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COMMISSION AUTHORIZED

JOHN M. MENDENHALL
 Acting Regional Director

February 17, 1988

The Honorable Frank Sawyer
 Ohio House of Representatives
 State Capitol
 Columbus, Ohio 43215

Dear Representative Sawyer:

The staff of the Federal Trade Commission¹ is pleased to respond to your request for comments on Ohio House Bill 658. This bill, if enacted, would repeal the Public Utilities Commission's authority to set contract carrier motor freight rates. It also would facilitate new entry into the industry while maintaining a standard that all entrants must be "fit, willing and able" to serve the shipping public. Under House Bill 658, highway contract carriers would be allowed to charge any rate they choose, but would be required to maintain safe and solvent operations.

This bill is a significant step toward bringing to consumers the benefits of price competition in Ohio's contract motor freight industry. In addition, by requiring that applicants for operating authority demonstrate familiarity with the Utilities Commission's safety rules, HB 658 directly addresses the issue of safety and serves the state's interest in protecting the health and welfare of its citizens.

¹ These comments represent the views of the Cleveland Regional Office and the Bureaus of Competition, Consumer Protection, and Economics of the Federal Trade Commission, and do not necessarily represent the views of the Commission itself or any individual Commissioner. The Commission has, however, voted to authorize the staff to submit these comments to you.

Our interest in this legislation arises from the Federal Trade Commission's mandate to preserve competition and protect consumers from deceptive and unfair business practices.² During recent years, the Commission's staff has studied the deregulation of trucking and has advocated increased reliance on market forces at both the federal³ and state levels.⁴ Our activities in this area and in matters of competition policy generally have provided us with substantial experience in analyzing the potential competitive consequences of trucking deregulation. While we have not done a specific empirical study on trucking deregulation in Ohio, we are familiar with the literature examining the experience nationally and in other states. The weight of that literature favors what we believe will be the impact of House Bill 658.

I. ARGUMENTS ADVANCED IN SUPPORT OF CONTINUED REGULATION.

Trucking regulation originally was intended to help protect the regulated railroads from competition from the then-unregulated and expanding trucking industry. It also was designed, in part, to support the trucking industry by restricting competition during the depression of the 1930's.⁵ We believe that neither rationale has any validity now.

² See 15 U.S.C. § 41 *et seq.*

³ See Comments of the Federal Trade Commission on Pricing Practices of Motor Common Carriers of Property Since the Motor Carrier Act of 1980, Ex Parte No. Mc-166, Before the Interstate Commerce Commission (Jan. 1983); Supplementary Comments of the Bureau of Competition, Consumer Protection and Economics, Federal Trade Commission on the Exemption of Motor Contract Carriers from Tariff Filing Requirements, Ex Parte No. Mc-165, Before the Interstate Commerce Commission (1983); D. Breen, Bureau of Economics of the Federal Trade Commission, Regulatory Reform and the Trucking Industry: An Evaluation of the Motor Carrier Act of 1980, Submitted to Motor Carrier Ratemaking Study Commission (March 1982).

⁴ See Comments of the Federal Trade Commission Staff to California Sen. Rebecca Morgan, on legislation to repeal the Public Utilities Commission's authority to set contract carrier motor freight rates (Dec. 31, 1987); Comments of the Federal Trade Commission Staff to the Legislative Audit Council of the State of South Carolina on Possible Restrictive or Anticompetitive Practices in South Carolina's Public Service Commission Statutes (Sept. 29, 1987); Statement of the Staff of the Federal Trade Commission on Economic Deregulation of Trucking to House and Senate Transportation Committees, Washington State Legislature (March 7, 1985).

⁵ Nelson, The Changing Economic Case for Surface Transport Regulation, in Perspectives on Federal Transportation Policy (James C. Millier III, ed. 1975).

In our experience those who support continued contract motor carrier regulation usually advance three main arguments: preventing predatory pricing, forestalling destructive competition, and maintaining safety. As discussed below, however, a number of empirical studies have concluded that none of these rationales supports the contention that continued regulation of contract motor carriers is either necessary or desirable.⁷

A. Predatory Pricing.

A primary argument advanced in support of continued regulation is the prevention of predatory pricing. The principal thrust of this argument is that larger, better financed companies will attempt to drive out competitors by selling trucking services below cost. The surviving firms will then raise their prices above the competitive level, eventually recouping their losses and increasing their profits.

