at pp.44-46, infra.

As is our usual practice, we have considered the return we would allow in light of the criteria spelled out by the court of appeals. From a total return of $2,100,000, interest payments of $1,346,000 would have to be made, leaving $754,000 for the equity holders. We must consider whether this is adequate to "pay dividends sufficient to attract investors, and retain a sufficient surplus to permit it to finance new equipment and generally to provide both the form and substance of financial strength and stability." D. C. Transit System, Inc. v. Washington Metropolitan Area Transit Commission, 350 F. 2d 753 (D. C. Cir. 1965). Again, we are convinced that this standard is met. While dividends could be paid, they would perhaps be at a lower rate than in the past, a fact fully justified in light of the company's more mature position in the community. We would allow a return of 30.93% on book value of equity. We think such return would be amply justified by the company's capital structure and our assessment of the risks it faces.28/ There would certainly be ample opportunity for growth in retained earnings at a rate which will permit the financing of new equipment.

We established in Table II that we must provide for operating revenue deductions other than income taxes totalling $37,951,924. Our analysis of the rate of return question has led to the conclusion that a return of $2,100,000 is justified. This leaves only the question of income taxes to be resolved before we can determine the company's total revenue requirements. The question of income taxes is one at which the company and the Commission staff are at odds. The company projected income tax payments on the full amount of the net income it will receive.

The staff, on Exhibit 5, Schedule 3, develops that for the period January 1 through July 31, 1968, the company will have available for the period beginning August 1, 1968, a net taxable loss carryover of $890,057. This carryover will offset any Federal Income Tax payable by the company up to the $890,057 carryover, and, as the Commission staff witness

28/It is interesting to note that, although we have allowed essentially the same dollar return in each of the last three D.C. Transit cases, the resulting percentage return on equity has differed, being somewhat higher each time. This is because the retained earnings balance has been declining significantly for the last two years due to losses incurred by the company.

testified, is based on the practice of determining income taxes for regulatory purposes which will actually be incurred and paid by the company during the period in accordance with the flow-through concept; consequently, net operating losses incurred must be carried back or forward in accordance with the current Federal Income Tax law which provides for a three year carryback and five year carryover from the loss year. Schedule 3, Exhibit 5, shows that as of December 31, 1967, the company had adjusted taxable income of zero for calendar years 1965, 1966 and 1967 which precludes carryback of any operating losses incurred in 1968 or subsequent years. Thus, all losses commencing with 1968 must be carried forward.

Inasmuch as losses have a cumulative carryover effect for tax purposes, in that a loss in one month is carried as an offset against the profits of the subsequent months, with income taxes being computed on the combined results of both months, the operating tax losses incurred by the company for the first seven months of 1968 will result in an offset to any profits subsequent to July 31, 1968. Since the future annual period commenced August 1, 1968, the tax loss of the seven months ended July 31, 1968, will be available to offset the equivalent amount of profits as they accrue from August 1, 1968, forward into the future annual period.

On this theory, if the company earneda return of approximately $2,100,000 during the future annual period, its income tax expense would be approximately $35,000, wholly for D. C. income tax since no Federal Income Tax would be payable.

Finally, on cross-examination of the staff witness, it was determined that the District of Columbia franchise tax rate increased from 5 percent to 6 percent on January 1, 1968. Staff, in its calculations of income taxes, used the old rate of 5 percent as did the company in its tax computations. On the pro forma operating statement for the future year at fares prescribed by the Commission the new franchise rate of 6 percent has been used to calculate D. C. income taxes.

We can conclude, therefore, that the company's revenue requirements including return on equity would total almost $40,100,000, broken down as follows:

Operating expenses	$34,367,584
Taxes, other than income taxes	1,303,702
Income taxes	35,245
Depreciation	2,475,154
Amortization, acquisition adjust.	(194,516)
Total operating revenue deduct.	$37,987,169
Return Requirement	2,092,682
Total	$40,079,851

When these figures are related to Table II, it appears that additional revenues of some $3,560,000 would have to be generated.

