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THE WHITE HOUSE
WASHINGTON
5/18/79

Arnie Miller

The attached was returned in
the President's outbox today
and is forwarded to you for
your information.

Rick Hutcheson

CL and Stu already have
copies.

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THE WHITE HOUSE
WASHINGTON
5/15/79

Mr. President

CL concurs with the outlined
recommendations.

Rick/Bill

*Commerce?
DOT?*

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THE WHITE HOUSE

WASHINGTON

May 15, 1979

Stu - Move - Very good - J
p.s. Let's move on ICC member appointments J

MEMORANDUM FOR: THE PRESIDENT

FROM: THE VICE PRESIDENT *WB*
BROCK ADAMS *TP*
GRIFFIN BELL *GBB*

FRED KAHN *Fra*
CHARLIE SCHULTZE *CLS & HE*
ESTHER PETERSON *EP*
STU EIZENSTAT *Stu*

SUBJECT: Recommendation on Trucking Deregulation

We have reached a consensus recommendation on an Administration bill to deregulate trucking. This memo brings you up to date on the status of the issue in Congress and with the public, and summarizes our recommendations.

Secretary Adam's detailed analysis of trucking regulation is attached as Appendix A.

A. Summary of Options and Our Recommendation

A trucking reform bill should have the following elements:

- o replacement of today's protectionist general policy statement with a new statement emphasizing competition.
- o liberalization of entry controls and removal of restrictions on operating certificates.
- o substantial revision or repeal of the industry's special immunity to set rates collectively.
- o rate flexibility within a zone of reasonableness.
- o expansion of agricultural commodities that are exempt from regulation.

Our choices range from (1) eliminating all trucking regulation after a transition period (as the Airline Deregulation Act); to (2) phased but substantial deregulation without a prescribed cut-off date for ICC regulation; to (3) codification of recent ICC reforms and a new general policy statement emphasizing competition.

Since any of these options is sound on the merits, we believe that our decision is basically a political one. Our choice should balance our commitment to deregulation with our interest in proposing a measure that has a reasonable prospect of enactment.

We recommend a middle course with the following provisions:

- o a competitive general policy statement
- o liberalized entry standards without specifying a date for eliminating ICC controls altogether
- o removal of restrictions on certificates (such as empty backhauls, circuitous routing requirements, prohibitions on intermediate stops)
- o repeal of the special antitrust immunity for collective ratemaking
- o zone of reasonableness for rates; 20% reductions are permitted without ICC interference.

This option entails substantial deregulation, but avoids precipitous change or final elimination of ICC controls. We believe that this more moderate course will improve our prospects for success in Congress. This recommendation does not reflect a compromise with the Teamster Union; we have made no commitment to them, and would recommend this option in any case.

A detailed discussion of our recommendation is presented later in the memo.

B. Status of Trucking Deregulation

1. Congressional Action to Date

The only bill that has been introduced in Congress is Senator Kennedy's bill repealing the special antitrust immunity for collective ratemaking and establishing a pricing "zone of reasonableness." His bill is cosponsored by Senators Ribicoff, Hayakawa and Metzenbaum. The Commerce Committee has primary jurisdiction and it is unlikely that it will seriously consider the measure.

Senator Kennedy is also preparing a bill that eliminates all ICC controls over trucking in 1985. For the transition period prior to 1985, his bill is very similar to our recommendation. Kennedy would like to work out a joint bill with us if possible.

Senator Cannon, whose Commerce Committee has jurisdiction, has held one day of exploratory hearings, but has not introduced any legislation. Cannon has an open mind on the issue, and is anxious to receive our proposal. He has scheduled hearings for June 26-27.

Passage in the House will be difficult. White House Congressional Liaison staff reports that members are receiving more mail opposing deregulation than on any other issue. Last January Jim Howard pledged to you that he would work cooperatively with us, but he has made no commitment to support us.

2. Public Support for Deregulation

Trucking deregulation is vigorously opposed by most of the industry and by the Teamsters. Their political strength is formidable, and will make our legislative battle far tougher than airline deregulation.

Editorial opinion on the issue, however, is universally favorable, and deregulation will be supported by a variety of groups including: The National Association of Independent Businesses, the Consumer Federation of America, NAM, Minority Truckers, the American Farm Bureau and some parts of the trucking industry. Deregulation of entry although not rates is supported by the National Industrial Traffic League, the largest shipper group in the country. Substantial deregulation is also supported by many companies such as Sears, Lever Brothers, Whirlpool, and International Paper.

C. Specific Recommendations

1. Truck Transportation Policy Statement

Existing Law. Today's general policy statement governing ICC decision making is protectionist and anti-competitive. The ICC has begun to emphasize competition, but it is hampered by a 44-year history of industry protectionism, and its recent decisions are being challenged in the courts.

Recommendation:

Adopt a policy statement that directs the ICC to consider: maximum reliance on competition to provide fair prices and adequate profits; reduction of barriers to entry; maintenance of fair wages and working conditions; transportation safety; expedited regulatory decisions; and improvement of service to small communities.

2. General Entry Standards

Existing Law. Under present law, an applicant for a trucking certificate must prove:

- (1) that it is "fit, willing, and able" (meets safety, insurance and financial requirements), and
- (2) that the proposed transportation is "required by the public convenience and necessity," as defined in the existing transportation policy statement.

Historically, these standards have been interpreted in an exceedingly restrictive manner. Incumbent carriers have been able to block new entry if they could show that the incumbent could provide the service, or that new entry would impair the existing carrier's operations.

Recommendation:

- (1) Preserve the public convenience and necessity standard, but direct the Commission to consider whether the new service will serve a useful purpose, responsive to the public needs; improve the applicant's fuel use; improve service, especially at smaller communities; and offer lower rates and a more competitive environment.
- (2) Retain the requirement that the applicant show it meets safety, insurance, and financial requirements.

- (3) Reverse the burden of proof and require opponents of new competition to show that the transportation applied for would be "inconsistent" with the public convenience and necessity.
- (4) After a transition, require the ICC to make a final decision on entry applications within 90 days of the filing date.
- (5) Grant the application of any fit, willing and able carrier to enter a point which an incumbent carrier abandons or does not serve, or which a railroad abandons. (That is, do not apply the public convenience and necessity test.)
- (6) Direct the ICC and the Department of Transportation to report to Congress in 1983 on whether the "public convenience and necessity" requirement should be phased out.

3. Restriction Removal

Existing Law. The ICC has authority to impose restrictions upon truck certificates. It has used this authority profusely, and has imposed the following types of restrictions on certificates:

- (1) Commodity Restrictions. Many certificates specify in great detail commodities that a carrier is authorized to haul. Some certificates for example, authorize the carrier to haul crated, but not uncrated machinery; permit paint hauled in 2-gallon cans but not paint hauled in 5-gallon cans. One recent certificate permits carriage of bananas, and allows carriage of pineapples but only if mixed with loads of bananas.

*Why does ICC
not act?*

These restrictions needlessly increase the number of trucks on the road, and cause many trucks to haul empty or nearly so because they are unable to obtain authorized freight.

- (2) Intermediate Stop Restrictions. Many certificates actually prohibit carriers from making intermediate stops between authorized points. This, of course, prevents carriers from maximizing their loads and keeps many towns, especially smaller ones, from receiving the best possible service.
- (3) Backhaul Restrictions. Many certificates specify that a carrier may haul named commodities from A to B, but with "no transportation for compensation upon return unless otherwise authorized." Only half of the new operating certificates awarded as recently as 1975 contained any backhaul authority at all. This means that unless the carrier already has backhaul authority or is willing to undergo once again the expensive and time consuming process of applying for new authority, it must return empty.
- (4) Routing Restrictions, including circuitous routing. Almost all certificates authorizing the carriage of general commodities actually specify the highway over which the truck must travel. In addition to restricting operating flexibility, this restriction harms service to small towns. A carrier cannot leave the highway to serve a town off the beaten track without violating its certificate.

In some instances carriers are required to take an indirect route or travel through a required "gateway city" to reach their destination. The result is needless loss of efficiency and fuel.

Recommendation:

-- Direct the ICC to devise and begin within 180 days a program for the phased removal of all certificate restrictions.

-- Certificate restrictions shall be removed by no later than the following dates:

- All backhaul restrictions on existing certificated carriers shall be removed immediately.
- All prohibitions on intermediate stops shall be removed immediately.
- All route restrictions, including circuitous routing and gateway requirements, shall be phased out by December 31, 1981. Prior to that date milestone requirements will be set.
- All commodity restrictions shall be removed no later than December 31, 1982.
- Any other restriction shall be removed by December 31, 1983.

-- The ICC shall adopt liberal standards and expedited procedures for action upon petitions from motor carriers to remove restrictions on their operating authorities prior to the statutory guidelines. Opponents to the change will have the burden of proof.

-- In order to allow carriers to rationalize their own systems, we propose to direct the ICC to develop a program allowing existing carriers to increase their operating authority by a limited amount each year without ICC approval. The ICC program should be focused on small communities.

Can we
"direct"
ICC?

4. Agricultural Exemption.

Existing Law. When the trucking industry was first regulated in 1935, several major farm organizations persuaded Congress to exempt certain agricultural commodities from ICC regulation. Farmers opposed regulation because it would (1) limit the flexibility needed for distribution of agricultural products, many of which are perishable or seasonal; and (2) unnecessarily increase trucking rates. An unregulated trucker is free to haul exempt "unprocessed" agricultural commodities to any point at any price. Associations of farmers called agricultural co-ops are allowed to haul products of their members, but only 15% of their tonnage can be regulated commodities hauled for non-members who are neither farmers nor farmer cooperatives.

The agricultural exemption is very arbitrary and should be improved. For example,

- fresh meat is not exempt but fresh chickens are,
- oranges and lemons are exempt, but orange and lemon peels are not,
- milk and whipped cream are exempt; butter and cheese are not,
- an exempt hauler may transport fresh tomatoes to the processing plant, but it cannot haul catsup or canned tomatoes on the way back to the growing area.

In order to haul non-exempt commodities on its back-haul the exempt hauler must either (1) get ICC authority, or (2) lease itself to a regulated carrier. The regulated carrier usually keeps 25% of the revenues in exchange for permitting the exempt hauler to use his certificate.

The agricultural exemption has worked quite well, and farm groups want it to be expanded and simplified.

Why just "edible" items? cotton, lumber, seed.

Recommendation: Broaden the agricultural exemption to include all edible items as well as all farm implements, fertilizers, and chemicals. Also, enlarge the ability of agricultural co-ops to fill empty backhauls with regulated goods. Secretary Bergland concurs with this recommendation.

5. Deregulation of Truckload Transportation

The regulated trucking industry can be divided into two parts: "truckload" and "less-than-truckload".

Truckload (TL) carriage has the following characteristics:

- they haul a shipment large enough to use the entire capacity of a truck, and many use specialized equipment, such as tank trucks;
- they usually have authority to carry specific commodities over large geographical territories;
- there is more rate competition and less reliance on rate bureaus. Rates are often individually negotiated between the carrier and shippers;
- this segment is not heavily unionized.

Less-than-Truckload carriage has the following characteristics:

- they can haul general commodities, but only over highways that are specifically designated in their certificates;
- rates are set by rate bureaus. There is little price competition;
- many small shipments from different shippers are consolidated at terminals to fill a truck;
- this segment is heavily union-organized.

Although some companies engage exclusively in TL or LTL service, many of the larger carriers have authority for both types of carriage.

Although TL and LTL carriers are subject to the same statutory requirements, the ICC has almost totally deregulated entry into the TL industry and TL rates are set by competition.

Recommendation:

Are we protecting LTL too much? Since the ICC has made so much progress in this area, we recommend a separate provision removing price and entry controls for specialized truckload transportation. After 2 years, permit any fit, willing and able carrier to provide specialized truckload transportation and eliminate ICC regulation over such rates. These rates would remain subject only to the antitrust law prohibitions on predatory pricing. In the case of household movers, regulation would be retained to protect against consumer abuse.

6. Rates.

Before a trucking company changes its rates, it must give the ICC 30 days advance notice. The ICC may disallow the proposed rates if they are not just and reasonable.

Most "truckload" rates are individually negotiated between the carrier and shipper, but the more numerous "less than truckload" rates are set by agreement among truckers through motor carrier rate bureaus. These rate bureaus are permitted to discuss and vote on rates -- conduct which would constitute a felony under the antitrust laws absent the special immunity passed by Congress in 1948 over President Truman's veto.

There is considerable evidence that rates would be lower if ICC regulation were reduced and the special antitrust immunity were repealed. This evidence is summarized in Appendix B.

*How much can
ICC do
now?
(none)*

Recommendation:

(1) Repeal the special antitrust immunity for trucking rate bureaus.

Note: Under this provision, rate bureaus could no longer vote on rates. They could, however, continue to publish rates. Carriers could also continue to interline and set joint-line rates so that a shipper can pay one rate even though his shipment must be carried by more than one carrier to get to its final destination.

(2) For the first two years, permit carriers to lower rates 20% and increase their rates up to 3% from rates existing in the prior year without ICC approval. After 2 years, rates above variable cost could not be ruled unlawful because they are too low and carriers could raise their rates 7% a year.

(3) All rates must be filed with the ICC at least 15 days before their effective date, unless the carrier and the affected shipper agree otherwise.

(4) Rates outside the zone remain subject to ICC approval. However, no suspensions would be allowed for any rate decrease, and suspension of rate increases could only be achieved if an opponent met standards for a temporary restraining order (i.e. the opponent could show irreparable injury).

7. Exit.

Existing Law. Although trucking companies are theoretically required to serve all points on their certificates, under existing practice carriers freely abandon towns and cities without ICC permission. The ICC does not vigorously enforce the "obligation" to serve all points, and has never revoked a certificate for failure to serve.

Trucking service to small towns does not raise the same difficult issues as small town air service. It is far less expensive for a truck to go into a small town than

for an airline, so small town service is more available. In addition, there are so many trucking firms (17,000 regulated ones as compared to less than 100 airlines, including commuter carriers) that substitute service is readily available if a particular company no longer wishes to serve.

These differences are demonstrated by the fact that trucking companies are applying today to enter small town service -- despite the threat of deregulation. Carriers are applying to enter towns that are so small that some do not even have airports. For example, on October 30, 1978, Commercial Lovelace Motor Freight, Inc. applied to serve between Charleston, West Virginia and St. Louis, Missouri, serving all intermediate points and the off-route points of Culloden and Milton, West Virginia.