One condition necessary for successful predatory pricing is high entry barriers. High entry barriers prevent a return of competitors when the predatory firm raises prices above the competitive level to recoup its losses. We believe that this condition does not exist in the trucking industry today.⁸ Currently, there are no significant regulatory barriers to entry. In addition, because trucks are highly mobile and can be transferred quickly to new markets, physical entry barriers are low. If the predator tried to raise its prices to noncompetitive levels, other firms should enter or re-enter the market, taking business away from the predator and forcing prices back to competitive levels. Because predation is unlikely to be profitable, carriers are not likely to attempt it.

⁶ Contract motor carriers are trucking firms that operate under contract to specific shippers. Contracts can be short term (single trip up to 30 days) or long term (30 days to 12 months). Each contract is negotiated, after which the rates are published.

⁷ These arguments have been discussed and dismissed in a number of studies. See generally Weinstein & Gross, Transportation and Economic Development: The Case for Reform of Trucking Regulation in Texas, Center for Enterprising, Southern Methodist University (Feb. 1987); D. Breen, *supra* note 3.

⁸ J. C. Miller III, Economic Regulation of Trucking, in Report of the Economic Advisory Panel to the National Commission for the Review of Anti-Trust Laws and Procedures (Nov. 9, 1978).

Recently, the General Accounting Office joined the Interstate Commerce Commission, the Motor Carrier Rate-making Study Commission and the Department of Justice in concluding that predation is unlikely to occur as a consequence of trucking deregulation.⁹ In Missouri v. Zenith,¹⁰ the Supreme Court stated that "predatory pricing schemes are rarely tried, and even more rarely successful."¹¹ In any event, firms that attempt to engage in predatory pricing also would be subject to public and private antitrust enforcement actions.

Proponents of regulation have argued that setting up an extensive terminal network, as required in the less-than-truckload (LTL) segment of the industry, is a barrier to entry that raises the attractiveness of predation. An FTC staff study of the impact of the Federal Motor Carrier Act of 1980, however, indicates that competition along routes increased with deregulation as scores of efficient LTL competitors expanded route networks. Examining 248 city-pairs, the study found that "the number of competitors per route increased between 1979 and 1981 for 179 of the 248 major routes" despite the absence of significant *de novo* entry into LTL trucking.¹²

⁹ United States General Accounting Office, Trucking Regulation: Price Competition and Market Structure in the Trucking Industry, 8-10 (Feb. 1987). The positions of the ICC, MCRSC, and DOJ are discussed in the GAO report.

¹⁰ 105 S. Ct. 1348 (1985).

¹¹ *Id.* at 1357-58, citing R. Bork, The Antitrust Paradox, 149-56 (1978); Areeda & Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697, 699 (1975); Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 268 (1981); Koller, The Myth of Predatory Pricing - An Empirical Study, 4 Antitrust L. & Econ. Rev. 105 (1971); McGee, Predatory Price Cutting: The Standard Oil (N.J.) Case, 1 J. L. & Econ. 157 (1958); McGee, Predatory Pricing Revisited, 23 J. L. & Econ. 289, 292-94 (1980).

¹² D. Breen, Market Structure and Competition in Trucking, FTC Staff Working Paper, 21 (Sept. 1984).

B. Destructive Competition.

Proponents of trucking regulation also argue that deregulation will lead to "destructive competition." Destructive competition may occur in industries characterized by declining demand, sunk costs, and a high ratio of fixed to total costs. These conditions are likely to create excess capacity and considerable pressure to cut prices. If price competition occurs, however, prices may persist below the total cost of providing services because the sunk nature of costs makes exit difficult. Firms facing chronic losses may, as a result, try to reduce costs by skimping on service, to the detriment of customers.

Conditions conducive for destructive competition are not likely to exist in the Ohio trucking industry. Fixed costs comprise only a small percentage of total costs, which include such variable costs as labor and fuel expenses. Trucks also are highly mobile assets which may readily and easily be transferred from less profitable to more profitable markets in response to fluctuations in demand, or sold or leased to other operators. Therefore, it is unlikely that destructive competition of this sort will occur.¹³

C. Safety.

Another argument that has been advanced against deregulation is that it will have an adverse effect on safety in the trucking industry, because carriers facing stiff competition will neglect maintenance, delay replacement of vehicles, and overwork drivers. We believe that reduced safety is not a necessary consequence of economic deregulation. In fact, a recent study of truck safety in California, conducted jointly by the California Public Utilities Commission and the California Highway Patrol was "unable to prove the hypothesis that CPUC economic regulation of trucking is significantly and positively linked to improved highway safety."¹⁴

¹³ See A. Kahn III, Economics of Regulation, 178 (1971) in which the author states, "[D]oes trucking have the economic attributes of an industry subject to destructive competition? It would be difficult to find one less qualified."

