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UNITED STATES OF AMERICA
FEDERAL TRADE COMMISSION
CLEVELAND REGIONAL OFFICE

V880059

COMMISSION AUTHORIZED

April 5, 1989

The Honorable Rodney T. Berry
West Virginia House of Delegates
State Capitol
Charleston, West Virginia 25305

Dear Delegate Berry:

The staff of the Federal Trade Commission is pleased to respond to your request for comments on proposed revisions to Chapter 24-A of the West Virginia Code.¹ Those revisions would partially deregulate the tow truck industry in West Virginia, allowing more rapid entry and price competition. We believe that the proposals would benefit consumers by increasing choices, improving service, and reducing prices.

Currently, tow trucks in West Virginia are regulated as common carriers under the state's Motor Carrier Law. That law creates an apparently significant entry barrier by requiring that all tow truck operators obtain a Certificate of Convenience and Necessity. We understand that such certificates are granted only after a complex application process and a sometimes lengthy hearing before the Public Service Commission (PSC). By increasing the cost of entering the tow truck business, this process may increase the price of towing services in West Virginia, to the detriment of consumers.

The proposed legislation will streamline entry requirements by eliminating the Certificate of Convenience and Necessity. All common carriers engaged in the business of towing, hauling or carrying wrecked or disabled vehicles would be required to register with the PSC, comply with applicable safety regulations and maintain adequate insurance. In addition, the PSC would set maximum towing rates, with competition permitted beneath those maximums.²

¹ These comments are the views of the staff of the Cleveland Regional Office and the Bureau of Economics of the Federal Trade Commission. They are not necessarily the views of the Commission or of any individual Commissioner.

² We do not address the costs and benefits of this form of rate regulation in our comment.

I. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission ("FTC") is an independent regulatory agency responsible for fostering competition and safeguarding the interests of consumers. Section 5 of the Federal Trade Commission Act³ prohibits unfair methods of competition and unfair or deceptive acts or practices. Through investigations of alleged violations of this statute, the staff of the FTC has gained experience in analyzing the effects of various trade restraints, and the costs and benefits of these restraints to consumers. Upon request by federal, state and local governmental bodies, the staff of the FTC regularly analyzes legislative and regulatory proposals to identify provisions that may impair competition or increase costs without offering offsetting benefits to consumers.

During recent years, the Commission's staff has studied the deregulation of trucking and has discussed the benefits of increased reliance on market forces at both the federal⁴ and state⁵ levels. Our activities in this area and in matters of competition policy generally have provided us with experience in analyzing the potential competitive consequences of trucking deregulation. We have not conducted a specific empirical study of tow truck deregulation in West Virginia. We are familiar, however, with the literature examining trucking deregulation nationally and in other states. While the West Virginia legislation covers only the tow truck industry, literature on the broader consequences of trucking deregulation may be useful. The weight of that literature supports

³ 15 U.S.C. 45

⁴ 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 of the 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).

⁵ See Comments of the Federal Trade Commission staff to the Speaker of the Rhode Island House Joseph DeAngelis, on legislation to exempt motor carriers such as tow trucks providing services to cooperative groups from regulation by the Public Utilities (April 26, 1988); 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).

what we believe will be the benefits of the proposed revisions to Chapter 24-A.

II. 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.⁶

In our experience, those who support continued regulation of motor common carriers usually advance three major arguments: preventing predatory pricing, forestalling destructive competition, and maintaining safety. As discussed below, however, a number of empirical studies on trucking have concluded that none of these rationales supports the contention that continued regulation of common 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, which may take the form of government regulation, prevent a return of competitors when the predatory firm raises prices above the competitive level to recoup its losses. One of the conditions necessary for predatory pricing exists when entry is regulated, and so, to the extent that a threat of predatory pricing exists, entry regulation exacerbates this threat, thus increasing the necessity of state price controls to avoid this threat. Barriers to entry will no longer exist if the proposed revisions to Chapter 24-A are enacted. The simplified registration requirements will permit new tow truck operators to enter the market quickly when existing operators raise rates above competitive levels.⁸ The absence of entry barriers makes detailed regulation of prices less necessary, assuming predation was more than a

⁶ Nelson, The Changing Economic Case for Surface Transport Regulation, in Perspectives on Federal Transportation Policy (James C. Miller III, ed. 1975).

⁷ See generally, e.g., 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 4.

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

remote threat. Moreover, because trucks are highly mobile and can be transferred quickly, the costs of entering (and exiting) a particular geographic area are apt to be relatively 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, motor carriers are not likely to attempt it.

In 1987, 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 Matsushita Electrical Industrial Co. v. Zenith Radio Corp.,¹⁰ the Supreme Court stated that "predatory pricing schemes are rarely tried, and even more rarely successful."¹¹

Predatory pricing remains at least a theoretical possibility.¹² However, this possibility does not seem to us to justify the type of entry restrictions embodied in the current West Virginia regulations.¹³ In any event, firms that attempt to engage in predatory pricing also would be subject to public and private antitrust enforcement actions.

B. Destructive Competition

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.

¹⁰ 475 U.S. 574 (1986).

¹¹ *Id.* at 589-90, 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. 137 (1958); McGee, Predatory Pricing Revisited, 23 J.L. & Econ. 289, 292-94 (1980).

¹² J. Tirole, The Theory of Industrial Organization, Cambridge: MIT Press, 1988, chs. 8 & 9.

¹³ The possibility of predation might, under certain circumstances, justify the imposition of minimum prices. However, to justify economically minimum price regulation in a specific industry, more than a general theoretical possibility of predation should exist. It would be desirable to also show that the conditions conducive to predation exist in the industry. Further, since minimum price regulations can hurt consumers if the minimum price is set too high, it would also be desirable to show that the expected benefits from setting minimum prices more than offset the expected costs.