Our consideration of the issues had reached this juncture, and in fact gone beyond to the subject of an appropriate rate structure, when two major developments occurred which must obviously have a major impact upon our deliberations. We refer, first, to the issuance by the court of appeals of two significant decisions on review of prior Commission orders and, second, to the final passage by the Congress of a revised schoolfare subsidy bill. Each of these events has received our careful attention and we must now spell out their effect upon our disposition of the present proceeding.

IV

THE IMPACT OF THE COURT DECISIONS

The two court decisions in question, Williams v. WMATC, D.C. Cir. No. 20,200, (Oct. 8, 1968) and Payne, et al. v. WMATC, D.C. Cir. No. 20,714 (Oct. 8, 1968) are quite lengthy and need not be fully summarized here. Briefly, however, they deal with orders in three previous rate cases decided by this Commission -- Orders 245 and 563 which disposed of the 1963 rate case; Order 564 which disposed of the 1965 rate case; and Orders 656 and 684 which disposed of the 1966 rate case.

The cases covered by those orders have not yet been officially remanded to us. In fact, D. C. Transit has sought a stay of the court's mandate while it seeks certiorari in the United States Supreme Court. However, we feel that the views expressed by the court should be taken into account in our decision here. One option open to us is to take no action in this case between now and December 13, 1968, the date by which we are required to act under Article XII, § 6(a)(2) of the Compact. The substantial losses being suffered by the company daily make that policy unwise. Another option would be to ignore the court opinions until the cases are officially remanded to us and decide this case as though they had never been handed down. We regard the opinions as being entitled to more consideration than that. Finally, there is the option we choose to follow -- to take interim action in this case while we await developments resulting from the court decisions. To understand our interim action, some review of the court opinions is necessary.

In one of the two decisions, handed down by the court sitting en banc, Commission Orders 245, 563 and 564 were set aside on various grounds and the cases in question are to be remanded to us for further action. Specifically, we were directed to supervise the establishment of a riders' fund on the basis of certain adjustments required by the court's decision.

A brief delineation of the issues dealt with by the court is necessary to an understanding of the problems we must now resolve before proceeding to decision in this case.

1. Rate of Return

The court set aside the Commission's determinations of rate of return in both the 1963 and 1965 cases.[29/] The company is required to place in a riders' fund any actual earnings in excess of the return conceded by protestants in those cases to be reasonable.

2. The Acquisition Adjustment Account

The court condoned the principle of changing the period over which the acquisition adjustment is to be amortized but directed that the amortization rate must maintain a reasonable relationship to accruals of depreciation of properties acquired from the predecessor company still remaining in service. Any previously allowed amortization we find to be excessive upon applying the court's standards must be placed in a riders' fund.

3. Depreciation Reserve Deficiency

The court held that any deficiency found to exist in the depreciation reserve may be charged against the ratepayer only to the extent that the company has not already recouped the amounts involved in the form of earnings in excess of a fair return. To the extent that the deficiency is not so recouped it is proper to charge it fully and immediately against the riders' fund. Thus, the previous charge against the riders' fund for this purpose is proper to the extent the deficiency is unrecouped. Any amount improperly charged in the past, however, must be restored to the riders' fund.

29/ As discussed in more detail at p. 39, *infra*., our rate of return determination in the 1966 case was fully upheld by the court in its second decision.

4. Investment Tax Credit

We are directed to reconsider, apart from the fact that Congress enacted § 203(e) of the Internal Revenue Code, whether sound regulatory policy requires "flow through" treatment of the investment tax credit.

This brings us to the court's second decision, reviewing our Orders 656 and 684, in which we disposed of the 1966 rate case. Three principal issues were dealt with:

1. Interim Order

The court affirmed our power to enter an interim order granting rate increases sufficient at least to cover operating expenses and debt service while we give consideration to rate of return problems.

2. Rate of Return

The court affirmed our holding on rate of return, stating that "the Commission's findings and conclusions on the subject of rate of return are adequately supported by the evidence, and. . .the Commission has responsibly exercised its discretion in conformity with the standards enuciated in D. C. Transit System, Inc. v. WMATC." We had allowed a return of $1,900,000 being $1,311,000 for debt service and a 14% return on equity.