¹⁴ California Public Utilities Commission & California Highway Patrol, AE 2678 Final Report on Truck Safety, Joint Legislative Report, 5 (Nov. 1987).

The legislature has a legitimate interest in promoting safety on Ohio highways. However, rather than attempting to effect safety indirectly through economic regulation, direct action to address safety issues appears preferable. A direct approach is consistent with HB 658, which mandates that motor carriers demonstrate a familiarity with the Utilities Commission's safety rules, and that those carriers provide financial statements showing that they have the financial capability to maintain safe equipment.

II. BENEFITS OF DEREGULATION.

Evidence of the benefits to consumers and competition produced by trucking deregulation can be gleaned from the experiences of other states. California, for example, experimented with partial economic deregulation of trucking from 1980 to 1986. During that time entry was virtually free, and rates, though regulated, were flexible.¹⁵ The result was lower rates with no loss in service.¹⁶

Experiences of other states also attest to the economic benefits of intrastate trucking deregulation. A study of trucking in New Jersey, for example, concluded that deregulation has worked well in that state.¹⁷ According to a study by W. Bruce Allen, shippers were satisfied with the available service, rates were about ten percent lower than they would have been under regulation, and intrastate carriers have prospered.¹⁸

¹⁵ Carriers were permitted to change rates, after a short waiting period, without having to show the change was cost-justified. There was no waiting period to match a competitor's rate.

¹⁶ M. Simmeron, "Analysis of The Impact of Deregulation of the General Freight Trucking Industry," Investigation No. 84-03-048, California Public Utilities Commission, 20-21 (Aug. 10, 1984) (based upon survey by CPUC of 239 general freight carriers and survey by California State University, Hayward, Institute of Research & Business Development of 559 shippers.)

¹⁷ W. Bruce Allen, S. Lonergon & D. Plane, Examination of the Unregulated Trucking Experience in New Jersey, U.S. Dept. of Transportation (July 1979).

¹⁸ W. Bruce Allen, Statement Before the National Commission for the Review of Anti-Trust Laws and Procedures (January 22, 1979).

Florida shippers and truckers generally thought truckers and shippers had no opportunity to profit from deregulation. According to the study, a year after deregulation 88 percent of shippers, as well as a surprisingly high 45 percent of truckers, supported it. Most shippers thought that service levels remained constant and that rate fluctuations had posed no difficulties. Only a few shippers converted to private carriage; many more such shipper conversions might have been expected if "destructive competition" had resulted in a large reduction in the number of truckers.¹⁹ Likewise, a later Department of Transportation study²⁰ found that 90 percent of Florida shippers believed that post-deregulation service was at least as good as service before deregulation, and 30 percent reported improvements. A majority of these shippers (58 percent) perceived that deregulation had held down rates. Finally, economists Blair, Kaserman, and McClave found that Florida's deregulation of intrastate trucking led to a 15 percent average reduction in motor carrier rates.²¹

The experience of other states is consistent with that of California, New Jersey and Florida. For example, in Wisconsin, 67 percent of shippers were satisfied with deregulation, and only six percent were dissatisfied. Seventy-three percent said that rate information was as readily available after deregulation as before. Carriers were evenly divided on the question of deregulation. Those with increased profits tended to favor deregulation, while some of those opposing deregulation were concerned about the loss of the asset value of their certificates of convenience and necessity.²²

In Maryland, intrastate household goods movers were not regulated. A study conducted in that state in 1973-74 revealed that the formerly regulated interstate household goods carriers charged 27 percent to 67 percent more than unregulated intrastate carriers for comparable moves.²³

¹⁹ Freeman, A Survey of Motor Carrier Deregulation in Florida: One Year's Experience, ICC Practitioners Journal, 51 (Nov.-Dec. 1982).