Commercial Lovelace also filed on February 12, 1979 to serve between Friendly and Ravenswood, West Virginia, serving all intermediate points and off-route points in Pleasants and Wood counties, West Virginia.

A more detailed analysis of small town service is provided in Appendix C.

Recommendation:

Since there is essentially free exit today, we recommend that our bill contain no provision on this issue, and that we leave existing practice undisturbed. If we codify existing practice and explicitly allow free exit, we will create an unnecessary political storm.

Elsewhere in this memo, we have made the following recommendations that will improve service to small towns.

(1) The policy statement will emphasize small community service.

(2) The public convenience and necessity standard that will be used in entry cases will emphasize small community service.

(3) Route restrictions will be liberalized to allow stopping at intermediate points.

(4) The automatic entry provision will focus upon small community service.

(5) The agricultural commodity exemption and agricultural co-op exemption will be broadened.

(6) There will be a small package exemption.

(7) There will be increased pricing flexibility, which will allow lower backhaul rates to small communities.

(8) Entry will be eased where rail or truck service is abandoned.

8. General Exemption Authority.

Under existing law, the ICC has very narrow authority to grant exemptions from ICC regulation.

We recommend granting the ICC broad exemption authority to enable the ICC to implement a more competitive policy. We also recommend exempting packages under 500 lbs. from entry and rate regulation. (Packages up to 50 lbs. are exempt today.)

9. Contract Carriers.

Contract carriers are ICC-regulated carriers who enter into contracts to give specialized service to a limited number of shippers.

Although the ICC has liberally granted applications for contract carriage, these carriers have been subject to many undesirable restrictions:

-- Rule of 8. Until recently, contract carriers were prohibited from entering into contracts with more than 8 shippers. This rule prevented small shippers from using this service.

-- Prohibition on Dual Operations. Until recently, the ICC prohibited a contract carrier from applying for common carrier authority.

Recommendation:

We recommend legislation codifying recent ICC decisions eliminating the Rule of 8 and removing the prohibition on dual operations.

To grant
"exemptions"
only?

10. Private Carriers.

Under existing law, non-transportation companies (such as Sears and Pet Milk) may transport their own goods without obtaining a certificate from the ICC.

Although these "private carriers" are not directly regulated by the ICC, their operations have been severely restricted:

(1) until recently they were prohibited from applying for authority to fill their backhauls with non-company commodities;

(2) they may not haul goods for their corporate subsidiaries except under very limited circumstances; and

(3) private carriers may lease their unused trucks to a regulated carrier only if the lease is for a minimum of at least 30 days. Private carriers are prohibited from "trip-leasing" or leasing to ICC carriers for a single trip.

As a result of these restrictions, private carriers are plagued with unusually high empty backhauls.

Recommendation:

-- codify recent ICC reform allowing private carriers to apply for authority to carry non-company commodities;

-- permit private carriers to "trip-lease" with certificated carriers for single trips;

-- permit private carriers to provide transportation for majority-controlled corporate subsidiaries.

11. Mergers.

Under existing law, the ICC has broad discretion to approve truck mergers which are "in the public interest." This standard is very loose, and permits the ICC to approve some mergers which are anticompetitive.

Recommendation:

Leave merger authority with the ICC for 5 years, but require the ICC to give more weight to the competitive

*Carters
where had
similar
problems*

impact of the proposed merger. After 5 years, transfer merger enforcement to the Department of Justice and the FTC. The standards of the Clayton Act would apply, making the trucking industry subject to the same antitrust standards applicable to the economy generally. This will not prevent all mergers, but it will prohibit those that are anti-competitive.

12. Other Provisions

The Department of Transportation is developing safety legislation to improve their authority to enforce safety regulations, and legislation to remove barriers to intermodal transportation companies.

E. Timetable and Procedure

We recommend circulating our proposal for comments before we formally send it to Congress. Senate and House members have specifically asked us to consult with them before we send up final legislation. Advance consultation should also result in public endorsements of our bill when we make our formal announcement.

We would like to begin circulating our proposal beginning May 17. Ballots on ratification of the Teamster contract are due on May 16, so publicity about our proposal will not endanger contract ratification. We will report back to you in late May with our final recommendation.

Appendix A

INTERAGENCY TASK FORCE*
TRUCK REGULATION REFORM OPTIONS

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*This options paper is the result of a task force consisting of representatives of the Departments of Agriculture, Commerce, Defense, Energy, Justice, Labor, and Treasury, the Council of Economic Advisors, Council on Wage and Price Stability, Federal Trade Commission, Interstate Commerce Commission, Office of Consumer Affairs, and the Office of Management and Budget.

entry. The focus in entry proceedings before the ICC has traditionally been to protect the existing carriers. The result is that there are about 40% fewer regulated carriers in the industry today than in 1940, despite the tremendous economic growth experienced in the meantime. The ICC has taken some steps recently to ease entry, as will be discussed later.

The existing system also limits competition by allowing motor carriers to meet among themselves to agree upon rates in rate bureaus.⁴ These bureaus operate under a special exemption from antitrust laws which would normally outlaw such joint pricing. While the ICC has authority to review the rate bureau decisions, historically this authority has been used to minimize competition.

In addition to the logic of economic analysis there is real world evidence that rates are too high. Much of it comes from comparisons of similar truck freight moving in regulated and unregulated markets. The Federal economic regulatory system does not apply to totally intrastate movements. Certain states, such as New Jersey, have only minimal economic regulation of trucking. A recent DOT study¹ compared unregulated intrastate New Jersey movements with regulated interstate traffic and concluded that rates on the unregulated movements were 10%-15% lower than the regulated movements.

Comparisons of rates in other unregulated sectors — within so-called "commercial zones" around urban areas — show that rates of regulated household movers may be 40%-67% higher than rates of unregulated movers.² In the mid-1950's, when movement of some agricultural products became unregulated, Department of Agriculture studies³ found lower rates and better service resulted. Four foreign countries' experience with deregulation also provides evidence that less regulation provides lower rates. While some analysts believe that

⁴A glossary of technical terms used in this paper is found at Tab E.

TRUCK REGULATORY REFORM OPTIONS

I. INTRODUCTION - THE NEED FOR CHANGE

Meaningful change of the system for economic regulation of the trucking industry should be a key point of the Administration's agenda for the 96th Congress to:

- Fight inflation by reducing motor carrier rates;
- Reduce the inefficiency and fuel waste of the present system;
- Reduce unnecessary red tape and bureaucracy; and
- Reduce barriers to minority participation in the trucking industry.

A number of agencies on the interagency task force have urged that deregulation of the intercity bus passenger industry be included in this options paper. It is not included because the truck options paper has involved a major effort and there has been no full consultative process with the bus industry, and because we believe it so important to tie truck deregulation with that of rails. DOT will be considering bus passenger deregulation, and developing a separate bus options paper, over the next few months.

INFLATION

Today's truck regulation stifles competition by limiting entry and allowing collective rate setting. Without competition or the threat of competition rates are inflated since carriers have little incentive to hold down cost increases, let alone reduce their rates. Critics of regulation maintain that billions of dollars in waste results.

When motor carrier economic regulation was instituted in 1935, broad authority was provided the Interstate Commerce Commission (ICC) to regulate

or the routes he may travel. The current system of fragmented authority also leads to excessive interlining between carriers, delays in shipment delivery, and increased industry costs. Empty backhauls, lower load factors, and circuitous routes also result. For example:

1. In one example cited in a study by the Federation of Rocky Mountain States,⁷ the highway mileage between Denver and Albuquerque was calculated to be about 400 miles, but the carrier's authority required it to go along a 700-mile route between these two communities. In another instance, a carrier had to go almost 900 miles to make what was usually a 540-mile trip between Denver and Omaha.

2. Because would-be carriers know that entry is tightly restricted, they often write their applications very narrowly to maximize the chance for getting into the market at all. The following are examples of applications taken from a few pages of a recent trade publication:⁸ authority to transport glass containers, not exceeding one gallon capacity, between three small towns in Pennsylvania (named) and one city in New Jersey; authority to transport skeet and trap targets from one point in Indiana to points in five states; authority to transport prepared dough in vehicles equipped with mechanical refrigeration from a city in Georgia to named points in several states.

3. The regulatory system imposes inefficiencies on both the regulated and the unregulated. Carriers are allowed to transport unprocessed agricultural items without ICC authority, but they may not carry regulated commodities. An exempt agricultural carrier may carry fresh produce to the canning plant but may not transport canned goods on the return trip as an exempt carrier. He may enter into a separate arrangement with a carrier with authority to carry canned goods from that plant, but there are restrictions on exempt carriers' ability to make such arrangements.

rates increased subsequent to the British deregulation of trucking, there is evidence that deregulation did cause some real rates to decrease.⁴

Additional evidence that rates are too high is the inflated value of trucking certificates and operating authority. The total market value of these certificates was estimated by the American Trucking Association⁵ to be in the billions of dollars in the early 1970s. This is well beyond any amount that could be attributed to ordinary business "goodwill." Certificates can have such high value only because they reflect the present value of future inflated profits which certificate buyers expect to be able to earn because they can charge more than they could without ICC limitations on entry and antitrust exemptions. It is interesting to note that industry financial experts have indicated that the market value of certificates has dropped dramatically in the last few months. This decline in market values evidently reflects uncertainty associated with fears the system may be deregulated and rates will have to come down as the industry becomes more competitive.

A final piece of evidence comes from the analysis of the impressive profits in the trucking industry. The ICC figures for 1976 indicate that large firms averaged returns on equity of nearly 24 percent.⁶ This is extremely high in an industry that does not require large capital investments, where there are no particularly large economic risks, and where lower returns would otherwise be expected. This figure compares with an average of roughly 14% return on equity in manufacturing.

INEFFICIENCIES AND WASTED FUEL

Existing regulation causes carriers to operate less efficiently than they could, raising costs and wasting fuel. Moreover, it stifles innovation, both in technology and in price/service options. Operating authority is normally narrowly granted, either by restricting the commodities a trucker can carry

to participate in the industry. This was not intentional, but it nevertheless happened. As mentioned earlier, most of today's operating authority can be traced to that authority created by the "grandfather" provision of the 1935 Act. Minority participation was quite limited in the industry at that time, however, and the restrictive entry policy has meant that minority participation in the industry has remained very low. For example, according to available evidence, of the 2,500 interstate household movers, less than 1% are minority-owned and no minority-owned carrier has broad geographic authority to move household goods.¹¹

The result of such restrictions is an excessive number of trucks on the highways with empty backhauls, partial loads, or on circuitous routes. DOT-ICC data⁹ show that more than 16% of unspecialized ICC-regulated vehicles travel empty. An even larger percentage of exempt vehicles travel empty. These empty trucks and unneeded miles increase the truckers' costs and waste fuel. A Department of Justice study¹⁰ estimates that the circuitry requirements alone waste at least 51 million gallons of fuel per year.

UNNEEDED BUREAUCRACY AND RED TAPE

The existing system is needlessly complex and cumbersome. A major issue is why over 2,000 federal bureaucrats are needed to regulate the business practices of what would otherwise be a good example of a competitive industry. There are literally hundreds of thousands of pages of tariffs (rate notices) filed each year, and sometimes individual tariffs go on for pages with intricate formulas and complicated calculations. The system also produces endless red tape. The last annual report of the ICC indicates that almost 8,000 cases were filed for motor carrier operating rights alone. There may be even more applicants this year. In addition, millions of rates are filed with the Commission annually. Even under more expedited Commission action cases can take months and years, and this means that businessmen who should be spending time thinking of ways to improve their operations, instead, have to think of ways of moving through the labyrinth of the current regulatory system.

INEQUITIES AND SOCIAL COSTS

The regulatory maze is particularly burdensome to small businessmen. Large businesses may be able to afford experts to wade through the complicated regulations and wait the long months to obtain decisions, but this is not true for the small entrepreneur.

The regulatory system has worked to restrict the opportunities for minorities

1. ICC-Licensed Carriers: Less-Than-Truckload (LTL)

LTL motor freight service is almost exclusively provided by regular-route common carriers of general freight. Regular route certificates specify all the points of origin and destination along with the detailed routes over which the carrier must travel. Common carrier service is provided by LTL carriers for a wide variety of packaged goods (general freight). Up to 90 percent of total LTL shipments weigh less than 1,000 pounds. The motor carrier services provided by LTL carriers can require fairly substantial terminal investment and handling operations to consolidate or distribute individual shipments before or after line-haul movements. These carriers essentially provide regularly scheduled service, often interchange traffic with other carriers, and rarely use specialized equipment. This segment of the industry is heavily unionized (both drivers and dock workers); and employees are typically covered by the Teamster Master Freight Agreement. In most cases, the rates charged for these shipments are collectively agreed upon and then proposed to the ICC regional rate bureaus. LTL carriers are not as prone to cyclical downturns or seasonal/peak-period service demands, as are other sectors of the motor carrier industry. Although the requirements for terminals and facilities pose some economic entry barriers, they are far from overwhelming, especially in comparison to other industries, such as the airline industry now being deregulated.

2. ICC Licensed Carriers: Truckload (TL) There are several categories of carriers which provide truckload service. Typically, TL shipments move directly between the shipper and consignee, thereby bypassing the distribution and consolidation operations which characterize LTL shipments. In comparison to the class rate structure of LTL movements, TL rates are more closely related to the carrier's cost of providing a particular service. This is because

II. STRUCTURE OF THE INDUSTRY

The trucking industry accounts for over half of total intercity freight revenues. ICC-licensed carriers account for just over 20 percent of the industry's total intercity ton-miles. In 1976, the estimated value of intercity motor freight services (both regulated and non-regulated) was estimated at \$56 billion; regulated carriers had operating revenues of \$26 billion. The trucking industry earns more revenue for services provided than any other industry in the transportation sector. There are approximately 17,000 regulated trucking companies in operation today. The industry employs more than one million people and is highly unionized, principally by the International Brotherhood of Teamsters.

The internal structure of the industry is highly mixed and can be categorized in many ways. One logical way is to divide carriers into those that provide truckload (TL) and less-than-truckload (LTL) traffic. Carriers providing TL and LTL have different operating patterns, costs and organizational structures, and provide very different types of freight service to shippers.

One way of defining truckload traffic is any truck rig that moves under a single bill of lading. In general, TL shipment consist of a point-to-point (shipper-to-consignee) shipment that "fills" a trailer. The concept of "fullness" depends upon the nature of the carrier's operations and the type of traffic carried, as well as the services demanded by the shipper. LTL traffic are those movements that do not fit the truckload (TL) definition. In terms of freight revenues, LTL carriers earn the majority of industry revenues.