3. Rate Structure

The court remanded the case to us so that we could make a cost allocation study which could be taken into account in assessing the validity of the rate structure. The court held that D. C. Transit could properly be granted a rate increase while this study was in progress.

These, then, are the court's holdings in the cases it has indicated it will remand to us. We will be assigned certain tasks on remand and we have already instituted steps to discharge those tasks at the proper time. We must, in addition, determine how those holdings should affect our disposition of this case. It seems to us that the problems raised are those we now discuss.

1. Can we, or should we, grant any rate increase at all in this case in light of the fact that the court's disposition of the 1963 and 1965 cases requires the creation of a riders' fund?

We have carefully considered this question. We do not know at the present time how much will ultimately be placed in the riders' fund. There are many complex questions to be resolved and we are disinclined to dispose of them precipitately. Meanwhile, the evidence in this case, which is practically undisputed, makes it perfectly clear that the revenues being produced by the present fare structure will fall far short of covering operating expenses and debt service in the future annual period, much less provide a profit for the owners. Continued operations in this state of affairs could at some point drive the company to the point where it is simply unable to continue to operate.

We find our answer to this dilemma in one fact. Even if we knew with precision right now the amount to be placed in the riders' fund, we would not consider it wise policy to apply that fund in such a manner as to reduce revenues below the level of operating expenses and debt service. To do so would simply be to invite a deterioration in the quality of service, to impair our ability to require service improvements, and to precipitate an eventual transportation crisis with unjustifiable hardship for the riding public. We are saying, in other words, that the wisest use of the riders' fund is to eliminate return to the equity holders until such time as full restitution is made of the amounts which the court has held were improperly obtained from the riding public.

This being so, it is entirely consistent with the court's decision to issue an interim decision in this case which makes those changes in the rate structure which are necessary in order to produce revenues sufficient to cover operating expenses and debt service while we consider what further action is required in light of the court opinions.

Indeed, the court's approval of our interim Order No. 656 in the second court decision lends support to our view of this problem. The court has clearly expressed its own concern with the deleterious consequences of forcing the company to operate at a loss and has recognized our power to deal with the problem on an interim basis. Thus there would be no conflict with the court's holdings in an order which merely covered the company's operating expenses and debt service while we consider in detail the issues raised on remand.

2. What effect must be given in <u>this</u> proceeding to the accounting adjustments held to be necessary in the court's disposition of the 1963 and 1965 cases?

Let us consider these adjustments one by one. First, there is the question of the proper treatment of the investment tax credit. That issue need not be disposed of prior to an interim disposition of this case since we are making no allowance for Federal income tax expense in this case. Thus, the investment tax credit can have no impact. Second, there is the depreciation reserve deficiency. The court has held that if there is in fact a deficiency properly chargeable to the riding public, it can properly be charged fully and immediately against the riders' fund. Hence, resolution of that question can have no impact on this case other than through the riders' fund, the significance of which we have discussed above.

Finally, there is the question of the proper amount of amortization of the acquisition adjustment account. This adjustment is one which requires some resolution before we issue a decision in this case because we must decide upon the proper amount to be amortized in the future annual period in computing the company's present revenue requirements. Prior to issuance of the court opinion, we had fixed the amortization amount for the future annual period at $194,516, in accordance with the methodology now found by the court to be faulty. The court has now directed that the amount to be allowed annually must maintain a reasonable relationship to retirements of properties acquired from Capital Transit, the predecessor company. At our direction, the staff has already embarked upon a study of actual retirements in an effort to establish the amount which should have been amortized to date in accordance with the principle laid down by the court. That study is not yet complete.