²⁰ Statement of Matthew V. Scocozza, Assistant Secretary for Policy and International Affairs, U.S. Department of Transportation, Before the Subcommittee on Surface Transportation, U.S. House of Representatives (June 20, 1984).

²¹ Blair, Kaserman & McClave, Motor Carrier Deregulation: The Florida Experiment, 68 Rev. Econ. & Stat. 159 (1986).

²² Wisconsin Office of the Commissioner of Transportation, Deregulation of Wisconsin Motor Carriers (July 1983). There may, however, be other capital losses.

²³ Breen, Regulation and Household Moving Costs, Regulation, 52 (Sept.-Oct., 1978).

Oregon deregulated the shipping of certain building materials in 1981. The results of this action were examined in two separate surveys by the Legislative Research Office of the Oregon Legislature.²⁴ All parties surveyed agreed that deregulation increased the number of carriers in the market. According to one survey, almost all shippers and most of the truckers with prior authority to carry these products believed that trucking rates had decreased. None of the groups surveyed believed that general rate levels had increased as a result of deregulation.

Consumer benefits of the type associated with deregulation at the state level have also been realized at the national level. Under partial federal deregulation, the number of grants of operating authority to carriers quadrupled, implying that entry into the trucking business has been greatly eased.²⁵ There also has been an increase at the national level in the number of independent rate changes, with the vast number of observed changes being rate decreases.²⁶ Between 1977 and 1982, interstate truckload rates fell about 25 percent and LTL rates fell about 12 percent. These declines occurred during a period of rising fuel costs and before the recessions of 1979-80 and 1980-81.²⁷ A recent federal study likewise found that regulated rates are higher than competitive rates for general freight trucking.²⁸

²⁴ Unpublished surveys conducted by the Oregon State Legislature's Legislative Research Office (1984).

²⁵ Office of Policy and Analysis, Interstate Commerce Commission, *The Effect of Regulatory Reform on the Trucking Industry: Structure, Conduct, and Performance* (June 1981). See also Statement of Reese H. Taylor, Jr., Chairman of Interstate Commerce Commission, Before the Surface Transportation Subcommittee of the House Committee on Public Works and Transportation on Implementation of the Motor Carrier Act of 1980 (Nov. 7, 1985).

²⁶ Statement of Reese H. Taylor, Jr., Chairman of Interstate Commerce Commission, Before the Senate Committee on Commerce, Science, and Transportation (Sept. 21, 1983). See also Staff Report, Interstate Commerce Commission, Highlights of Activity in the Property Motor Carrier Industry (March 1985).

²⁷ Moore, Rail and Truck Reform - The Record so Far, Regulation, 39 (Nov/Dec, 1983).

²⁸ Motor Carrier Rate-making Study Commission, Collective Rate-making in the Trucking Industry, (June 1, 1983).

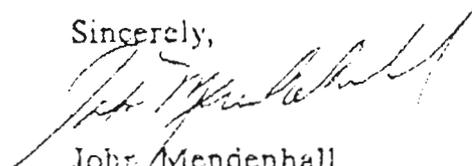
Not only does competition appear to result in service improvements, but competition for other services and efficiencies are likely to be gained as well. According to one authority, shippers who shipped small quantities were forced either to pay exorbitant rates or to seek alternatives to the regulated carriers prior to deregulation.²⁶ With the advent of deregulation, shippers no longer must avoid the inefficiencies of regulated trucking by building up shipping inventories and raw materials, or by investing in their own trucks to assure the service they require. The need for under-utilized private trucking fleets or expensive inventory buildups is reduced when truckers can offer innovative responses to shippers' service needs.

III. CONCLUSION.

A significant body of evidence suggests that deregulation lowers trucking rates and improves service. We believe that HB 658 is an important step in moving to a more competitive motor carrier industry in Ohio. It will result in significant benefits for consumers and competition. Contract trucking firms will be free to add needed service and to compete on rates without waiting long periods of time for Utilities Commission approval. This freedom should improve the competitiveness of Ohio's manufacturing community and result in lower shipping rates.

We appreciate this opportunity to present our views. We would be happy to supply copies of the studies referred to in this letter.

Sincerely,



John Mendenhall
Acting Regional Director

²⁶ R. Delaney, The Disunited States: A Country in Search of an Efficient Transportation Policy, Cato Policy Analysis No. 84 (March 20, 1987).