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UNITED STATES OF AMERICA  
FEDERAL TRADE COMMISSION  
SAN FRANCISCO REGIONAL OFFICE

COMMISSION AUTHORIZED

December 31, 1987

The Honorable Rebecca Q. Morgan  
State Capitol  
Sacramento, California 95814

Dear Senator Morgan:

The staff of the Federal Trade Commission is pleased to respond to your request for comments on Senate Bill 727.<sup>1</sup> This bill, if enacted, would repeal the Public Utilities Commission's authority to set contract carrier motor freight rates. It also would establish a new safety inspection program for all trucks and maintenance terminals. Under SB 727, highway contract carriers would be allowed to charge any rate they desire, but would be required to maintain their trucks in safe operating condition.

This bill is a significant step toward bringing to both consumers and competitors the benefits of price competition in California's contract motor freight industry. By directly addressing the issue of highway safety, SB 727 also promotes the state's interest in protecting the health and welfare of its citizens.

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.<sup>2</sup> During recent years, the Commission's staff has studied the deregulation of trucking and has advocated increased reliance on market forces

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<sup>1</sup>These comments represent the views of the San Francisco 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.

<sup>2</sup>See 15 U.S.C. §§ 41 et seq.

at both the federal<sup>3</sup> and state level.<sup>4</sup> Our activities in this area and our familiarity with competition policy issues generally have provided us with substantial experience in analyzing the potential competitive consequences of trucking deregulation.

I. ARGUMENTS ADVANCED IN SUPPORT OF CONTINUED REGULATION

Trucking regulation was originally intended to help protect the regulated railroads from the then-unregulated and expanding trucking industry. It was also designed, in part, to support the trucking industry by restricting competition during the depression of the 1930's.<sup>5</sup> Neither rationale has any validity in 1987.

Those who support current contract motor carrier<sup>6</sup> regulation in California have advanced three major arguments: preventing predatory pricing, forestalling destructive competition, and

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<sup>3</sup>See Comments of the Staff 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 (January 19, 1983); Supplementary Comments of the Bureaus 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 Rate-making Study Commission (March 1982).

<sup>4</sup>See 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 (September 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).

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

<sup>6</sup>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.

maintaining safety. As discussed below, however, empirical studies demonstrate that none of these rationales supports the contention that economic regulation of contract motor carriers is either necessary or desirable.<sup>7</sup>

### Predatory Pricing

The first 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 service below cost. The surviving firms will then raise their prices to supracompetitive levels, 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. This condition apparently does not exist in the trucking industry today.<sup>8</sup> There presently are no significant regulatory barriers to entry. Trucks are highly mobile and are quickly transferred to new markets. A carrier would be unable to later recoup the losses it sustained while engaging in predatory pricing. Thus, when the predator tried to raise its prices to supracompetitive levels, other firms would 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.

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

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<sup>7</sup>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 (February 1987); D. Breen, supra note 3.

<sup>8</sup>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).

deregulation.<sup>9</sup> Indeed, predatory pricing is highly unusual in any sector of the economy. The Supreme Court recognized this principle in Matsushita v. Zenith,<sup>10</sup> stating that "predatory pricing schemes are rarely tried, and even more rarely successful."<sup>11</sup> In any event, firms that attempt to engage in predatory pricing also would be subject to law enforcement actions brought under state and federal antitrust statutes.

#### 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 create considerable pressure to cut price. If price competition breaks out, 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.

The conditions conducive for destructive competition do not exist in the California 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. It is unlikely, therefore, that destructive competition of this sort

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

<sup>10</sup>106 S. Ct. 1348 (1986).

<sup>11</sup>Id. at 1357-58, citing R. Bork, The Antitrust Paradox, 149-156 (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. 137 (1958); McGee, Predatory Pricing Revisited, 23 J. L. & Econ. 289, 292-294 (1980).

will occur.<sup>12</sup>

### Safety

A final argument 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. There is no necessary link between economic deregulation and reduced safety. 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."<sup>13</sup> Phase One of the CPUC/CHP study, published earlier this year, found that the number of California's annual truck-at-fault accidents per 100 million miles traveled actually decreased nearly 30 percent between 1976 and 1986,<sup>14</sup> a period during which, as discussed below, California experimented with deregulation.