Meanwhile, we do have before us the staff's 1964 study of property retirements which could be expected over the years. The court referred to this study with some approbation in its opinion. Williams v. WMATC, slip opinion, p. 47, n. 150. We have consulted that study to ascertain the retirements that the staff then projected for what is now, in this case, the future annual period. We find that the staff projected that 7.8% of the properties in question would be retired during each of the years 1968 and 1969. Applying this percentage to the balance in the acquisition adjustment account at January 1, 1964, we find that the staff's 1964 methodology would lead to the conclusion that the proper amortization amount in this case is $190,068, a figure within a few thousand dollars of the amount we would allow applying the old technique overturned by the court. This is coincidence, of course, but it is helpful in determining our present course of action.

We take note of the court's direction that any amounts heretofore charged against the acquisition adjustment account ~~which are now found to be excessive are to be placed in the~~ riders' fund. We further note that the evidence presently available to us indicates that allowance of an amount in this case which has a reasonable relationship to pertinent property retirements would produce a figure very close to that which we would allow under our old methodology. In light of both these facts, we believe the appropriate course of action is to use an amortization of $194,516, the figure we would have used prior to the court decision. When our prior decisions are before us on remand, we will obtain detailed evidence on actual retirements from January 1, 1964 to date, as well as up-to-date projections of retirements for future years. We will then make whatever adjustments are necessary in light of amortization we have previously allowed by charges to the riders' fund. When those charges to the riders' fund are made, we will also reflect whatever adjustments are necessary as a result of the amortization figure we use here.

It appears, therefore, that, of the three adjustments ordered by the court, only one requires any action in this proceeding. That one item can be handled in a manner entirely consistent with the court's decision while the detailed disposition on remand is being worked out. Hence, the adjustments ordered by the court do not preclude action on the pending case now.

3. Can we, or should we, take any action on rates in light of the necessity for a cost allocation study as directed by the court?

The court of appeals has directed that one of the bases for establishing a just, reasonable, and non-discriminatory rate structure should be a cost allocation study and we are directed to undertake such a study. We have already directed the staff to start work on it and to engage the services of independent experts as needed. We will be issuing shortly an order instituting a formal proceeding in which this problem will be treated fully and exhaustively. The question which arises is whether we can or should make any fare adjustments while that study is in progress. The court has already given us a clear and unequivocal answer to this question. Having directed that the study be made the court said:

> [W]e do not view our holding in this regard as requiring that the rate increases ordered by the Commission be rescinded, and <u>we leave the matter of any immediate fare adjustments to the Commission's discretion</u>. . . . [W]e think the Commission, balancing the possibility of unfairness to particular customers or classes of customers against the company's immediate need for increased revenues, might have <u>deferred consideration of the questions relating to discrimination while granting Transit's request for a fare increase</u>. And we hold that <u>it is within the Commission's discretion to follow that course on remand</u>. <u>Payne</u> v. <u>WMATC</u>, slip opinion, pp. 37-38. [Emphasis supplied]

The court's views on this problem make it perfectly clear that, without denigrating the importance of the cost study, a clear showing of need lays the foundation for fare adjustments on an interim basis prior to completion of the cost study. We find that the financial situation of the company, as spelled out at pp. 17 and 22 of this order does establish a need for action now.

In summary, therefore, consideration of the questions raised by the court decision leads us to the conclusion that we should proceed to a disposition of the present proceeding now.

Nothing in those decisions suggests that we should imperil the company's ability to provide adequate and continuous service, and a rate structure producing revenues which at least cover operating costs and debt service is a prerequisite to avoiding that peril. We do feel that, at least on an interim basis, however, we should not allow for a return on equity until we have a clearer view on the issues to be resolved in the establishment of the riders' fund. Hence, that portion of the revenue requirement as previously determined, supra, p. 34, which represents return on equity should now be eliminated.

We turn next to the school fare subsidy legislation.

V

THE IMPACT OF THE SCHOOLFARE SUBSIDY LEGISLATION

The present fare for school children in the District of Columbia is 10¢. This fare does not, in our judgment, cover the cost of carrying these children. Under present law, we are required to provide the company with a fare structure which produces revenues sufficient to cover all costs and provide a fair return. Thus, the cost deficit arising from the schoolfare was made up by the fares collected from other bus riders. The bus riding public was thereby subsidizing the cost of school transportation. This was a manifestly unfair situation since this cost was the responsibility of the community-at-large and should be borne out of public revenues.