TL carriers are constrained by competition from railroads and the threat of private carriage. TL carriers often require specialized equipment (e.g., tank trucks) and are closely limited in terms of the commodities they may transport, but generally have wide latitude as to the routes over which they may operate. The TL category is composed of two broad groupings: specialized common carriers and contract carriers.

a. Specialized Common Carriers The ICC separates specialized common carriers into 16 different commodity categories (e.g., liquid petroleum, refrigerated products, household goods, etc.). Specialized carriers generally have irregular-route operating authority, and handle full truckload shipments of freight. Traffic levels for these carriers have increased rapidly. The typical movement involves almost no consolidation with shipments of other commodities or parties, and the average size of a shipment is usually quite large. Specialized carriers rely heavily on the service of independent truckers (owner-operators), who lease their service and equipment to carriers holding this type of authority.

b. Contract Carriers Approximately 4,000 carriers are classified as contract carriers. The essential distinction between a common carrier and a contract carrier is that contract carriers do not hold themselves out to provide service on demand. They provide dedicated service and often specialized equipment to meet the unique transportation needs of individual shippers. Unlike common carriers, the rates charged for these movements are negotiated between the carrier and the shipper, and ICC has only minimum rate authority. The contractual agreement can be long-term in nature, and is filed with the ICC. Historically, the Commission has limited the ability of a contract carrier to provide dual operations; i.e., both contract and common carriage by the

same operator. The Commission has recently undertaken some reform in this area.

The Commission also places arbitrary restrictions on the number of shippers a contract carrier can serve, which only reduces competition with other types of carriers while unfairly constraining the growth of contract carriers. These restrictions tend to discriminate against small shippers. Since a contract carrier can only serve a limited number of shippers, it has every incentive to enter into contractual arrangements with the largest shippers it can find. The overall effect of this restriction results in inefficient and costly system-wide operations.

3. Non-ICC Regulated Carriers

a. Private Carriage A private carrier is a company whose primary business is not transportation (e.g., a supermarket chain), which hauls its own property. Private carriage, which accounts for the largest single component of intercity motor freight traffic, has varied operating practices and service needs. At the present time, private carriers are prevented by the ICC from entering into for-hire operations for their own corporate subsidiaries, and from entering into short-term agreements for leasing equipment to a common carrier. They are also prohibited from employing owner-operators in the transport of their own traffic. These restrictions are particularly unproductive in that they lead to excess capacity, poor fuel utilization, and extra costs. Nevertheless, private trucking has grown rapidly.

DOT studies¹² demonstrate that companies turn to private trucking when they are dissatisfied with existing regulated carriers. This dissatisfaction is especially pronounced when specialized equipment is required or when shippers

III. ICC REGULATION AND RECENT TRENDS

With the appointment of Chairman O'Neal in April, 1977, the Commission embarked upon a reexamination of many procedural and substantive aspects of its regulation of interstate truck transportation. A task force composed of six members of the Commission's staff was appointed to make recommendations for improving truck entry regulation. The Task Force's report, submitted July 6, 1977, contained 39 recommendations for easing entry control which the Commission has recently been deciding on a case-by-case basis. While these reforms represent an important first step toward liberalizing entry, the Commission could have gone significantly further in dismantling the numerous obstacles to entry and in reforming other areas of its authority, especially pricing flexibility and rate bureau reform.

1. Entry Before a new carrier may enter the industry or before an existing ICC carrier may expand its authority, approval must be obtained from the ICC and a determination made that the applicant is "fit, willing and able" and that the proposed service is required by the "public convenience and necessity". The Commission's three standards pertaining to public convenience and necessity entry were developed in 1936 in the seminal Pan American decision. 1 M. C. C. 190 (1936). In its consideration as to whether an applicant has satisfied the public convenience and necessity standard, the Commission determines whether (1) the applicant has established a public need for the proposed service; (2) the existing carriers can satisfy the demonstrated service need; and (3) the proposed service will cause protestants to suffer competitive harm of such degree as to outweigh the benefits to the general public. These criteria

desire new or alternative transportation services. The relative size of private trucking operations — and the fact that a recent survey¹³ found that a majority of large industrial shippers planned to increase the size of their private trucking operations significantly — indicates substantial problems with the level and structure of rates and services provided by regulated carriers.

b. Exempt Carriers Various exemptions from economic regulation are specified within the Interstate Commerce Act. The single most important exemption involves the movement of unprocessed agricultural commodities. These commodities are transported primarily by the estimated 100,000 or more owner-operators, who provide a highly flexible service to meet rapidly changing demands for agricultural movements. Through relatively high productivity, these truckers achieve costs which, at least under the present regulations governing rail traffic, make them cost-competitive with railroads in many transportation markets. As a result of their flexibility and competitive rates, they have captured a large part of agricultural traffic that once moved primarily by the railroads.

As noted above, however, because they are "exempt" does not mean they operate without restrictions or could not carry freight more efficiently. In addition to statutory impediments, regulations also limit the ability of owner-operators to solicit and participate in transporting regulated traffic. Owner-operators are also prohibited from carrying regulated and nonregulated traffic simultaneously.

to prove that the service it proposes cannot be performed by existing carriers. In addition, the proposed policy would loosen requirements for contract carriers. Opponents would have to establish that granting new contract authority would so endanger their operations that they would not be able to provide adequate service within the scope of their authorities. If adopted, and if the Commission does not place a heavy burden on applicants to demonstrate a public need for the proposed service, the proposed rules would ease entry significantly. These rules would still allow the potential for fit and financially responsible carriers to be denied entry into the industry even though they proved a need for their service, however.

2. Ratemaking Trucking rate reform involves primarily three major issues: (1) collective ratemaking; (2) the structure of rates; and (3) rate flexibility. These issues must be addressed if true reform is to be achieved.

The ICC has wide discretion to determine maximum and minimum rates for common carriers. The Interstate Commerce Act also gives the ICC authority to approve collective ratemaking agreements. These agreements are conducted in rate bureaus: private associations of common carriers who discuss and determine rates for individual shippers. All motor carrier rate bureau members (whether they carry the traffic or not) may discuss and vote not only on joint and through rates (where two or more carriers are involved in one shipment) but also on single line rates where only one member is involved. In addition, these rates are based on the average cost of a sample of the larger carriers not the lower costs incurred by the more efficient carriers.

Rate bureaus were granted antitrust immunity in 1948 with the passage of the Carriers' Rate Bureau Act (more commonly known as the Reed-Bulwinkle

have remained unchanged to this day despite fundamental structural changes in the economy and the trucking industry.

Historically, the applicant had the burden of proving that the proposed service was required by the public convenience and necessity. On October 6, 1978, in the Liberty Trucking decision, 130 M. C. C. 243, the Commission reversed years of precedent by shifting the burden of proof regarding the third criteria to the existing carriers who protest the granting of new authority. In another recent decision, the Commission issued final rules which sharply limit the carriers permitted to intervene automatically in operating rights cases to those who not only hold a certificate similar to that being sought, but who have in fact performed the service in the recent past. These restrictions, which place a burden of proof on protesting carriers, should make it easier for new applicants to obtain operating authority by reducing previously lengthy and expensive hearings. These rules represent some reform toward liberalizing entry, but do not eliminate many impediments to entry.

On November 30, the ICC proposed a rulemaking proceeding which, if adopted, would represent the most significant change in the Commission's traditional "protectionist" attitude. Under the proposed policy, an applicant would merely have to demonstrate that the service being proposed would "serve a useful public purpose, responsive to a public demand or need." New common carrier authority would be granted commensurate with the demonstrated need unless the existing carriers could demonstrate that a new carrier would impair their operations contrary to the public interest. In essence, this proposal shifts the burden of proof for showing the potential disruptive effects on existing carriers to those same carriers, thus eliminating the need for an applicant

in summer months by household goods carriers results, in part, from ICC regulations that do not permit peak load pricing. Since carriers are unable to balance demand through price incentives in off-peak months, they overbook for five frantic months of the year, with a resulting deterioration in service.

3. Mergers Motor freight common carriers have sought end-to-end mergers as a means of balancing traffic flows, decreasing circuitry, increasing equipment utilization, and improving service to shippers. More expedited traffic movements and fewer joint movements of traffic between carriers often lead to service improvements and cost savings for both shippers and carriers. Under existing law, motor carriers are only permitted to merge when the Commission determines that the merger is consistent with the public interest. Carriers with combined revenues under \$300,000 do not have to seek ICC approval for merger.

Regulatory restrictions on entry, especially for established carriers seeking to broaden their operating authority into new geographic and commodity markets, provide trucking companies with incentives to merge. Carriers interested in expanding their authority have often merged with other carriers holding the desired authority, rather than pursue the lengthy, costly, and sometimes futile process of seeking additional authority through Commission procedure and review. Under liberalized entry, a carrier's incentive for intra-industry mergers as a means of rationalizing its own route network would be reduced dramatically.

In its policy statement of November 30, 1978, the Commission expressed concern that its current merger policy may lead to the reduction of effective competition and service, especially in short-haul markets and small communities.

Act). In essence, this Act allows potential competitors to agree upon rates and file them with the ICC. The anticompetitive effect of these organizations on rates charged is largely responsible for the shift toward private carriage and excess industry earnings. The ICC has the authority to review rates but generally has accepted rate bureau proposals. In those few cases where the Commission has suspended rates, it has attempted to set rates so as to maintain the existing rate structure. One recent decision, however, indicates that the Commission is questioning the current system of ratemaking. On November 27, 1978, by overturning a general rate increase proposed by a major rate bureau, the Commission overhauled the criteria that motor carriers must meet to justify future rate increases. Moreover, the Commission determined that the profits of the motor carrier industry were already inflated. The ICC further decided that the rate of return for motor carriers should be no higher than that for all manufacturing industries (approximately 14 percent), which is substantially below the current composite return for the major motor carrier rate bureaus.¹⁴

Inadequate pricing flexibility also currently exists. Rates based upon the level of service provided for an individual shipper, not rates based on the average costs of a group of carriers as currently practiced through collective ratemaking, are highly desirable. Flexible and innovative ratemaking would yield significant benefits to both shippers and carriers. Shippers would be able to select those rate/service features which most fully reflect their shipping requirements. A carrier relying upon flexible pricing could implement different levels of freight service. Through flexible pricing a carrier could charge rates that reflected these service differentials. For example, scandalous over-booking

a step toward regulatory reform. Further reforms could be expected if new commissioners were appointed who supported the Administration's economic policy favoring deregulation. There are currently five Commissioners plus one acting until a replacement is named. Thus effectively there are six vacancies on the Commission. In addition, two Commissioners' terms will expire at the end of 1979 and two more at the end of 1980.

However, even if the Commission were to propose more substantial reform, a major legislative thrust would still be required to achieve the objective of significant lasting reform.

Without legislation, the ICC's apparent forward movement could be hindered by several developments. First, the proposed ICC reform initiatives will take a very long period to achieve. The individual dockets designed to effectuate reform on each aspect of the motor carrier industry could take several years. Second, even after the Commission does act, it is likely that any significant administrative reform will be tied up in litigation, perhaps for several years, with an uncertain outcome. The American Trucking Association and other affected parties will contest any significant Administrative reforms in the courts.

Finally, many of the ICC- proposed reforms, even if subsequently adopted, will not be cemented into the law without legislation. Future Commissions could undo the work of a reform Commission. A somewhat similar situation was faced with the air deregulation bill. With the support of this Administration, the CAB instituted far-reaching changes to deregulate the air carriers. The question was raised at that time whether legislative change was still needed. The unanimous response by the Administration and the CAB was to continue

Frequently, a long-haul carrier will purchase the authority of a short-haul carrier and use that new authority as a means of extending its long haul service into another market. The Commission has announced that if a new service is intended by the merger, the proper vehicle is the filing of an application for new authority. Under the proposed rules, the Commission will authorize an acquisition of operating authority only if the acquiring carrier establishes that it will continue to perform service similar in scope to that performed under the operating authority being acquired.

Intermodal mergers between railroads and motor carrier are presently restricted by Commission policy. Intermodal ownership and operations would increase the coordination between the modes and achieve cost economies for the participating carriers and increased service options and benefits for shippers. By increasing the attractiveness of multimodal service, the different modes could specialize in those transportation functions they perform most economically (e.g., rail carrier linehaul movements and motor carrier pickup and delivery). Rail ownership of trucking companies should be encouraged as a means of achieving more appropriate and profitable transportation service on low-density branchlines. Forced maintenance of rail service on such routes is a serious drain on the rail industry's currently poor earnings. Further, decreasing costs and improving the service for intermodal movements would bring about a more appropriate intermodal division of traffic based upon lower shipment costs.

CONCLUSION

Although the ICC's proposals do not eliminate all the problems created by the motor freight carrier regulatory scheme, these proposals represent

IV. OPTIONS

Many alternative reform proposals can be suggested. However, the issues can be grouped into three comprehensive options. Administrative change at the ICC would continue under each of the three options.

Option 1. Phased Total Deregulation:

Deregulation would take place over a transition period of, say, five years, in order to permit shippers to adjust their freight distribution patterns and service requirements and to offer carriers an opportunity to redeploy their equipment and other assets. The legislation would schedule important intermediate steps toward total deregulation during the transition period. At the end of the period all distinctions between the types of carriers would disappear.

1. Features

a. Entry/Exit

This option would completely eliminate the Commission's authority to prescribe conditions of entry or exit for the industry after a transition period of, say, five years. At that time, all applicants would be allowed into the industry once certain basic safety, insurance and financial requirements were satisfied. During the transition period the legislation would require the Commission to place maximum emphasis on competition; shift the burden of proof in entry cases from applicants to protestants; and allow a carrier into the industry once it had secured shipper support or proposed a lower rate and/or a new freight service.

b. Certificate Restrictions

For established carriers, this option envisions the gradual removal of all commodity and route restrictions during the transition period, although

to seek legislative change. Chairman Kahn himself testified that without legislative change, the CAB faced long internal proceedings and monumental lawsuits. In order to achieve lasting regulatory reform for motor carriers, as well, some form of legislation is necessary.

f. Private Carriers

This option includes permitting private carriers to trip-lease and provide transportation for majority-controlled corporate subsidiaries during the transition period; at the end of the period all restrictions would be removed.

g. Owner-Operators

Owner-operators would immediately be allowed to lease their services and/or equipment to private carriers. Commission leasing restrictions which currently impair the ability of owner-operators to solicit and transport regulated traffic would gradually be removed. By the end of the transition period, these independents would then be allowed to solicit and transport any freight they desire.

h. Freight Forwarders

The operations of freight forwarders are closely tied to those of trucks, especially LTL carriers, against whom they compete in many aspects of their operations. For these reasons, the deregulation of trucks must be accompanied by the deregulation of forwarders.

i. Securities

The Commission's responsibility for regulating truck industry stocks and securities would be transferred to the Securities and Exchange Commission.