The legislature has a legitimate interest in promoting safety on California's highways. However, rather than attempting to affect safety indirectly through economic regulation, it seems preferable to address safety issues directly. This is exactly the approach taken in SB 727, which mandates that all trucks and maintenance terminals undergo safety inspections at fixed intervals.

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<sup>12</sup>See A. Kahn III, 2 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."

<sup>13</sup>California Public Utilities Commission & California Highway Patrol, AB 2678 Final Report on Truck Safety, Joint Legislative Report, 3 (November 1987).

<sup>14</sup>California Public Utilities Commission & California Highway Patrol, AB 2678 Report on Truck Safety, Joint Legislative Report (June 1987). Similarly, injuries and fatalities from heavy truck accidents decreased nationwide following the passage of the Motor Carrier Act in 1980. Weinstein & Gross, supra note 7, at 50. See also Corsi, Fanara, & Roberts, "Linkages Between Motor Carrier Accidents and Safety Regulation," 20 Logistics & Transp. Rev. 149, 156-157 (June 1984); Beilock, "Are Truckers Forced to Speed?," 21 Logistics & Transp. Rev. 277 (September 1983).

## II. BENEFITS OF DEREGULATION

The best evidence of the benefits to consumers and competition produced by trucking deregulation is California's own experience. California experimented with partial economic deregulation of trucking from 1980 to 1986.<sup>15</sup> During this time, entry was unrestricted, and rates, though regulated, were relatively flexible.<sup>16</sup> The result was lower rates with no loss in service.<sup>17</sup>

The experience of California's fresh fruit and vegetable (FF&V) shippers and carriers illustrates the benefits enjoyed by California consumers and competitors under the experimental deregulation. FF&V shipments were essentially deregulated after July, 1983, when minimum rate tariffs were cancelled and not replaced with transition tariffs. A 1986 survey of FF&V shippers and carriers found that up to 70 percent of truck load shippers reported decreased real rates after deregulation.<sup>18</sup> Likewise, up to 93 percent of truck load carriers reported decreased real rates. Moreover, 21 percent of the FF&V shippers reported that overall service had improved, while less than half of that

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<sup>15</sup>In 1986, the California Public Utilities Commission returned to full economic regulation and ordered all carriers to boost their rates by 10 percent and each carrier to establish its own tariffs based on cost justifications.

<sup>16</sup>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.

Just prior to relaxing rate regulation, the CPUC dropped the requirement for certificates of convenience and necessity. Motor freight carriers wishing to offer their services were required only to show "fitness": proof of financial responsibility, insurance, and residency in California. These fitness requirements still apply.

<sup>17</sup>M. Simmerson, "Analysis of The Impact of Reregulation of the General Freight Trucking Industry," Investigation No. 84-05-048, California Public Utilities Commission, 20-21 (August 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 569 shippers.)

<sup>18</sup>Frey, Krolick & Tontz, The Impact of Motor Carrier Deregulation: California Intrastate Agricultural Products, 22 Logistics & Transp. Rev. 259, 266 (Sept. 1986).

percentage reported that service had declined.<sup>19</sup>

Competitors would also benefit from deregulation through significant savings in regulatory fees.<sup>20</sup> These savings would be in addition to those arising from reduced regulatory-related administrative costs currently incurred by contract motor carriers.

The experiences of several other states 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.<sup>21</sup> Shippers were satisfied with the available service, rates were about ten percent lower than they would have been under regulation, and intrastate carriers prospered.<sup>22</sup>

Florida's experience is particularly interesting because deregulation occurred so quickly that truckers and shippers had no opportunity to prepare for it. Nevertheless, according to one study, a year after deregulation 88 percent of shippers, as well as a surprisingly high 49 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 conversions might have been expected if "destructive competition" had resulted in a large reduction in the number of truckers.<sup>23</sup>

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<sup>19</sup>Frey, Krolick & Tontz, supra note 18, at 268.