Proponents of trucking regulation also argue that deregulation will lead to "destructive competition." Destructive competition may occur in industries characterized by fluctuating 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 when demand falls. If price competition occurs, however, prices may persist below the total cost of providing services because the sunk nature of costs makes capacity adjustment difficult. It is also said that firms facing transitory 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 motor carrier industry in general, nor, we believe, in the tow truck industry in particular. Fixed costs constitute 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 uses or geographic markets in response to fluctuations in demand, suggesting that costs specific to a particular location or geographic region are apt to be relatively small. Therefore, it is unlikely that destructive competition will occur.¹⁴

C. Safety

Another argument that has been advanced is that deregulation 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 ("CPUC") 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."¹⁵

The legislature has a legitimate interest in promoting safety on West Virginia's highways. However, rather than attempting to affect safety indirectly through economic regulation such as this, direct action to address safety issues may be preferable. A direct approach is consistent with proposed amendments to Chapter 24-A, which mandate that motor carriers comply with the Public Service Commission's safety rules, and that tow truck operators maintain adequate liability insurance.

D. Market Failures Specific to Towing

¹⁴ 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."

¹⁵ California Public Utilities Commission & California Highway Patrol, AB 2678 Final Report on Truck Safety, Joint Legislative Report, 3 (Nov. 1987).

Regulatory oversight of towing services has sometimes been justified because of possible abuses associated with the towing of cars authorized by someone other than the owner (e.g., when a car is illegally parked). This is known as "nonconsent" towing. These alleged abuses consist of damage to the towed vehicle (for which the owner is not compensated), and the imposition of excessive charges for the towing and storage of the vehicle. Although regulatory mechanisms may sometimes be necessary to remedy such problems, it seems unlikely that a Certificate of Convenience requirement would be useful in this capacity. Indeed, by protecting incumbent towers from new competition, a Certificate of Convenience requirement may actually facilitate the establishment of supracompetitive prices and the provision of poor quality service.

There are other types of regulation which might be better suited to alleviating any problems that might be associated with nonconsent towing. For example, because the PSC will retain authority to set maximum towing rates, any problems resulting from excessive rate charges for nonconsent towing can be addressed through the application of this authority.¹⁶ Additionally, if the state determines that the uncompensated damage to vehicles resulting from non-consensual towing is a problem requiring a regulatory solution, one possible solution would consist of requiring nonconsent towers to post performance bonds that would be forfeitable in the event of unsatisfactory performance. This would provide nonconsent towers with an incentive to provide service of acceptable quality, without depriving consumers of "consent" towing services of the benefits of free entry.

III. BENEFITS OF DEREGULATION

Evidence of the benefits to consumers 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.¹⁷ The result was lower rates with no loss in service.¹⁸

Experiences of other states also attest to the economic benefits of intrastate trucking deregulation. A study of trucking in New Jersey, for

¹⁶ To foster competition, the maximum rate set should not be below a competitive rate.

¹⁷ 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.

¹⁸ M. Simmerson, "Analysis of The Impact of Deregulation of the General Freight Trucking Industry," Investigation No. 84-05-048, 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 596 shippers.)

example, concluded that deregulation has worked well in that state.¹⁹ According to W. Bruce Allen, one of the study's authors, 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.²⁰

In Florida, deregulation occurred so quickly that truckers and shippers had no opportunity to prepare for it. Nonetheless, 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;²¹ many more such shipper conversions might have been expected if predatory pricing had resulted in a large reduction in the number of truckers, or if "destructive competition" had caused service quality to diminish.²² Likewise, a 1982 Department of Transportation study²³ 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.²⁴

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

¹⁹ W. Bruce Allen, S. Lonergon & D. Plane, Examination of the Unregulated Trucking Experience in New Jersey, U.S. Dept. of Transportation (July 1979).

²⁰ W. Bruce Allen, Statement Before the National Commission for the Review of Anti-Trust Laws and Procedures (January 22, 1979).

²¹ Private carriage occurs where the shipper owns the motor carrier.

²² Freeman, A Survey of Motor Carrier Deregulation in Florida: One Year's Experience, ICC Practitioners Journal, 51 (Nov.-Dec. 1982).

²³ 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).

²⁴ Blair, Kaserman & McClave, Motor Carrier Deregulation: The Florida Experiment, 68 Rev. Econ. & Stat. 159 (1986).

some of those opposing deregulation were concerned about the loss of the asset value of their certificates of convenience and necessity.²⁵

In Maryland, intrastate household goods movers were not regulated. A study conducted in that state in 1973-74 revealed that the then-regulated interstate household goods carriers charged 27 percent to 67 percent more than unregulated intrastate carriers for comparable moves.²⁶

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.²⁷ 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.

IV. CONCLUSION:

A significant body of evidence suggests that deregulation of trucking services lowers rates and improves service. We believe that the proposed amendments to Chapter 24-A constitute an important step in moving to a more competitive tow-truck industry in West Virginia. It should result in significant benefits for consumers and competition. Entrepreneurs will be free to add needed service and to compete on rates without waiting long periods of time for Public Service Commission approval.

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

Sincerely,



Mark Kindt
Cleveland Regional Director

²⁵ Wisconsin Office of the Commissioner of Transportation, Deregulation of Wisconsin Motor Carriers (July 1983). There may, however, be other capital losses.

²⁶ Breen, Regulation and Household Moving Costs, Regulation, 53 (Sept.-Oct., 1978).

²⁷ Unpublished surveys conducted by the Oregon State Legislature's Legislative Research Office (1984).