2. Strategies

There are two basic approaches to achieving total phased deregulation.

Strategy A. Remove all restrictions on all categories of carriers simultaneously over a transition period. No distinctions would exist in the legislation between types of truckers or categories of traffic. This approach is simplest to formulate, to draft, and to explain. It focuses the attention of Congress and the public on the entire industry, and it minimizes the possibility that during the legislative debate powerful interest groups (i.e., organized

c. Rates and Rate Bureaus

Collective ratemaking would be prohibited and rate bureaus would no longer be exempt from antitrust immunity (i.e., repeal the Reed-Bulwinkle Act). After five years, the Commission would be prohibited from setting maximum and minimum rates. Transportation charges would be set by market forces, although legal prohibitions against truly anticompetitive pricing behavior would be enforced under antitrust statutes. Until there was complete deregulation of truck-entry, an extended no-suspend pricing zone would be instituted. Special procedures would be implemented to handle rate requests outside the zone. This transitional ratemaking framework would allow both carriers and shippers the opportunity to adjust their distribution and service patterns to the new market-oriented environment. The phased removal of rate regulation for trucks would coincide with the deregulation of operating and rate regulations for rail carriers.

d. Mergers

After enactment, all responsibilities for both intra-industry and intermodal mergers would be transferred to the Department of Justice and the Federal Trade Commission. The same competitive standards that apply to other sectors of the economy would then be applied to the trucking industry.

e. Contract Carriers

During the transition period, contract carriers would be granted common-carrier authority if they so desired. They would also be able to enter into contractual arrangements with any number of shippers they desire, as long as they provide dedicated or specialized service. After the transition, they would be deregulated in the same manner as common carriers.

be appropriate because of the more extensive capital investment needed for LTL operations and the longer time needed for both carriers and shippers to adjust their business operations to altered market conditions.

In either approach, State regulations, if any, which affect interstate traffic would have to be reviewed and possibly preempted to achieve the maximum benefits available from total reform.

3. Arguments For and Against

Pros

- Option I offers the greatest overall anti-inflationary benefits.
- A proposal in this form is the easiest to understand and the best vehicle for subsequent discussion and education.
- This approach allows the greatest leeway for bargaining purposes. We can always accept less if our original proposal seems unattainable.
- Such an approach clearly defines the new market environment for carriers and shippers; consequently, such an approach minimizes uncertainty over future "rules of the game" and allows all parties to adjust to the new system.
- This approach is consistent with the recent reforms in aviation.
- Such a framework is not piecemeal, and does not rely upon ICC review and interpretation.

Cons

- Opposition for this proposal is very substantial, and will come from carriers, labor, and shippers; however, many large shippers will support it. The preference of many parties is for reform, not total deregulation.
- Carriers and some shippers will advance arguments of chaotic competition and the potential for anticompetitive practices absent regulation.

labor and the "industry," presently dominated by the large LTL carriers) will deflect the thrust of the legislation away from that part of the trucking industry most in need of regulatory reform (LTL operations).

Strategy B. Draft legislation around the TL and LTL distinctions presented in this paper. Complete removal of entry and route restrictions for TL carriers could be recommended after a very short transition period of perhaps 6 months. Some constraints on rate flexibility for TL carriers would be imposed until restrictions affecting the ability of rail carriers to compete effectively were relaxed. This more rapid deregulation of TL carriers might be appropriate because of the economics of TL operations, the extent of intramodal and intermodal competition already existing in that segment of the industry, and the Commission's more lenient entry and ratemaking policies for regulated TL carriers. Legislation in this form would also help alleviate shipper concerns over rail deregulation, particularly in the area of branchline abandonment and possible perceived anticompetitive rail practices after deregulation. TL carriers compete directly with rail carriers in many areas, and a complete easing of entry and pricing restrictions would help promote the efficient substitution of freight traffic between the modes while allowing more competition into certain markets now relying substantially on rail transportation. Moreover, this approach builds on the momentum already begun by the ICC in the area of TL deregulation.

For LTL carriers a more gradual relaxation of all entry and current operating restrictions would take place. This transition period would last up to five years. The slower conversion to deregulation for LTL carriers might

would also shift the burden of proof in all entry cases, and allow carriers into the industry when they have shipper support to propose a lower rate and/or different type of freight service.

b. Certificate Restrictions

For TL carriers, all commodity and route restrictions would be removed over a short transition period. The most burdensome route and operating restrictions would be removed immediately for LTL carriers, and these carriers would be granted a certain amount of flexibility to enter/exit markets without ICC review and approval.

c. Rates and Rate Bureaus

Collective ratemaking would be abolished, and rate bureaus would lose their anti-trust immunity. For TL carriers, no maximum or minimum rate regulation would exist after a transition period sufficient to allow rail carriers the ability to compete. Normal anticompetitive pricing provisions would exist for all carriers. For LTL carriers, the Commission would still retain the authority to set minimum and maximum rates for rate proposals outside a "no-suspend" pricing zone. Special provisions could be drafted for the Commission to grant new or additional authority in those instances when a carrier proposed a rate request in excess of the no-suspend zone.

d. Mergers

All authority over mergers would be transferred to the Department of Justice and Federal Trade Commission.

e. Private/Contract Carriers and Owner-Operators

Restrictions on dual operations and the number of shippers a contract carrier can serve would be removed. Private carriers would be granted easier intercorporate transportation provisions and access into the for-hire trucking sector. Easier leasing arrangements for exempt carriers would allow some

The teamsters will argue that safety and their wages will suffer.

- It may be difficult to enlist consumer support since the benefits to the individual consumer may be quite small, although the overall national benefits could be quite significant. There may be no early dramatic results from ICC-initiated reforms comparable to the airline experience to bolster the deregulation argument.
- If the proposal is seen as too radical, we may lose the opportunity for a realistic hearing and support from more moderate groups.
- There are gaps in the data and relevant studies to confirm the magnitude of the benefits to be derived from the proposed changes.
- The proposal provides limited ability to monitor the industry and correct any short-term economic dislocations that arise for carriers shippers, or communities.

Option 2. Substantial Deregulation Through Selective Legislative Change

This option would immediately deregulate TL carriers but, during a short transition period only relax many of the current restrictions on LTL carriers in the areas of entry/exit, rates and operating restrictions. The ICC would retain certain jurisdictional authority in these areas, however. A regulatory framework would continue to exist for resolving shipper concerns and a common carrier obligation for LTL carriers would remain.

1. Features

a. Entry/Exit

Except for financial, insurance, and safety requirements, all entry and exit restrictions would be removed for TL carriers after a short transition period. For LTL carriers, entry standards would be redefined legislatively so that the Commission would be required to place maximum emphasis on promoting competition within this sector of the industry. The legislation

- The proposal tends to be complicated and hard to understand.
- It leaves less bargaining room than Option 1, and it may be easier for opponents to "pick-off" key provisions from such a complicated bill.

Option 3. Administrative Action and Limited Legislative Change

This option would place primary reliance upon ICC administrative reforms.

The Administration's objectives would be articulated in regulatory proceedings before the Commission. In addition to administrative action, change would be sought by legislation to do the following:

- (a) Increase and define the Department of Transportation's right to petition the ICC for changes in rulemaking, and require the ICC to respond in a timely manner.
- (b) Amend the basic policy statement of the ICC to require it to place increased reliance upon competition in all its decisions.
- (c) Impose specific time limits on all ICC proceedings.
- (d) Deregulate entry and ratemaking in the TL sector of the industry.
- (e) Reform the rate bureau provisions, and restrict collective ratemaking.
- (f) Move toward a no-suspend zone for ratemaking in the LTL sector.
- (g) Provide the ICC with broad powers of commodity exemption from truck deregulation.

Pros:

- This option provides some benefits in terms of increased competition.
- It provides Congressional sanction to current ICC efforts and lessens the opportunities for court challenges to ICC-initiated reforms.
- It provides maximum flexibility to adjust to possible unforeseen circumstances.
- It reduces opposition to change, and would be the easiest

additional, but not complete, participation by those carriers in regulated traffic.

f. Forwarders

Substantially reduced entry requirements for LTL carriers, combined with total deregulation for TL carriers, would place LTL carriers at a considerable competitive disadvantage. This circumstance will, presumably, encourage LTL carriers to undertake more competitive pricing policies while they seek to offer more innovative services. These market incentives would encourage shippers to consolidate their shipments for the purpose of purchasing unregulated truckload service. Freight forwarders would become increasingly important under this option, and they would also be deregulated as a means of encouraging competition.

2. Arguments For and Against

Pros:

- Option 2 offers many of the benefits of Option 1.
- Opposition may not be quite as vocal for this proposal. The option could be characterized more as reform and not "a destruction of the whole system."
- It allows additional time for monitoring the changing situation, conducting additional analysis, and correcting any economic dislocations.

Cons:

- The proposal would still encompass a very substantial amount of opposition. It goes well beyond anything the ATA, Teamsters, or many of the shipper groups wish although many larger shippers might prefer total deregulation to a partial approach.
- It relies upon some administrative discretion to implement certain reforms and could be frustrated by an uncooperative ICC. Because of this the anti-inflationary benefits are less certain.

V. DISCUSSION OF ANTICIPATED ARGUMENTS AGAINST DEREGULATION

There will be a number of arguments advanced against any deregulation effort, some based on legitimate concerns and some with little foundation. After 43 years of regulation, there are understandably uncertainties about substantive changes in the system. The arguments have to do with fears of industry "chaos", destruction of certificate values, deterioration of service to small communities, reduction in industry safety, increased industry concentration, adverse effects on labor and the environment, and predatory and discriminatory carrier practices. Finally, the argument is addressed that no change is needed because an enlightened ICC is already granting 97% of new applications for entry.

It should be kept in mind that all these arguments will be raised no matter which option is chosen. We have analyzed these arguments and either assess their validity or indicate how they might be addressed in a legislative proposal. The evidence on many of these issues is sometimes anecdotal and sometimes based on empirical studies. The data base is limited, and because of the complexity of the industry, analytical efforts have not countered all the arguments completely. Because of these problems some of the arguments in favor of deregulation have been based on theoretical economic analysis rather than empirical evidence or case studies.

1. Chaos in the Trucking Industry Perhaps the most pervasive argument which will be raised against trucking deregulation is that it will result in "chaos"; that is, excessive volatility of freight rates and very high turnover of carriers. There is little reason to expect significant and prolonged disruption, however.

Cons:

- Many of the benefits are uncertain because implementation relies to a great extent upon administrative discretion, and could be frustrated by an uncooperative ICC.
- Maximum uncertainty makes it difficult for carriers and shippers to adjust and plan, and also creates the maximum incentive to fight and not to adjust to the changes.
- It could be viewed by critics of regulation as a withdrawal from the Administration's commitment to deregulation.
- There will still be opposition, and little may be achieved for the legislative effort.

and existing carriers have purchased the operating rights of others, rather than go through the lengthy certification process before the ICC. These operating rights, or certificates, are often traded at substantial prices.¹⁶ Their value is largely, but not entirely, due to restrictive ICC entry policies. Established truckers will argue that deregulation will destroy these certificate values and that this would be unfair to present holders, particularly those who may have recently purchased certificates at substantial sums, and others who had planned to sell them off as a retirement nest egg.

There are a variety of views on the current value of certificates. Sources in the financial community and in the trucking industry indicate that in the past few months the market value of certificates has dropped substantially. This may be attributed to the ICC's recent attitude toward entry and rate increases, as well as publicity and uncertainty about possible future truck deregulation. Several years ago, before ICC reform initiatives, the Council on Wage and Price Stability estimated industry-wide certificate values to be in the range of \$3-4 billion.¹⁷ Book values are estimated to be approximately \$600 million for all carriers.¹⁸

To the extent that certificate values reflect restrictive ICC entry policies, deregulation would eliminate or at least greatly reduce them. However, certificate values probably also partly reflect what would in other industries be called "goodwill." Goodwill is the value of the firm as a going concern with established customers and market position. In certain instances the value of the firm will increase after deregulation, since the host of regulatory restrictions which handicap carrier efficiency will be eliminated. Carriers will have flexibility to adapt to market conditions, to exploit market opportunities freely, and

There is likely to be more turnover of carriers than at present, both among new entrants and inefficient firms already in the industry. However, small businesses in all industries experience failures. This in itself may not be undesirable, because the alternative requires both prohibiting individuals from entering and having a chance to succeed, and protecting the least efficient ones.

Everything we know about the trucking industry suggests that turnover will not pose a serious problem of disruption. First, unregulated or significantly less regulated intrastate markets such as New Jersey function well without regulation.¹⁵ Second, private and exempt trucking exist without ICC entry and rate regulation. Both sectors function relatively well, do not have abnormally high turnover rates and have maintained their market share over time. Third, the ease with which trucking capital can be shifted from one market to another, or disposed of in the well-functioning second-hand equipment market, substantially reduces the potential harm from whatever carrier failure does occur. Fourth, there is no evidence of chaos in the TL sector of the trucking industry which is largely unregulated, and entry into the LTL sector will still be somewhat limited by the heavier capital requirements. Fifth, the allegedly chaotic conditions of the 1930s, which are at the root of today's concern over chaos, reflected the massive unemployment and consequent lack of other opportunities during that period. The industry today is substantially larger, more mature and more stable, and the disastrous economic conditions of the Great Depression are not likely to recur. Finally, because deregulation can be phased in over a period of time, any disruption can be softened.

2. Erosion of Carriers' Certificate Values In many cases, prospective

is wrong. First of all, regulated service to rural areas is far from satisfactory now in many cases. Studies conducted by state and regional authorities¹⁹ indicate that under the present system service is often quite limited to rural areas; often only one or two carriers serve a particular small community. Second, even if this cross-subsidy is desirable, the current regulatory system contains no mechanism to ensure that it actually occurs. In considering rate proposals, the Commission merely reviews the request to ensure that industry earnings will be appropriate. There is no quid pro quo between the Commission and the individual carrier to require that any excess earnings on certain routes will be used to subsidize unprofitable small community service. It is also a mistake to believe that it is the same carrier which always serves both the rural and non-rural routes. Rural routes are in many instances served by carriers operating only in those areas, and cross-subsidy is impossible in these cases.