<sup>20</sup>The California Legislative Analyst has estimated that complete deregulation of the state's trucking industry would save motor carriers approximately \$17.5 million annually in regulatory fees. Report of the Legislative Analyst to the Joint Legislative Budget Committee, "State Regulation of the Trucking Industry," The 1987-88 Budget: Perspectives and Issues, 229. The proportional savings to contract carriers would be considerable.

<sup>21</sup>W. Bruce Allen, S. Lonergon & D. Plane, Examination of the Unregulated Trucking Experience in New Jersey, U.S. Dept. of Transportation (July 1979).

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

<sup>23</sup>Freeman, A Survey of Motor Carrier Deregulation in Florida: One Year's Experience, ICC Practitioners Journal, 51 (Nov.-Dec., 1982).

Likewise, a later Department of Transportation study<sup>24</sup> 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 the deregulation of intrastate trucking led to a 15 percent average reduction in motor carrier rates.<sup>25</sup>

The experience of other states is consistent with that of 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.<sup>26</sup>

In Maryland, intrastate household goods movers were not regulated. A study conducted in that state in 1973-1974 revealed that the then regulated interstate household goods carriers charged 27 percent to 67 percent more than unregulated intrastate carriers for comparable moves.<sup>27</sup>

Oregon deregulated the shipping of certain building materials in 1980. The results of this action were examined in two separate surveys by the Legislative Research Office of the Oregon Legislature.<sup>28</sup> All parties surveyed agreed that

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<sup>24</sup>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).

<sup>25</sup>Blair, Kaserman & McClave, Motor Carrier Deregulation: The Florida Experiment, 68 Rev. Econ. & Stat. 159 (1986).

<sup>26</sup>Wisconsin Office of the Commissioner of Transportation, Deregulation of Wisconsin Motor Carriers (July 1983). California contract carriers are not required to obtain certificates of convenience and necessity and so would not suffer such an asset loss. There may, however, be other capital losses.

<sup>27</sup>Breen, Regulation and Household Moving Costs, Regulation, 53 (Sept.-Oct., 1978).

<sup>28</sup>Unpublished surveys conducted by the Oregon State Legislature's Legislative Research Office (1984).



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.<sup>29</sup> 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.<sup>30</sup> Between 1977 and 1982, during which time partial federal deregulation was implemented, interstate truckload rates fell about 25 percent and less-than-truckload rates fell about 12 percent. These declines occurred during a period of rising fuel costs and before the recessions of 1979-1980 and 1980-1981.<sup>31</sup> A recent federal study likewise found that regulated rates are higher than competitive rates for general freight trucking.<sup>32</sup>

The evidence is clear and convincing: deregulation lowers trucking rates. California's own experience indicates that significant consumer benefits, in the form of lower shipping prices, can be expected from the deregulation of contract motor freight carrier rates.

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<sup>29</sup>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).

<sup>30</sup>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 1986).

<sup>31</sup>Moore, Rail and Truck Reform -- The Record So Far, Regulation, 39 (Nov./Dec., 1983).

<sup>32</sup>Motor Carrier Ratemaking Study Commission, Collective Ratemaking in the Trucking Industry (June 1, 1983).

IV. CONCLUSION

We believe SB 727 is an important first step in moving to a more competitive motor carrier industry in California. Although SB 727 does not totally deregulate California's intrastate trucking industry, it will result in significant benefits for consumers and competition. Contract trucking firms will be free to compete on rates without waiting for CPUC approvals. This freedom should improve efficiency and result in contract carrier rates returning to the levels that existed during partial deregulation. The truck and maintenance terminal inspection program mandated by SB 727 will help to ensure that these cost savings are not gained at the expense of truck safety.

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

Very truly yours,

*Janet M. Grady*  
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Regional Director