Schoolfare subsidy legislation had existed for several years but because of certain provisions therein, D. C. Transit was unable to qualify for subsidy payments. This Commission took the lead in recent months in urging strongly upon the Congress that this inequity be remedied. Responding to this problem, the Congress has now enacted revised school fare subsidy legislation. Under its terms, D. C. Transit will be entitled to a payment, for each school child carried, of the difference between the schoolfare (presently 10¢) and the lowest adult fare (presently 25¢). This will produce a subsidy of about $1,100,000 annually. The payments will be made monthly, beginning with September, 1968. The United States Senate and United States House of Representatives have already approved appropriation of the necessary funds out of the District of Columbia budget.

In supporting the legislation, we made it clear that the benefits of the subsidy should and would be passed along to the riding public. That is, the revenues forthcoming through the subsidy would not serve simply to increase the profits of the company's owners. Those profits would remain at the level fixed by the Commission. Rather, the subsidy payment would be used to reduce the amount which would otherwise be produced from the farebox. For instance, in the present case, assuming that, absent the subsidy, passenger revenues of $30,000,000 were found to be necessary to cover expenses and provide the return we consider appropriate, the availability of the subsidy makes it possible to establish fares which would produce only $29,000,000. In the Committee reports on the new legislation, and in the floor debates preceding passage, it is crystal clear that it is Congress' intent that we treat the subsidy in this manner. Hence, the amount of increased revenue we had previously found to be necessary, supra, p. 36, must now be reduced by approximately $1,100,000, the amount which is projected to be available through the schoolfare subsidy.[30]

VI

THE APPROPRIATE RATE STRUCTURE

It appears then that the court decisions and the schoolfare subsidy legislation must have a considerable impact upon our present decision. Because of the court decisions and the consequent riders' fund, we must reduce the revenue requirement, at least on an interim basis, by $746,682, the amount we would otherwise have allowed as a return on equity.

30/ For a discussion of impact of this subsidy payment on the appropriate rate structure, see pp. 47 and 48, infra.

The very welcome addition of revenues available through the schoolfare subsidy makes it possible to reduce the need for additional farebox revenues by $1,100,000.

Let us review, therefore, where we now stand. We had previously determined that the company required total revenues in the future annual period of $40,079,851. See p. 36 supra. This figure can now be reduced to $38,233,169, by subtracting $746,682 for return on equity and $1,100,000 for the schoolfare subsidy. We had also previously determined that the present fares would produce total revenues of $36,517,368 in the future annual period. See Table II, p. 21, supra. Thus, it now appears that the company requires additional farebox revenues totalling $1,715,801.

At this point, we should consider the results to be expected at the fares proposed by D. C. Transit. The following table sets out those results, taking into account the adjustments discussed at pp. 17, 19-20, 34-35, supra:

TABLE III

INCOME STATEMENT
FUTURE ANNUAL PERIOD
ENDING JULY 31, 1969 AT FARES PROPOSED BY APPLICANT

		Future Annual Period at Proposed Fares
1.	Operating revenues:	
2.	Passenger	$37,586,068
3.	Charter bus	2,104,578
4.	Government contracts	125,305
5.	Station and vehicle	171,904
6.	Other	68,412
7.	Total	$40,056,267
8.	Operating revenue deductions:	
9.	Operating expenses	$34,367,584
10.	Taxes, other than income taxes	1,303,702
11.	Income taxes	35,245
12.	Depreciation	2,475,154
13.	Amortization of acq. adjustment	(194,516)
14.	Total operating revenue deductions	$37,987,169
15.	Net operating income (or loss)	$ 2,069,098
16.	Operating ratio	94.8%
17.	Rate of return on operating revenues	5.2%

We conclude, therefore, that the fares proposed by applicant are unjust and unreasonable in that they would provide the applicant with revenues in excess of those to which he is presently entitled.