Moreover, the Commission has very limited tools to assure even minimum service to the small communities listed on a carrier's certificate. The law does not provide the Commission with authority to regulate scheduling. Even though a carrier is obligated to serve a particular community, it is free to reduce the level of service it provides to a community to the minimum required by its common carrier obligation. Under the present system, the carrier has every incentive to avoid serving markets which it feels are unremunerative and there is little to stop him. In fact, although the Commission may investigate service performance after receiving complaints from shippers, the limited size of the Commission's field force and its need to enforce other ICC regulations reduces the enforcement credibility of the common carrier obligation. The enforcement problems in this area have been well-documented by Congressional

to expand or contract to optimal size. The overall efficiency of the industry is likely to increase. Many of these factors should act to offset the decline in that portion of certificate values which is due to monopoly restriction. The net effect should vary widely from firm to firm. Those firms which are severely hampered by certificate restrictions today are likely to experience a substantial appreciation in the overall value of the firm. However, less efficient firms will be disadvantaged.

The net effect of these changes should be for investors to base their investment decisions on the true economic value of the carrier rather than on the inflated earnings made possible by restrictive ICC policies. To some extent this change is already taking place as investors are placing less reliance on certificates as collateral for loans.

For reasons of equity, however, the problem of depreciated certificate values may have to be addressed in any deregulation legislation.

3. Small Communities Some shippers and regulated truckers argue that small communities receive good trucking service as a result of the existing regulatory system. They argue that ICC practices encourage carriers to subsidize service to small communities by their greater-than-normal earnings in other markets. A variation of this argument is that large shipments subsidize unprofitable small shipments, and many of these small shipments go to small towns. It is also argued that deregulation will end this cross-subsidy and therefore cause a deterioration in small community service, or cause rates for small communities to increase.

There is, however, no economic evidence to support this argument. There is theory and little fact, and there are good reasons to believe the theory

compete will be to cut back on their safety expenditures. They have also argued that a by-product of the certification procedure is an identification system, with names, addresses, and scopes of activities. This system makes it easier to spot problems and locate offending carriers, and it is alleged deregulation will end this system.

The evidence is inconclusive that a change in the regulatory system will cause increased safety problems. Furthermore, there are several reasons to believe that deregulation will not adversely affect carrier safety. First, large segments of the motor carrier industry today operate without certificates. Extensive analysis of the available data by several Federal agencies provides evidence supporting both sides of the safety issue, but does not conclusively demonstrate that non-regulated truckers are less safe than regulated truckers. Cutting safety expenditures does not necessarily save money, nor does cutting such corners as hours of service. Such cuts cause accidents and accidents cost money. There is little reason to believe that truckers would engage in unsafe activities which might jeopardize the critical components of their businesses — their drivers, their trucks, and their customers' cargo.

Second, the ICC does not regulate the safety of trucks, just as the CAB does not regulate the safety of airlines. It is the DOT that has the broad safety authority to regulate truckers. Economic regulation and safety regulation are separate but, in some respects cooperative functions under the present system. DOT does not rely upon the ICC regulatory process to ensure the safe operations of truckers. The ICC, however, does make use of DOT safety information in considering carrier requests for operating authority. It would be a mistake to rely upon an economic regulatory system to guarantee safety.

and state studies.²⁰ For instance, a study by the Public Service Commission of Wyoming²¹ found that only half the carriers authorized to provide small community service actually did so.

Third, service to small communities can be profitable. It should not be overlooked that many small communities rely upon unregulated agricultural haulers to deliver their necessary fruits and vegetables, and a USDA study²² shows this segment of the industry to be relatively stable and prosperous. Another DOT study²³ of regulated small carriers serving rural areas found that this service could be profitable, especially where the carrier tailored his operation to the needs of the small community environment. The Senate Commerce Committee funded an independent study which found that 75 percent of the carriers serving small communities believed that the business was "desirable." This figure jumps to 93 percent for the larger small communities with populations between 10,000 and 25,000. The study concludes, "Predictions of wholesale elimination of service to small communities following deregulation are completely unsupported by the data Rather, it appears that service to small communities would not deteriorate and might, in fact, improve under deregulation."²⁴ Change in the regulatory system could improve service to small communities by allowing freer entry into routes, by allowing the agricultural exempt carriers to carry regulated goods back to the rural areas, and by allowing selected rate increases to attract additional service where appropriate.

4. Safety Many groups, including the ATA and the Teamsters, have argued that deregulation will have an adverse impact upon the safety of trucking operations. They argue that deregulation will bring increased competition and that one of the ways that carriers will attempt to trim their costs to

The present ICC system does not guarantee profits to each and every carrier, nor does it earmark profits for safety expenditures. In the end, there must be a separate safety regulatory authority.

Additionally, it should also be noted that the options in this paper all include some requirement that carriers entering the industry be fit and financially responsible, which would include adequate safety criteria.

Safety can always be improved, however, and the DOT continues to recommend that certain additional authority be granted including a penalty system that acts as a greater deterrent to safety violations, greater reliance upon civil penalties and better protection against retaliatory firings for drivers who report safety violations. With these improvements, the safety of the trucking industry can be not only maintained but improved.

5. Concentration in the Trucking Industry Opponents, especially the Teamsters, argue that deregulation will cause an increase in trucking concentration and market dominance by a few large firms. They cite results of deregulation in Australia which led to high concentration, especially in the freight forwarder industry. There are a host of reasons -- including demographic and economic -- why the Australian experience is not applicable to this country, but the primary reason is the absence of a comparable antitrust system in Australia.

In this country given ease of entry into the industry under deregulation, the current large number of firms, and the absence of any significant economies of scale, concentration should not become significant at the national level as a result of deregulation. Because there are minimal efficiency or cost advantages for larger firms, smaller firms can and do compete effectively, which inhibits a trend to bigness. Some have argued that there are "network

advantages" for large carriers because some shippers prefer to deal with one large carrier rather than a series of small carriers. These network effects may pose some barriers to entry in the LTL sector, but they are insignificant compared with barriers in other industries such as the air industry now being deregulated.

Concentration should be considered not only from a national viewpoint, but in individual markets as well. As industry spokesmen admit and studies²⁵ show, concentration may be very high now in many corridors between metropolitan areas, where a small number of carriers are authorized to operate. The removal of ICC entry restrictions should help reduce concentration in individual markets because of actual or threatened expansion by new or existing carriers. Also, in areas where the industry is unregulated there is no demonstrated trend toward concentration.

6. Impact on Labor. The basic thrust of the Teamsters' opposition to deregulation is it will destabilize the industry. The Teamsters take credit for bringing rationality in labor relations and responsible administration of collective bargaining agreements to trucking; the concept of uniform wages and working conditions under a National Master Freight Agreement dates back only to 1964.

The Teamsters see deregulation as disrupting these established employment relationships. With the elimination of the working structure of the industry as it is known today, they believe carriers will begin to cut corners. It is in this context that the Teamsters' fears of proliferation in the use of owner-operators arise.

The Teamsters recognize the independent owner-operator as a significant

element in the trucking system. A number of the major common carriers organized by the Teamsters have established separate "special commodity" divisions to handle steel, furniture, and other specialized freight, and utilize owner-operators for such traffic. The Master Freight Agreement folds in such operations under the terms of the contract for wages and benefits (including rates to be paid for equipment owned and driven by the owner-operator), but specifically prohibits the engaging of owner-operators to displace regular drivers.

With the advent of deregulation, however, the Teamsters see the demarcation on use of owner-operators breaking down, as carriers seek to shave costs. Unless the law is clarified, the Teamsters are confronted with conflicting interpretations by the National Labor Relations Board, the ICC, and the Department of Justice as to the right of owner-operators to belong to a union. The Teamsters thus envision the situation where their work is being siphoned off by owner-operators — while the Teamsters are handcuffed in organizing these independents because they are legally held to be private contractors, rather than employees of the carriers for whom they are driving.

While deregulation under the Interstate Commerce Act will not directly affect the responsibilities for trucking safety lodged with DOT, the Teamsters argue that economic regulation — by stabilizing the structure of the industry — tends to build in safety. Conversely, they argue, the relaxation of controls will lead to cost-cutting in labor-related costs and expenditures for safety, especially among independent owner-operators. Because the owner-operator functions legally as a contractor rather than an employee, they argue, he is far more prone to bypass safety requirements, given the economics of his

operation — and the pressures on him for nonconformance will increase under deregulation. As noted in the safety section above, this argument has questionable validity because of the economics of his operation.

Rate-making procedures are of concern to Teamsters because they impinge on the financial viability of trucking employers. The major carriers use the rate bureaus primarily to keep tabs on their competitors; rate-making procedures are probably most necessary to the stability and survival of small companies. The critical question for the Teamsters is what happens under deregulation, and a possible return of the "dog eat dog" days.

The issue of jobs under deregulation has already surfaced under recent ICC rulings. As the boundaries on regulated carriers (where the Teamsters are the strongest) are eliminated, so that private carriers and owner-operators can move in and out of what is now the regulated carriers' domain, the Teamsters believe the impact on their jobs will be direct and drastic; and that private carriers, especially the large companies, will be able to wheel and deal with shippers, to the detriment of small-size common carriers. Rather than ease of entry eliminating predatory practices, deregulation will encourage such behavior, in the Teamsters' view.

We cannot precisely predict the efficiency gains from deregulation, but we do expect some gains which may slow the growth of employment in the trucking industry. There may also be some downward pressure on wage settlements. For both of these reasons, we expect strong demands from the Teamsters for labor protection in the legislation.

On the other hand, deregulation may have certain effects which would be advantageous to organized labor in the trucking industry. According to

our best available information, labor among regulated carriers is much more intensely organized than among private carriers. There has been a significant trend in recent years for the regulated segment of the industry to grow less rapidly than the private carrier segment of the industry. A DOT study on private carriers²⁶ found that many firms are in private carriage because of the many restrictions placed upon regulated carriers. If these restrictions are removed, this trend can be stopped if not reversed, thus providing certain new opportunities for unionization.

7. ICC Easing of Entry The carriers will argue that legislation is not necessary because the ICC already grants almost all applications. During fiscal year 1978, the figure was 96.7%.

The Commission, however, has far from dismantled all the numerous obstacles to applicants for operating rights. The statistical evidence, taken alone, presents an artificially high and unrealistic picture of entry in the trucking industry. First, the figure represents both full grants as well as partial grants of authority. Consequently, even applications that were denied in significant part by the Commission and granted in small part are counted as granted. This figure also represents only those applications which reached decision on the merits, and fails to reveal those applications that were either dismissed or withdrawn. Many also believe that most of the approved applications have been for TL carriers, rather than LTL carriers. Moreover, this figure represents a pre-judged, self-selected group of applications that the carriers believe are small enough or so inconsequential as to be approved without controversy. Many carriers still believe that it is fruitless to seek extensive operating rights and these fears have been justified as recently as November 22, 1978, when

two applications for additional operating authority were denied because the applicants failed to demonstrate that the existing service was "inadequate in some substantial respect." Anderson Trucking Service, Inc. MC-05876, Sub.211; International Transport, Inc. MC-113855. These cases demonstrate that entry can be restricted at any time and in an arbitrary manner.

8. Environmental Effects of Motor Carrier Deregulation There is some concern that substantial deregulation of the trucking industry, specifically the prospect of liberalized entry and expansion within the industry, will result in adverse environmental consequences such as increased highway congestion and air and noise pollution caused by a growth in truck traffic. These environmental issues are inextricably related to other social concerns such as safety and energy and have significant implications for future highway design and investment decisions.

The argument which underlies this concern is that the existing system of regulation which restricts entry, effectively limits the number of trucks on the highway, thereby reducing the adverse environmental effects of truck traffic.

While deregulation of the trucking industry may result in some growth in the number of trucking firms, this does not necessarily mean an increase in the number of trucks on the highway. The number of trucks is determined by the amount of cargo to be shipped and the operating efficiency of the firms within the industry and the division of freight between trucks and rails.

Deregulation may even result in less truck traffic on the highways. Carriers will be able to rationalize their service patterns by discarding specific route designations and eliminating backhaul restrictions, both of which will

foster price competition among firms. Additional price competition will, in turn, instill a new discipline on costs and operating efficiency.

This could mean a decrease in the number of truck-miles necessary to haul available cargo, because with less circuitous routing and empty mileage, trucks will travel more fully loaded. The unknown factor is what happens to the division of traffic between railroads and trucks. Unless there are unforeseen large diversions of freight from railroads to trucks, the net result could be a reduction in the undesirable environmental consequences of trucks such as highway congestion and air and noise pollution.

9. Predatory and Discriminatory Practices Some small carriers and shippers will argue that rate freedom will lead to predatory (below cost) pricing. This argument envisions large carriers with adequate financial resources charging below-cost prices to drive small competitors out of the market, and then recouping the initial losses by charging monopoly prices.

The key ingredient for exercise of predatory pricing is the bar to potential competitors when it is time to recoup the initial losses. Under the present system, there are no real barriers to entry in the TL sector, and predatory pricing is not a problem. Under deregulation, the highest barriers to entry of the LTL sector — the ICC public necessity and convenience criteria — will be removed or reduced, and the fairly heavy capital requirements will be no higher than before. Thus, since would-be predators will have a more credible threat of entry with deregulation, the monopoly situation will not likely develop. It would be also relatively easy to allay fears by providing protection against predatory conduct in the legislation, at least during the transition period, as was done in the air bill.

The same small carriers and shippers may argue that discriminatory pricing will also result from rate freedom. They will contend that large shippers will use their market power to obtain preferential rates and services unavailable to small shippers.

Large shippers already use their bargaining power — as other firms throughout the economy use theirs — to obtain rate and/or service advantages. As an economic fact of life, it often does cost less (per unit of service supplied) to serve the trucking needs of a large rather than a small shipper. Such carrier-and-shipper-specific cost differences should be reflected in the rates charged. Under the current regulatory system not enough emphasis is placed on the variable pricing of motor freight services; the end result is excessive and costly service competition between carriers instead of more price competition, which is often preferable to shippers. If necessary, discriminatory pricing may be prohibited as part of the legislation.