Since the fares proposed by applicant are unjust and unreasonable, we must establish an appropriate rate structure. Because the increases we now find necessary are so drastically below those which were proposed by applicant and which were discussed at the hearings, we feel that it is necessary to reopen the record and hear testimony from the parties on the appropriate changes in the rate structure to produce additional revenues of $1,715,801. The company's present financial position makes it imperative that these further hearings proceed with dispatch and our order will so provide.

To assist the parties, and particularly the company and the Commission staff in preparing acceptable proposals, some general discussion of principles seems useful.

First, our consistent guiding principle in assessing changes in the rate structure has been that the burden of producing needed additional revenue should be spread equitably over all classes of riders. See Order No. 684, pp. 34-40, and Order No. 773, p. 64. The rate structure we adopt here must meet that standard.

Second, the revenues now available to D. C. Transit through the revised schoolfare subsidy legislation must have their impact exclusively upon intra-District fares. The subsidy is based upon bus usage by District school children and the subsidy funds are provided through the D. C. budget, <u>i.e</u>., through the taxes paid by District residents.

The concept that the subsidy would be applied to reduce intra-District fares permeated the Congress' deliberations on the legislation. Perhaps its clearest expression was a statement by Senator Spong, Chairman of the Subcommittee which held hearings on the bill. He said:

> I cannot [address myself] to the subject of the Federal Government and/or the District Government subsidizing the bus operators beyond the confines of the District of Columbia.

Hearings before the Subcommittee on Fiscal Affairs, Committee on the District of Columbia, U.S. Senate, 90th Congress, 2nd Sess., on S. 3672 and H.R. 18248, p. 24.

Similar concern was expressed by members of the House Committee. Mr. Abernethy stated:

> I do not think that we or you would want to have the District subsidizing the transportation costs of Maryland and Virginia riders.

Hearings on H. R. 7802 before Subcommittee No. 3, Committee on the District of Columbia, House of Representatives, 90th Cong., 1st Sess., p. 31.

In establishing a fare structure, therefore, it must be clearly demonstrated that the resulting intra-District fares, and the intra-District fares alone, reflect the impact of the schoolfare subsidy. To accomplish this result, the proposals of the parties should follow a two-step process. First, it should be assumed that additional revenues totalling $2,815,800[31/] must be raised. Adjustments in fares other than intra-District fares which produce an appropriate portion of <u>that</u> total increase should then be established. Only after having thus established the proper amount to be raised from non-intra-District fares, should the question of adjustments to intra-District fares be considered. The intra-District increases should be designed to produce only that amount left to be produced after giving effect to the other increases established without regard to the subsidy payment.[32/]

31/ The actual increase required ($1,715,801) plus the subsidy payment ($1,100,000).

32/ It would be useful, although perhaps not essential, to have an indication as to what intra-District fare adjustments would be necessary in the absence of the subsidy.

VII

SUMMARY

It would be well to review our handling of the other complex problems presented to us in this proceeding. We have reviewed the evidence concerning operating results of the historical year and the operating results which can be expected during the future annual period at present fares and we find that present fares would be unjust and unreasonable in that they would produce insufficient revenues to cover operating expenses and provide a fair return. We have considered the evidence on record concerning a fair return and have concluded that, were it not for the recent court decisions, a return of 5.2% on gross operating revenues would be appropriate. On the basis of this determination, we computed that the company would require total revenues of $40,079,851 during the future annual period, an increase of $3,562,483 over revenues which could be expected under present fares. We then give effect to two recent major events: the Court of Appeals decisions and the schoolfare subsidy legislation. The court decisions led us to conclude that, for at least an interim period, we should reduce the amount of additional revenues required by $746,682, the amount which would otherwise be necessary to provide the return on equity we have found to be appropriate. The schoolfare subsidy legislation has enabled us to further reduce the amount required to be produced through fare increases by $1,100,000, the projected amount of the schoolfare subsidy payment. Thus, we finally conclude that the company now requires additional revenues of $1,715,801. We reject the fares proposed by applicant because they would produce additional revenues far in excess of this amount. Because the amount now required through fare increases is so substantially less than was discussed in the hearing already held, we direct that new fare proposals be prepared and exchanged between the parties and that a further hearing be held thereon on Friday, October 25, 1968. We would expect to issue a further order fixing an appropriate interim rate structure very promptly after that hearing. In considering the rate changes required, the parties have been directed to allocate the full impact of the schoolfare subsidy payment to intra-District fares.

VIII

FINDINGS OF FACT

We have stated our findings of fact on the issues in this proceeding in the foregoing discussion.

IX

CONCLUSIONS OF LAW

The Commission concludes as a matter of law:

1. That the present fare structure of applicant is unjust and unreasonable in that it will not produce sufficient revenues in the future annual period to enable the carrier to meet operating expenses and earn a reasonable return, thus imperiling the company financially.

2. That the issues regarding a riders' fund raised by the opinion of the U. S. Court of Appeals in *Williams v. WMATC*, require that no return on equity be allowed for the time being.

3. That a just and reasonable fare structure on an interim basis would be one which produces gross revenues totalling $38,233,169 in that such revenues would enable the company to cover operating expenses and the cost of debt service.

4. That the fares proposed by applicant would be unjust and unreasonable in that they would produce gross revenues in excess of the amount set forth in paragraph 3 above.

5. That it is necessary to reopen the record and hold further hearings limited to the subject of appropriate adjustments to rates to produce additional revenues of $1,715,801.

THEREFORE, IT IS ORDERED:

1. That this proceeding be, and it is hereby, reopened to receive additional testimony from the formal parties on the subject of appropriate adjustments to existing rates to produce additional passenger revenues of $1,715,801.

2. That any party desiring to present proposed changes in rates in accordance with paragraph 1, above, be, and is hereby, directed to file such proposals with the Commission, and serve them on all other parties by personal service not later than Wednesday, October 23, 1968, at 10:00 A.M.

3. That the hearing on the reopened portion of the proceeding be, and it is hereby, scheduled for Friday, October 25, 1968, at 9:00 A.M. in the Hearing Room of the Commission, 1815 North Fort Myer Drive, Arlington, Virginia.

4. That the tariffs described in Order No. 854 be, and they are hereby, further suspended until November 4, 1968, unless otherwise ordered.

BY DIRECTION OF THE COMMISSION:

George A. Avery

GEORGE A. AVERY
Chairman

AVERY, Chairman, concurring:

I endorse and support all statements and directives set forth in the foregoing opinion. In addition, a further word of guidance on the appropriate rate structure may be helpful. Under the terms of Article VI of the Compact, the ultimate responsibility for intra-District fares rests with the Commission's D. C. representative. In that capacity, I wish to put forth for consideration some ideas on possible changes in intra-District fares to raise that portion of additional fares properly allocable to the District.

It has long been felt by scholars of urban transit rates that charging a higher price for travel during peak hours is not only appropriate but wise. The cost of maintaining a capability of meeting peak demand can justifiably be recognized in pricing the service furnished during the peak demand period. Moreover, by providing for a lower fare when demand is not at its peak, more riding in the off-peak period is encouraged. This tends to lessen the discrepancy between peak and valley, thereby making for a more efficient overall operation. For discussion of the merits of pursuing a pricing policy of this nature, see Garfield & Lovejoy, Public Utility Economics, 240-41 (1st Ed. 1964), and Fitch, "Prices and Costs in Urban Transportation Financing," Proceedings - The Dynamics of Urban Transportation. (Automobile Manufacturers Association, 1962).

I would ask that in considering the changes required in the rate structure to produce the needed revenues, the parties consider the feasibility of applying this principle. I wish to emphasize that in making this suggestion I am not directing that a fare structure to this type be proposed. I am merely suggesting it for consideration. Perhaps this would provide a more desirable rate structure, at least while we undertake the cost study called by the court, than the more traditional approach of simply adjusting all cash and token fares and/or the differential between them. At any rate, consideration of the idea, and an expression of ideas thereon, would be welcome.

DOUB, Commissioner, concurring in part and dissenting in part.