FOOTNOTES

- ¹W. Bruce Allen, et al., Examination of the Unregulated Trucking Experience in New Jersey, prepared for the U.S. Department of Transportation under Contract #DOT-CS-700054, July, 1978.
- ²Denis A. Breen, "Regulation and Household Moving Costs," Regulation Vol. 2, No. 5 (Sept/Oct 1978) pp. 51-54.
- ³Interstate Trucking of Fresh and Frozen Poultry under Agricultural Exemption, U.S. Department of Agriculture, Marketing Research Division, Marketing Research Report No. 224, March 1958; Interstate Trucking of Frozen Fruits and Vegetables under Agricultural Exemption, U.S. Department of Agriculture, Marketing Research Division, Marketing Research Report No. 316, March 1959; Supplement to Interstate Trucking of Frozen Fruits and Vegetables under Agricultural Exemption, U.S. Department of Agriculture, Supplement to Marketing Research Report No. 316, July 1961.
- ⁴D. Daryl Wyckoff, "Motor Carrier Deregulation -- Some Unanswered Questions" (speech delivered to the Joint Meeting of the Ohio Chapter of the Transportation Research Forum and the Eastern Central Motor Carriers Association, December 17, 1974). Allen and Hymson, however, point out that Wyckoff failed to correct for the 20 percent rate of inflation in Britain at that time. See W. Bruce Allen and Edward B. Hymson, "The Costs and Benefits of Surface Transport Regulation: Another View" in Paul W. MacAvoy and John W. Snow, eds., Regulation of Entry and Pricing in Truck Transportation (Washington, D.C., American Enterprise Institute, 1977), p. 100.
- ⁵American Trucking Associations, "Accounting for Motor Carrier Operating Rights," Brief and Petition to the Financial Accounting Foundation, 1974.
- ⁶Interstate Commerce Commission, 1977 Annual Report, Table 10, p. 144.
- ⁷Motor Common Carrier Freight Rate Study for Nine Western States, Final Report, prepared for Federation of Rocky Mountain States, Inc., in cooperation with U.S. Department of Transportation, May 1975.
- ⁸Traffic World, various issues.
- ⁹Edward Miller, "Effects of Regulation on Truck Utilization," Transportation Journal, Vol. 13, No. 1 (Fall 1973), pp. 5-14.

¹⁰See Position of the United States Department of Justice to Eliminate Motor Carrier Gateway Restrictions on a Gradual Basis, Petition for I.C.C. Rulemaking, August 22, 1977, at 6.

¹¹A case in point is Timothy Person. Allstates Transworld Van Lines, Inc. MC-144009. Mr. Person, president of Allstates Transworld Van Lines asked the ICC for national household goods operating rights. Person proposes to operate primarily in inner city areas, a market long ignored by the large firms. His application was automatically opposed by such industry giants, as National, United, Bekins and Global Van Lines. Hearings will be held in Washington, St. Louis, as well as Los Angeles with Person required to bear the expenses of a transcontinental proceeding. Even if the ICC ruling in February is favorable to Person, he still may face administrative appeals and possible court challenges by the protestants. See, "White Mayor Pleads the Case for a 'First' for Black Mover," The Washington Star, October 27, 1978, at F-5.

¹²Private Carriage Motivation and Impact of Rural Location PS-50367, Drake Sheahan/Stewart Dougall Inc., prepared for U.S. Department of Transportation, Report No. 2273, March 28, 1975; Evaluation of Potential Changes to Federal Economic Regulations Governing Private Carriage, Drake Sheahan/Stewart Dougall Inc., prepared for U.S. Department of Transportation, Report No. DOT-OS-40113, December 6, 1974; SUPPLEMENT Evaluation of Potential Changes to Federal Economic Regulations Governing Private Carriage, Drake Sheahan/Stewart Dougall Inc., prepared for U.S. Department of Transportation, Report No. 2228, March 20, 1975.

¹³Ibid.

¹⁴Investigation and Suspension Docket No. M-29772, General Increase S.M.C.R.C., April, 1978 (decided November 27, 1978).

¹⁵See footnote 1.

¹⁶For example, the certificates of a bankrupt firm were sold for over \$20 million. "Selling of Associated's Rights Combines Drama with \$20.6 Million Price," by Patricia Cavanaugh, Transport Topics, July 19, 1976.

¹⁷Council on Wage and Price Stability, "The Value of Motor Carrier Operating Authorities," June, 1977, p. 7.

¹⁸This estimate is based on a 1974 figure of approximately \$380 million for all Class I motor carriers (\$286 million of which was for intercity carriers of general freight), and a 1972 figure of \$27 million for Class II carriers. These are the most recent data available from ICC. Allowing for a 50% increase in book values in the intervening years yields the \$600 million figure.

¹⁹ See footnote 7.

²⁰ Improved Service to the Small Shipper Is Needed, Comptroller General of the United States, CED-77-14, Washington, D.C., December 22, 1976.

²¹ See footnote 7.

²² Stability of Motor Carriers Operating Under the Agricultural Exemption, by Walter Miklius and Kenneth L. Casavant, prepared for U.S. Department of Agriculture under Research Agreement No. 12-17-04-8-917-X, August 1975.

²³ Economic Analysis and Regulatory Implications of Motor Common Carrier Service to Predominantly Small Communities, Submitted by R. L. Banks & Associates, Inc., Washington, D.C., a final report to the U.S. Department of Transportation, pursuant to DOT-OS-50095, June 24, 1976.

²⁴ The Impact on Small Communities of Motor Carriage Regulatory Revision, prepared at the request of the Senate Commerce, Science, and Transportation Committee by Policy and Management Associates, Inc., Cambridge, Mass., June, 1978, p. 128.

²⁵ "Numbers of Competing Carriers on Selected Routes" (DOT draft).

²⁶ U.S. Department of Transportation, Office of Transportation Planning Analysis, Industrial Shipper Survey, September, 1975.

Appendix B. The Effect of Deregulation on Rates

There is considerable evidence that rates are higher as a result of ICC regulation, and that deregulation would produce substantial savings in the cost of truck transportation.

1. Collective agreement on prices -- commonly known as price fixing -- is a felony, punishable by fines up to \$100,000 and 3 years imprisonment for individuals, and \$1 million for corporations. The trucking industry, however, has a special immunity from the antitrust laws which permits carriers to collectively set rates. This immunity was enacted by Congress in 1948 over the veto of President Truman. Truman warned that the exercise by private groups of this substantial control over the transportation industry involves serious potential harm to the public.

While some rates are set competitively (particularly rates for truckload shipments), most rates are set by groups of trucking companies known as rate bureaus. Although rate bureau agreements are subject to ICC review, effective oversight is impossible: over 5,000 pages of tariffs are filed each day before the ICC.

The combination of minimal ICC oversight and collective ratemaking means that the trucking industry, acting in concert, sets rates for the public -- not the government agency charged with safeguarding the public interest. This arrangement differs sharply from the airline industry. Prior to deregulation, the CAB, not airline associations, set fares. Even so, the CAB estimates that consumers saved \$2.5 billion in 1978 as a result of deregulation.

The rates set by rate bureaus are unnecessarily high.

o Rates set outside rate bureaus are lower. Some rates, especially those for truckload shipments, are individually negotiated between the trucking company and the shipper. Truckload rates for 15 sample commodities have risen at a lower rate than either the Wholesale or Consumer Price Indexes. By contrast, rates set by rate bureaus have risen at a faster rate than either the CPI or WPI for the same commodities.

o The trucking industry is enormously profitable. The average return on equity for the 8 largest regulated trucking companies is nearly twice the average return for firms in the Fortune 500 in 1973 and 1974. The ICC recently found that trucking companies from the major rate bureau in the South had a composite rate of return as high as 20%. These returns far exceed the 14% currently being earned by unregulated manufacturing industries -- despite the fact that

the ICC believes a 14% return is appropriate for the trucking industry.

○ ICC certificates are bought and sold for enormous sums -- a price ultimately paid by the consumer. The American Trucking Associations called the operating certificate the "most valuable asset" of a motor carrier. For example, when Associated Transport went bankrupt in 1976, the operating rights carried on its balance sheet at \$976,000 sold for just over \$20 million. Eastern Freightway, Inc., recently sold rights for about \$3.8 million.

2. There is empirical evidence that deregulation would lower rates.

○ In the mid-1950's, fresh and frozen dressed poultry and frozen fruits and vegetables, which had been subject to ICC regulation, were declared exempt commodities by the courts. As a result of deregulation, the USDA estimates that trucking rates dropped 33% for poultry and 19% for frozen fruits and vegetables. And there is no doubt that deregulation was the cause for the rate decreases: when Congress voted to re-regulate these commodities, trucking rates increased significantly.

○ Unregulated intrastate rates in New Jersey are 10-15% lower than rates for comparable interstate shipments.

○ Unregulated household mover rates are 40-67% lower within Maryland than rates for comparable interstate shipments.

○ Trucking deregulation in foreign countries has lowered rates. Rates in unregulated Canadian provinces are about 7% lower than in regulated areas. One study reports that in 1973 one large European manufacturing company paid about 50% more to have its products moved a given distance in West Germany -- where the trucking industry is strictly regulated -- than to move them the same distance in unregulated Great Britain, Belgium, Holland, or Sweden.

○ Shippers and some truckers have testified that deregulation would lower rates. For example, a spokesman for the American Farm Bureau testified before your Antitrust Commission that "...if agriculture had been saddled with a totally regulated motor carrier and barge transportation system for the past 35 years, the cost of transportation, which now accounts for nearly 10% of the nation's food bill, would be a third greater; and we would be experiencing far more difficulties in securing needed transportation services."

Appendix C.

Trucking Deregulation and Service to Small Communities

Trucking service to small communities is the most difficult issue we will face in the deregulation debate. The trucking lobby's claim that small towns will lose service is their most potent political threat to Congressional action on deregulation.

The trucking industry makes the following arguments:

- o Small town service is relatively unprofitable. Trucking companies provide this service only because the ICC requires them to do so. Regulation, the truckers argue, does not give them a free ride -- they are protected from competition in exchange for their obligation to provide service to undesirable small points that would not otherwise be served.

- o Profits from major city, long haul markets must be large enough to cross subsidize unprofitable service to small towns.

The Department of Transportation, which has studied this issue for many years, disputes these industry claims. The Department concludes that far from justifying restrictive regulation of the trucking industry, the current system has impaired rather than guaranteed rural motor carrier service.

The following summarizes our major evidence on this issue:

1. Recent actions by the trucking industry show that small town service is desirable.

The ICC has recently begun to emphasize competition and reduce regulatory constraints. Many trucking companies argue that the industry has already been effectively deregulated. The industry's reaction to the new emphasis on competition is a good indication of how the industry will behave in a less regulated environment.

In the first 7 months of FY 1979, the industry has done -- or not done -- the following with respect to small town service.

- (1) Carriers are applying to begin service to hundreds of small towns, and hence undertake the "obligation" to serve them. Some of these towns are so small that they have never had air service -- and do not even have airports.

For example, Majority Leader Byrd has complained that airline deregulation has had an adverse impact on air service to small West Virginia points. By contrast, in February 1979, a trucking company applied to begin service to haul general commodities between Friendly and Ravenswood, W. Va., serving all intermediate points and all off-route points in Pleasants and Wood Counties. Ryder Truck Lines, one of the nation's largest companies, applied in November 1978 to serve between Charleston, W. Va. and Lexington, Kentucky, also serving all intermediate points.

Meridian, Mississippi has complained that Delta Airlines stopped air service. By contrast, Roadway Express, another large company applied in January 1979 to begin service between Meridian and St. Louis, Missouri.

o Commercial Lovelace Motor Freight, Inc. applied on January 1, 1979 to serve:

(1) Between Cincinnati, Ohio and Bettendorf and Davenport, Iowa and

(2) Between Rock Island and Moline, Illinois

serving all intermediate points and off route points of Albion, Bridgeport, Canton, Fairfield, Lawrenceville, and West Salem Illinois, Bruceville, Carthage, Colfax, Frankfort, Kokomo, Linton, Marion, Lafayette, Napoleon, Rushville, Washington and West Lafayette, Indiana, Clinton Camanche, Fairport, Montpelier and Muscatine, Iowa, and all off-route points in Champaign, Henry, Knox, McLean, Peoria, Rock Island, Tazewell, Vermilion and Woodford Counties, Illinois, points in Boone, Fountain, Hamilton, Hendericks, Montgomery and Shelby Counties, Indiana and points in Scott County, Iowa.

2. In some instances, carriers are paying enormous sums for small town certificates.

Last October, a truck company paid \$225,000 for rights to serve between Boston and Brunswick, Maine, including all intermediate points between Portsmouth, N.H.; York Harbor, York Village, York Beach, Kennebunkport, Old Orchard, Lewiston, and Portland Maine.

3. In the first 7 months of FY 1979 no trucking company has asked the ICC to delete a small town from its certificate, and thereby cease its "obligation to serve."

In the 7 months of FY 1979, no trucking company has requested deletion of a small town from its certificate. There has been a total lack of such requests despite the fact that the ICC has granted virtually every revocation of all or part of a certificate during this period.

This situation contrasts sharply with the airline industry, in which airline carriers frequently applied for (and the CAB often granted) deletion of small points from their certificates.

4. Carriers who are not regulated by the ICC provide extensive small town service.

The ICC exempts from regulation two major classes of trucking companies: (1) haulers of exempt agricultural commodities, and (2) private carriers, which are non-transportation companies (such as Sears) who own their own trucks and haul their own commodities. These trucking companies are not regulated by the ICC; and may serve or abandon any point at will. And yet these carriers provide extensive service to small communities.

(1) Exempt agricultural haulers. A spokesman for the regulated trucking industry recently estimated that 65% of produce carried by trucks is hauled by unregulated carriers. And yet there is no small town in America that does not have fresh fruits and vegetables in its stores.

Chuck Fields, a spokesman for the American Farm Bureau Federation, an organization with over 40 years of experience with unregulated truckers, recently testified:

"The communities that are now being served by the unregulated sector of trucking are largely the small communities where agriculture exists. So that, in itself, is an indication that service will be provided. I wonder if you have ever thought of the fact that you go to the smallest hamlet grocery store in America and find eggs, for example. There is no board in Washington that regulates the transportation

of eggs, regarding certain supplies of eggs are needed at given points. The market system makes it possible for eggs to be there when the consumer wants them. We wonder, sometimes, if there is a secret board here in Washington that manages all of that. But we find that there isn't. It does work; the market demand does create the response, and we get the service." (May 15, 1978, before the Senate Judiciary Committee)

(2) Private Carriers. A recent study commissioned by the U.S. Senate Committee on Commerce, Science and Transportation shows that small towns are heavily reliant on private carriage. And yet these carriers serve small towns solely on their own initiative. Since they are not regulated by the ICC, they have no "obligation" to provide this service.

II. Studies confirm that ICC regulation does not guarantee small town service.

1. The ICC does not vigorously enforce the "obligation" to serve small towns.

The ICC does not even know which companies have authority to serve a particular point, much less which companies are actually providing the service.

In the 44-year history of motor carrier regulation, the ICC has never revoked a certificate on the grounds that a carrier failed to provide small town service.

2. The ICC does not require carriers to serve all points for which they have authority. Studies confirm that carriers are not serving many of the points for which they have authority and hence an "obligation" to serve.

For example, the Wyoming Public Service Commission (PSC) examined the extent to which ICC-regulated trucking companies meet their common carrier "obligation" to serve towns within the predominately rural state of Wyoming. The PSC selected 11 towns for study: Casper, Cheyenne, Cody, Gillette, Jackson, Laramie, New Castle, Rawlins, Riverton, Rock Springs, and Sheridan.

The Wyoming PSC found that on the average only half of the carriers authorized to serve any one of these 11 towns were doing so.

These abandonments go unnoticed by the ICC because carriers simply stop providing service. Unless a shipper complains, the ICC has no way of knowing that service has ceased.

3. Service to small towns is profitable -- either in its own right, or as feed to its overall operations.

(1) There is no evidence that major city service cross-subsidizes small town service. Neither the rate structure nor ICC rate regulation is designed to allow excess profits on major city routes to cross subsidize small town service. In reviewing proposed rates, the ICC determines whether they are reasonable, or whether they would give the industry excess earnings. The ICC does not approve rate levels based on the commitment of carriers to subsidize unprofitable service.

(2) Studies prepared by the Department of Transportation conclude that a lot of service to small towns is being provided by common carriers who specialize in serving smaller, rural communities.

According to interviews conducted with management officials, these carriers serve in small, short-haul, LTL markets which larger ICC carriers have largely neglected in recent years.

Yet, these carriers were showing a net overall profit of their books. According to a DOT study, these carriers:

"succeed because they are specialists in serving markets requiring the kind of attention which appears to be uneconomical for larger carriers to offer. In essence, small carriers appear to be better equipped to handle shipments in small markets because their pickup and delivery service, as well as terminal operations, are geared for small LTL shipments, their managements maintain close relations with customers, tight control over their organizations, and pay close attention to changing market conditions.

(3) Other studies show that many large carriers are avoiding small town service by entering into pooling agreements with smaller carriers.

Since 1971, the ICC has encouraged the creation of formal "pooling arrangements" under which local, short-haul carriers agree to provide pick-up and delivery service to and from certain points on behalf of one or more long-line, interstate carriers.

Pooling arrangements provide a mechanism by which long-line carriers can retain operating rights to smaller points without directly serving them. Many long-haul carriers simply cease serving points which they are theoretically obliged to serve.

This abandonment of service goes unnoticed by the ICC because other carriers who specialized in serving smaller points fill the service gap.

4. Existing regulation harms service to small towns.

o Route certificates for regular route, general commodity carriers often specify the actual highway the carrier must follow.

If a carrier leaves the highway to serve a small town off the beaten track, he is violating the law.

o Route certificates often specify that carriers may not serve intermediate points between cities authorized for service.

o Exempt haulers of agricultural commodities are unable to fill their backhauls with other commodities unless they can overcome severe regulatory restrictions.

THE WHITE HOUSE

WASHINGTON

Date: 6 January 1979

MEMORANDUM

FOR ACTION:

EIZENSTAT
MOORE *attached*
MCINTYRE - *Thurs pm*
SCHULTZE
KAHN

FOR INFORMATION:

THE VICE PRESIDENT

FROM: Rick Hutcheson, Staff Secretary

SUBJECT: BROCK ADAMS MEMO, "RAILROAD REGULATORY LEGISLATION"

*DOT
→ memo
given to Pres 1-19-79*

**YOUR RESPONSE MUST BE DELIVERED
TO THE STAFF SECRETARY BY:**

TIME: ATTACH TO DEC 15
BROCK ADAMS MEMO,
DAY: SURFACE TRANSPORTATION DEREGULATION.
DATE: TION.

ACTION REQUESTED:

Other: Your comments

STAFF RESPONSE:

I concur. No comment.
Please note other comments below:

PLEASE ATTACH THIS COPY TO MATERIAL SUBMITTED.

If you have any questions or if you anticipate a delay in submitting the required material, please telephone the Staff Secretary immediately. (Telephone, 7052)

THE WHITE HOUSE
WASHINGTON

1/22

She will provide
periodic updates
re whole area, including
updates re Treasury
negotiations. - pm
Dann.

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THE WHITE HOUSE

WASHINGTON

January 19, 1979

MEMORANDUM FOR: THE PRESIDENT
FROM: STU EIZENSTAT *Stu*
SUBJECT: Adams Recommendations on Surface Transportation Regulatory Reform

In mid-December we received a lengthy options paper from Secretary Adams concerning regulatory reforms for trucks and railroads. We delayed forwarding this to you pending receipt of the Secretary's actual recommendations. Following a final round of consultations the Secretary has now forwarded his recommendations concerning railroad regulation. (A summary of these is attached.)

These recommendations are currently under review within the White House and will be presented to you for final decisions later this month. We intend to use this period for further consultation with the Congress, the Cabinet, and with affected groups, especially railway labor and shippers.

As you know Secretary Adams has delayed submission of his recommendations on trucking regulatory reform in light of the ongoing discussions with the Teamsters. We plan to announce our nominees for the ICC as soon as possible, followed by presentation of legislation later in the spring.

Bob Strauss has recommended that before you make final decisions on this proposal that you meet with a few truckers designated by Frank Fitzsimmons. This meeting has been scheduled for Monday, January 22.

DOT is also preparing an options paper dealing with regulation of intercity buses. This should be complete by early February.



THE SECRETARY OF TRANSPORTATION
WASHINGTON, D.C. 20590

JAN 5 1979

MEMORANDUM FOR THE PRESIDENT

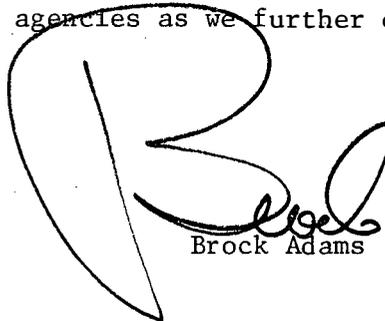
THROUGH: Mr. Rick Hutcheson
Staff Secretary

SUBJECT: Railroad Regulatory Legislation

On December 15, 1978, I submitted to you papers describing options for the deregulation of the rail and truck industries. The rail paper proposed sweeping changes in railroad regulation and provided optional legislative provisions in five important areas--rate flexibility, rate bureaus, rate discrimination, mergers and abandonments. With this memorandum, I submit my recommendations as to these provisions.

The legislation I am recommending is based on a complete reassessment of the current regulatory scheme. It would result in a more limited but rational and efficient rail system. Prompt passage of this legislation is, I believe, imperative if a healthy rail system is to survive without massive Federal subsidy.

I also transmit the recommendations and comments received to date from agencies to which we circulated the December 15th rail paper. Additional agency comments will be forwarded as we receive them. We will be working closely with these agencies as we further develop the legislation.


Brock Adams



Attachments

THE WHITE HOUSE
WASHINGTON
January 19, 1979

BILL/RICK:

Re DOT Options Paper on Railroad
Regulatory Reform -- CL's Response

RR Deregulation should be a DOT issue. Many Members fear that a moving out of routes in their districts will be so politically hot that it could be trouble. The bill could hurt: inflation & loss of routes! Should be kept away from the White House. (JF)



THE SECRETARY OF THE TREASURY
WASHINGTON

U.S. DEPT. OF
TRANSPORTATION

1978 DEC 29 PM 5:30

December 29, 1978
U.S. DEPT. OF TRANSPORTATION
EXECUTIVE SECRETARIAT

MEMORANDUM FOR THE HONORABLE BROCK ADAMS
SECRETARY OF TRANSPORTATION

Subject: Reform of Railroad Regulation

Your memorandum of December 20 requested recommendations on reform of railroad regulation and comments on the DOT options paper.

In my view, our choices are between an even greater Federal financial involvement in rail freight service or a substantial reduction in the regulatory controls currently imposed on railroads. I strongly favor the latter course. In particular, I support granting the railroads much greater flexibility in adjusting their rates, freedom to abandon uneconomic lines, and greater latitude in arranging mergers, intermodal operations, and cooperative use of tracks and equipment.

These reforms would permit the railroads to reduce their costs and increase their revenues and, consequently, would work to increase the railroads' profits from their persistently low levels. Over the longer term, the gains to the railroads would result in a more efficient transportation system, which would be beneficial to the economy at large. In my opinion, these effects are a compelling reason for reform of railroad regulation.

Reform of railroad regulation would also have some benefits in terms of our concerns with inflation and energy. First, by increasing the railroads' profits, reform would work directly to reduce the demand for subsidies. The President's actions to limit the Federal deficit make this particularly important. Second, higher rates of return are crucial if the railroads are to attract the capital required to maintain and upgrade their equipment and rights of way. This consideration is significant in view of the Congressionally mandated

conversions from oil and gas to use of coal in electricity generation, which will increase the demands for rail transportation.

I recognize that reform of railroad regulations also has the potential for some unfavorable consequences in terms of our policies on inflation and energy. However, I do not feel that these possibilities argue against reform of railroad regulation. Carefully structuring a transition period would make it possible to accomplish reform of railroad regulation within our policies on inflation and energy.

I have these general comments on the options:

- o To the extent possible, it seems best to bring the railroads under the laws and enforcement procedures that prevail for the unregulated sectors of the economy.
- o Because of the possible impacts on inflation and energy matters, it is important to relax current controls gradually. While detailed analysis might suggest otherwise, the five-year period mentioned in the DOT options paper seems reasonable.
- o Several options offer a choice between statutory guidelines and mechanical rules. I would favor the mechanical rules, as they reduce reliance on adjudicatory process which causes significant delays and creates uncertainties in business decision making.

I compliment you and your staff for providing such complete and thoughtful proposals.



Anthony M. Solomon
Acting Secretary

U. S. DEPARTMENT OF LABOR
OFFICE OF THE SECRETARY
WASHINGTON

U.S. DEPT. OF
TRANSPORTATION

1978 DEC 29 PM 5:42

DEC 29 1978

OFFICE OF SECRETARY
OF TRANSPORTATION
EXECUTIVE SECRETARIAT

MEMORANDUM TO BROCK ADAMS

FROM THE SECRETARY OF LABOR *copy*

SUBJECT: Comments on Regulatory Reform of Surface
Transporation-Rail Issues

Thank you for the opportunity to comment on the draft options paper on deregulation in the rail industry. Given the complexity of the subject and manner in which the paper is drafted it is difficult to give detailed comments on each of the options.

The structure of the options paper is to address a series of issues ranging from the "proposed new national transportation policy" to "abandonment." I believe it would be very helpful if the paper could be structured to address certain generic issues and provide options with respect to such issues. For example, one could address the issue of the deregulation "adjustment period" and discuss the pros and cons of differing time periods, rate bands, etc. under this heading. Similarly, alternative rate setting procedures under a deregulated system including the anti-trust, rate bureaus, notice, etc. could be handled as a single issue.

In addition to structure, the options paper could be improved by providing an economic analysis as to the benefits and costs to be achieved by taking each major option. This is extremely important. Specifically efforts should be made to quantify the costs to the groups which may face major adjustments, namely, labor and captive shippers. A discussion of who should or will pay these costs is also important.

Finally, each major option should discuss more clearly the major interest groups' positions along with a brief reason for their position. As it is currently written, several pros and cons indicate that "shippers" would be for or "labor" would be against the option. This is really not very helpful, particularly if not done on a consistent basis.

Given the interests of labor in this subject, I would appreciate your timetable and the next steps you anticipate taking in this area.

MEMORANDUM FOR BROCK ADAMS
SECRETARY
DEPARTMENT OF TRANSPORTATION

FROM: John P. White
Deputy Director

SUBJECT: Rail Regulatory Reform

As you are aware from our budget "passback," the Office of Management and Budget is extremely interested in the railroad regulatory reform issue. We took that opportunity to discuss fully with you our view of the "railroad problem"--a problem which greatly involves government regulation--so that our budget recommendations would fit within a broader framework and make sense not just as budget recommendations but as sensible transportation policy.

I am gratified to see that by and large the Department agrees with the idea that "sweeping changes in railroad regulatory legislation" are needed as you stated in your December 15 memorandum to the President. We also agree with your assessment that rail regulatory reform legislation should move as quickly as possible. I appreciate the opportunity to comment on your specific proposals and options before you make your final recommendations to the President. Nevertheless, I will, of course, be called upon to give advice to the President in the course of Executive Office review once the Staff Secretary receives the Department's final proposals.

Before discussing specific regulatory reform issues, I wish to share with you OMB's four basic objectives.

- 1) We want to move as quickly as possible to give regulatory relief to the financially troubled railroads--particularly ConRail--to avoid more Federal subsidies if possible. Even complete deregulation may be too late for ConRail if it has to wait 5 years for deregulation to occur.

- 2) We want to solve the "captive shipper" problem (which may be more a problem of perception than of fact) in a way that promotes effective competition where none exists today. However, we believe that provisions for the rare case of truly captive shippers should not impede deregulation where the shipper is not captive. New market entry techniques in the captive shipper situation seem more promising to us than trying to regulate maximum rates to achieve this goal.
- 3) Where possible, the standard for rail reform should be to place the railroads on the same competitive, economic footing as most other industries.
- 4) The result of deregulation should be the cessation of Federal subsidies in any form to the railroads after a transition period.

In order to achieve the first objective we are concerned about the pace of the transition period. As a member of the USRA Board of Directors I am sure you are aware that ConRail may need to be able to price itself out of losing lines of business within the next 2 or 3 years if it is to have a realistic chance to become profitable. Our "passback" proposal assumed that ConRail might be deregulated before other railroads due to its unique financial situation. The problem with that proposal, which we realized at that time, was that we cannot easily construct and maintain entirely different regulatory systems for different railroads.

Nevertheless, we believe it might be possible to treat ConRail or other railroads differently in one respect. Your three options for dealing with maximum rate regulation imagine a transition period during which a zone of reasonableness expands. Within this zone rates would be totally free of regulatory control. We believe it would be possible to increase the size of that zone more quickly for a limited number of railroads. In return for this privileged treatment, we believe ConRail (or any railroad seeking accelerated deregulation) should be required to sell trackage rights to other railroads and shippers as protection against monopolistic abuses. In all other respects it would be treated as any other railroad. If DOT thinks we cannot or should not treat any railroad differently, we would recommend to the President that the size of the zone of reasonableness and the rate at which it expands must be adequate to meet ConRail's needs.