With two exceptions, I am in complete agreement with the conclusions reached by my colleagues in the majority opinion. The first exception relates to the proposed treatment of the $1,100,000 to be received from the District Government as a school subsidy for the transportation of students in the District of Columbia. The second exception is that there is no reason for finding a rate of return for the company at this time.

Under the heading "The Appropriate Rate Structure," the majority opinion requires that the impact of the revenues from the schoolfare subsidy legislation must be exclusively upon intra-District fares. This they justify on two grounds. First, that the subsidy is based upon bus usage by District school children and the subsidy funds are provided through taxes paid by District residents. Secondly, brief quotes from statements made by Senator Spong and Congressman Abernethy during hearings on the subsidy legislation to the effect that they would not want to have the District subsidize the transportation costs of Maryland and Virginia riders.

The economic effect of the majority conclusion on this issue is to have the Maryland portion of the increase computed as if the full increase were $2,815,800, instead of the actual increase of $1,715,800. The District's portion of this overstated revenue requirement will be reduced by $1,100,000, which is the amount of the school subsidy.

Let us now consider what is wrong with this treatment, required by the majority, and represented by them as necessary and desirable.

It is a generally recognized principle that there is no economic justification for a student fare that is lower than an adult fare, because it costs mass transportation companies as much to transport a passenger who is attending school as to handle any other type of passenger. Nor is it reasonable to argue that a student takes less room in a vehicle than those required to pay full fare.

Heretofore, the difference between the student fare and the cost to transport a District student has been subsidized by all of the adult riders on the company's system whether they be District riders or Maryland riders. This has been changed and from here on the difference between the student fare and the cost to transport the District student, is to be subsidized by the District government. This is intended to mean that the difference in cost will no longer be borne by the adult riders of the whole system whether they be Maryland or D. C. riders.

My colleagues ignore the fact that this government subsidy will be completely utilized in meeting the costs for the actual transportation of the school children and propose where Maryland is concerned to use the money twice. They say that the revenues required to be produced from adult District fares should also be reduced, under the new fare structure, by the full amount of the subsidy. This is unconscionable and amounts to Maryland riders continuing a subsidy for the school children while the adult riders in the District siphon off a portion of the school subsidy at the expense of the Maryland rider. It was certainly not the intention of Congress to provide a $1,100,000 subsidy to the adult rider in the District, but that is the effect. Any other conclusion has to completely ignore the result achieved by the majority.

In addition to the error in the treatment of this subsidy, the majority opinion does not recognize its own finding that a cost of service study be made to assure that there is no discrimination in the company's rate structure. This study is being implemented in a separate proceeding. It would seem wise to await the outcome of this analysis of the fare structure before attempting to adjust the District fares on a basis different from that applied to Maryland riders. Without the benefit of this study, the action of the majority amounts to crystal ball gazing at its worst.

I can fully appreciate the economic problems that face a large segment of the population of any metropolis. In sympathy with this, the funds raised by taxation of District residents for partial payment of the transportation costs of school children should under no circumstances be used to benefit Maryland riders. Because the full subsidy plus the contribution of parents through the fare box will meet only the cost of transporting the student there cannot possibly be any benefit to Maryland riders. Therefore, in filing my dissenting opinion, it should be clear that I am not opposed to government assistance in the transportation of school children nor do I seek any share for Maryland. I am opposed, however, to the use of the money twice at the expense of Maryland riders.

With respect to the rate of return of 5.2% on gross operating revenues allowed by the majority in its opinion, I am of the view that it is unnecessary to consider this question at this time. In the majority opinion it is concluded that, at least on an interim basis, there will be no dollar allowance on equity until certain issues are resolved in the establishment of the riders' fund. Later in the opinion, that portion of the revenue requirement which represents return on equity is eliminated. I, of course, am in agreement that there should be no dollar allowance made at this time for return on equity. In view of this, a finding of a percent return is not an issue that need be determined now and amounts only to an exercise in arithmetic. When it becomes necessary in the future to make such a determination, conditions may have so changed as to require a different finding on this question.