The best solution to the captive shipper issue we can recommend at this time would be to submit irresolvable railroad-shipper disputes about rates outside of the zone of reasonableness to binding arbitration. The arbitrators would make three findings:

- 1) Is the shipper captive? If not, the shipper would bear the costs of arbitration and would not be given any rate relief. If the shipper is captive, the railroads would bear the cost of arbitration. A fairly strict definition for determining "captivity" would be written into the law such as those suggested in your options paper.
- 2) Could another railroad, or the shipper itself, be able to provide effective competition to the incumbent carrier under a trackage right agreement or by acquisition or construction of a new rail line? If so, the law could authorize acquisition, construction or the mandatory sale of trackage rights for a reasonable fee and for a reasonable length of time.
- 3) If effective competition could not be provided, the arbitrators would set a reasonable maximum rate which covers the fully allocated cost of providing the service including the cost of capital. We have no preference for any particular formula that might be devised to guide the arbitrators and make their job less complex.

As you stated in your December 15 and 20 memoranda, "...it is very difficult to have just a little regulation." We believe the system outlined above is the best way out of that dilemma. A system of arbitration would encourage railroads and shippers to agree on rates and services as in other unregulated markets. The truly captive shipper would have an effective threat of going to arbitration and getting new entry through trackage rights, acquisition or construction for itself or another railroad. This threat would, in most cases, counterbalance the railroad's market power. The marginally captive shipper who could, with a little initiative, find other competitive carriers would be discouraged from holding out for arbitration by strict decisional guidelines and the probability of having to bear the costs of arbitration. Assuming that the number of truly captive shippers is small and that the pressures for settlement great, we expect that the actual use of arbitration and/or mandatory trackage rights would be small. As further insurance against monopolistic behavior, at the end of the transition period we would require all railroads to make trackage rights available at reasonable rates.

4

In general, for the other proposals and options presented in your paper, we prefer to see the ~~maxim~~ possible deregulation package proposed in the President's legislation. We would like to emphasize, however, our understanding that the common carrier obligation (Issue 9) would be restricted to providing service at rates which presumably would be deregulated in all but a few cases. If railroad rates were not deregulated as extensively as we hope, the common carrier obligation should be eliminated completely or somehow restricted to markets in which railroad rates provide adequate profits.

We look forward to receiving DOT's final recommendations on rail deregulation and we anticipate early submission of the comparable papers on deregulation of the truck and bus industries.



ASSISTANT SECRETARY OF DEFENSE
WASHINGTON, D. C. 20301

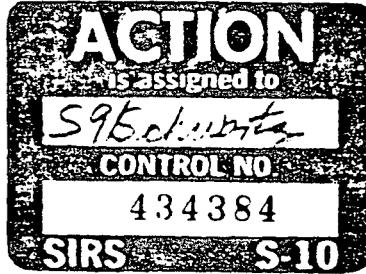
U.S. DEPT. OF
TRANSPORTATION

1978 DEC 29 AM 12:26

MANPOWER,
RESERVE AFFAIRS
AND LOGISTICS

OFFICE OF SECRETARY
OF TRANSPORTATION
EXECUTIVE SECRETARIAT

8 8 11 1978



Action 3-9

Honorable Brock Adams
Secretary of Transportat:
Washington, D. C. 20590

Dear Mr. Secretary:

This is an interim reply to your recent memorandum to Members of the Cabinet, subject: Regulatory Reform of Surface Transportation - Rail Issues.

The Department of Defense is one of the nation's largest shippers and has a vital interest in the future of the railroads. It is unfortunate that we were not a participant in your interagency railroad deregulation effort.

We support your initiative to create a viable rail industry with minimum Government controls. However, we must insure that any changes preserve a national rail transportation system capable of meeting defense peacetime, contingency, and mobilization requirements. We rely heavily on your leadership and on the Interstate Commerce Commission to insure these national defense requirements are met.

You will be provided more details on our position by January 10, 1979. We look forward to becoming an active participant in your future initiatives.

Sincerely,

Richard Danzig
Acting Principal Deputy Assistant
Secretar of Defense (MRA&L)

U.S. DEPT. OF TRANSPORTATION
FEDERAL TRADE COMMISSION
WASHINGTON, D. C. 20580

OFFICE OF THE SECRETARY
1979 JAN -4 PM 3:07

OFFICE OF SECRETARY
OF TRANSPORTATION
EXECUTIVE SECRETARIAT

January 4, 1979

The Honorable Brock Adams
Secretary of Transportation
Department of Transportation
Room 10200
400 7th Street, S.W.
Washington, D.C. 20590

Re: Rail Deregulation Options Paper

Dear Mr. Secretary:

This letter responds to your December 20, 1978 letter inviting comments on the approaches to railroad regulatory reform outlined in the Options Paper attached to your letter. Our comments are based upon the experience the Commission acquired in the railroad rate bureau proceedings and the market dominance proceeding as well as our general expertise in competition questions. We think the Options Paper generally presents an excellent range of choices for making railroads more effective competitors. The purpose of this letter is to indicate which options we believe should be recommended to the President.

Maximum Rate Regulation

We favor a continuation of limited regulation by the Interstate Commerce Commission ("ICC") of maximum rates because railroads do not face effective intermodal competition for certain important commodities, e.g., coal away from the Mississippi River. Thus, we do not favor Option A, elimination of ICC maximum rate regulation, and do recommend Option B, which delineates a careful approach to defining circumstances in which railroads have market dominance. We do not favor Option C, which would require a triannual census of transportation of every commodity on a state-by-state basis, as it is impractical and expensive. (See p. 9 of the Options Paper.)

Minimum Rate Regulation

We agree that the ICC's authority over minimum rate regulation should be ended; however, we disagree with the proposal that the test for determining whether a rate is unlawfully low should be whether the sale is at "unreasonably low prices for the purpose of destroying competition or eliminating a competitor." */ The statute from which this language has been copied is a criminal statute which does not permit private rights of action. **/ Because few cases have been instituted under this statute its contours are unclear. ***/ Thus, a better way of achieving the intent of the Options Paper--that predatory pricing in the railroad industry be governed by the same standards used in the rest of the economy--would be to leave the task of preventing predatory pricing to antitrust enforcement under all the existing antitrust laws, which collectively embody more sophisticated tests for predatory pricing. ****/

*/ The quoted section in the Options Paper is not from the Clayton Act, but is Section 3 of the Robinson-Patman Act. 15 U.S.C. § 13a.

**/ Nashville Milk Co. v. Carnation Co., 355 U.S. 373 (1958).

***/ The constitutionality of this statute was upheld over the dissents of three Justices who believed the statute to be unconstitutionally vague. U.S. v. National Dairy Products Corp., 372 U.S. 29 (1963).

****/ See the Commission's recent decision in Borden, Inc., ___ F.T.C. ___ (1978), for an example of a concrete and objective predatory pricing test which is appropriate under the circumstances of that case, which involved a charge of monopolization. Other tests have been used in different situations.

Removal of ICC regulation over maximum rates, or drastic curtailment of ICC maximum rate regulation--a major facet of the Options Paper--would be inconsistent with the continuation of rail rate bureau antitrust immunity. As Consolidated Rail Corporation recently stated:

The existing collective ratemaking process seems incompatible with a system of free market pricing. If this is indeed the case, Conrail does not believe it can continue to participate in this collective ratemaking system while simultaneously advocating that society should place greater reliance on the free market to determine price and service levels. */

Moreover, the innovative pricing goals of the Railroad Revitalization and Regulatory Reform Act of 1976 ("4-R Act") have not yet been realized. This is largely due, we think, to rate bureaus and the cartel mentality they engender. Similarly, the goals of the proposed rail regulatory package may never be achieved unless antitrust immunity for rate bureaus is eliminated.

Not only is application of the antitrust laws to railroad ratemaking desirable, it can be accomplished without unduly complicating the ratemaking process. Single-line ratemaking will not be impeded by the removal of the rate bureaus' antitrust immunity. **/ Furthermore,

*/ Comments of the Consolidated Rail Corporation in Section 5b Application No. 3, Eastern Railroads-Agreement 7 (Nov. 20, 1978).

**/ We strongly disagree with the assertion that ending antitrust immunity would delay ratesetting (Options Paper at 14). In fact, current rate bureau procedures make impossible quick response to intermodal competition. For example, the Western Rate Bureau wants to continue its 120-day notice provision for making rate changes. Verified Statement of T.M. Curley at 21 in Section 5b Application No. 2, Western Railroads-Agreement (Nov. 20, 1978).

ICC regulation of minimum rates should cease immediately. There is no public interest in phasing in a rate floor so long as carriers are prohibited from pricing predatorily by the existing antitrust laws which prevent predatory pricing. If predatory prices are ruled out, well-run railroads will not initiate unprofitable rates. If a railroad can profitably sell its services more cheaply and has legitimate business purposes for doing so, the public interest is best served by allowing it to do so.

Railroad Rate Bureaus

The Commission agrees with the principle enunciated in the proposed new preface to the Interstate Commerce Act that there should be "[m]aximum reliance on competitive market forces. . . ." */ Thus, we strongly favor the immediate elimination of antitrust immunity for railroad rate bureaus because of the anticompetitive effects of rate bureau price-fixing.

Rate bureaus have fostered excess capacity. This, in turn, raises operating costs and leads to an inappropriate quality of service to rail users. By maintaining uniform rates for all routes between any particular two points, even where the different routes have different costs, rate bureaus prevent the market from allocating traffic among competing lines in an efficient manner. Thus, the rate bureaus' uniform pricing policies cause underutilization of the most cost-effective routes, overutilization of less efficient routes, and the maintenance of excess capacity. In sum, rate bureaus have played a major role in causing the economic plight of the railroads.

*/ Page 1 of the Options Paper.

in the vast majority of interline situations, */ and perhaps in all of them, rates can be established consistently with the antitrust laws. If it develops, however, that there are instances in which joint ratemaking might violate the antitrust laws, such violations can be avoided through the railroads' implementation of combination rates. The benefits that will be derived from universal competitive ratemaking will far outweigh any increased transactional costs that may be associated with the utilization of combination rates. Moreover, interline service itself could be eliminated in those instances through increased reliance on trackage agreements.

In sum, a weighing of the anticompetitive effects that would result from continuing antitrust immunity for joint-line rates against the possible problems associated with making joint-line rates in the absence of antitrust immunity leads us to oppose Option A, which is similar in most respects to the ICC's interpretation of the 4-R Act. We also oppose empowering another agency to grant antitrust immunity (Option B). Finally, Option C--having the Department of Justice issue advisory memos--may provide

*/ There is no serious dispute that railroads with no competitive overlap between their joint-lines and any of their other lines, e.g., end-to-end connectors, can interline without fear of antitrust suits. Even where competitors make joint rates there is no reason to assume, absent price-fixing between the competing lines, that the railroads would be vulnerable to continued antitrust suits. First, because the alternate competing routes generally offer different services and have different cost characteristics, if rate bureau uniform pricing practices did not exist, one would expect different prices on the different routes. Even if the prices of the alternate routes were similar, the existence of discussions on the joint-line rates does not mean that an antitrust suit would necessarily succeed.

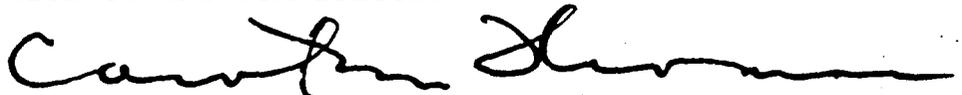
useful advice in limited situations. However, this option is not likely to mollify the railroads, particularly since the advice would not be any more binding on a court in a case brought by a shipper than are the Department of Justice's existing business review letters or the FTC's advisory opinions. Thus, we also oppose Option C, as it does not constitute a real alternative to elimination of antitrust immunity and the railroads will severely criticize it on that basis.

Mergers and Acquisitions of Control

We favor Option A. Although we recognize that there is excess capacity in the railroad industry, and that there is therefore some sentiment in favor of a more permissive merger rule than Section 7 of the Clayton Act, we think your proposal on consolidation, trackage agreements and market swaps will, over time, solve that problem. Moreover, railroads would be afforded much greater certainty by having mergers adjudicated under Section 7 than would be the case if Option C were adopted.

We congratulate you on a thoughtful and generally sound analysis of a subject of major significance to the country.

By direction of the Commission.



Carol M. Thomas
Secretary

WASHINGTON

DATE: 18 DEC 78

Bill Shanley

FOR ACTION: STU EIZENSTAT

FRANK MOORE *nc*

JACK WATSON *-Wed 113*

JIM MCINTYRE -

ATTORNEY GENERAL BELL *wed attached*

*Please
Draft Trust*

INFO ONLY: THE VICE PRESIDENT

HAMILTON JORDAN

JODY POWELL

JERRY RAFSHOON

ANNE WEXLER

CHARLIE SCHULTZE

ALFRED KAHN

SUBJECT: BROCK ADAMS MEMO RE SURFACE TRANSPORTATION DEREGULATION

+++++

+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +

+ BY: 1200 PM WEDNESDAY 27 DEC 78 +

+++++

ACTION REQUESTED: YOUR COMMENTS

STAFF RESPONSE: () I CONCUR. () NO COMMENT. () HOLD.

PLEASE NOTE OTHER COMMENTS BELOW:

WASHINGTON

DATE: 18 DEC 78

FOR ACTION: STU EIZENSTAT

- next wk for 1/2

FRANK MOORE

JACK WATSON

JIM MCINTYRE (*attached*)

*T2/2/78
Judice
wants to
comment*

INFO ONLY: THE VICE PRESIDENT

HAMILTON JORDAN

JODY POWELL

JERRY RAFSHOON

ANNE WEXLER

CHARLIE SCHULTZE

ALFRED KAHN

SUBJECT: BROCK ADAMS MEMO RE SURFACE TRANSPORTATION DEREGULATION

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+ RESPONSE DUE TO RICK HUTCHESON STAFF SECRETARY (456-7052) +

+ BY: 1200 PM WEDNESDAY 20 DEC 78 +

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ACTION REQUESTED: YOUR COMMENTS

STAFF RESPONSE: () I CONCUR. () NO COMMENT. () HOLD.

PLEASE NOTE OTHER COMMENTS BELOW: