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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 the most unproductive of these restrictions would be eliminated immediately.

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.

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 Secuities 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 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 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.

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 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 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.

of the three options to pass.

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.

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.

There is likely to be more turnover of carriers then 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. <u>Erosion of Carriers' Certificate Values</u> In many cases, prospective

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 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 ststem. 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 is wrong. First of all, regulated service to rural areas is far from satisfactory now in many cases. Studies conducted by state and regional authorities[19] 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.

Morever, 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 unrenumerative 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 and state studies.[20] For instance, a study by the Public Service Commission of Wyoming[21] 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 study[22] shows this segment of the industry to be relatively stable and prosperous. Another DOT study[23] 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

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.

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. <u>Concentration in the Trucking Industry</u> 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 studies[25] 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 expension 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 stablizing 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 carriers[26] 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

[1]W. Bruce Allen, et al., Examination of the Unregulated Trucking Experience in New Jersey, prepared for the U.S. Department of Transportation under Contract #DOT-OS-700064, July, 1978.

[2]Denis A. Breen, "Regulation and Household Moving Costs," Regulation Vol. 2, No. 5 (Sept/Oct 1978) pp. 51-54.

[3]Interstate 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.

[4]D. 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.

[5]American Trucking Associations, "Accounting for Motor Carrier Operating Rights," Brief and Petition to the Financial Accounting Foundation, 1974.

[6]Interstate Commerce Commission, 1977 Annual Report, Table 10, p. 144.

[7]Motor 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,

[8]Traffic World, various issues.

[9]Edward Miller, "Effects of Regulation on Truck Utilization," Transportation Journal, Vol. 13, No. 1 (Fall 1973), pp. 5-14.

[10]See _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.

[11]A 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.

[12]_Private 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.

[13]_Ibid_.

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

[15]See footnote 1.

[16]For 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.

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

[18]This 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-50096, 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.

Tab F

Glossary*

Backhaul: The return movement. The direction of movement where less freight is available. (See Prime Haul.)

Certificates and Permits: Common and contract motor carriers must receive ICC approval to operate in interstate transportation. A common carrier receives a certificate of public convenience and necessity, and a contract carrier receives a permit.

Commercial Zone: An urban area defined by the ICC, within which transportation is exempt from ICC regulation.

Common Carrier: A truck or bus business that offers its service to the general public. Common law and the Interstate Commerce Act require that common carriers offer their services to all on a nondiscriminatory basis.

Contract Carrier: A truck or bus business engaging in for-hire transportation under agreement with a limited number of shippers.

Exempt Carrier: A special statutory exemption allows certain goods—primarily unprocessed agricultural products—to be transported by truck without ICC regulation. Carriers operating under this exemption are called exempt carriers.

For-Hire Carrier: A bus or truck company that offers its services for a fee.

Gateway: A geographical point where a motor common carrier combines or "tacks" two separate ICC operating authorities. If the carrier moves traffic from a point within one authority to a destination within another authority, the freight must generally pass through this common point.

General Freight: A broad, unspecialized freight category. Also, that type of carrier whose authorization is for the carriage of general freight.

Grandfather Rights: Operating authorities granted to carriers in existence before motor carrier transportation came under the ICC in 1935. Since that time, new carriers, or carriers attempting to expand, have been required to meet certain tests before they are permitted to participate in the industry. Carriers in business prior to 1935 were exempted from these requirements and "grandfathered" into the industry.

Interstate Commerce Commission. The Federal Commission with the authority for economic regulation of surface transportation.

Interstate Traffic: A transportation movement involving more than one State or a foreign country.

Intrastate Traffic: Transportation which takes place entirely within one State.

Joint or Interline Freight: Freight which moves under one rate via two or more carriers. This rate, called a joint rate, is generally less than the rates for the two or more separate movements.

Leasing: Rental of one carrier's trucks to another carrier, a practice now tightly regulated by the ICC. For example, agricultural-exempt carriers may lease their trucks to regulated carriers for single trips, but private carriers may lease their equipment and drivers to regulated carriers for no less than 30 days at a time.

LTL: "Less Than Truckload" shipments.

Motor Carrier: As defined in the Interstate Commerce Act, includes both common and contract carriers. ICC regulated motor carriers carry about 40 percent of all intercity motor freight.

Owner-Operator: An individual who owns and operates his or her own truck. Generally owner-operators do not have certificates or permits and must work either for someone with authority from the ICC or as an exempt carrier.

Prime Haul or Front Haul: In movements between two cities, one direction is considered the prime haul and the other is the backhaul. The direction for which the availability of freight is greater is the prime haul.

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*This glossary is intended as an aid to those unfamiliar with motor carrier terminology. For a more comprehensive and technical explanation, the reader should consult the Interstate Commerce Act.

Private Carrier: A non-transportation company that hauls its own property.

Rate Bureau: A private association of common carriers which decides on rates to propose to the ICC. Under the Interstate Commerce Act, rate bureaus are exempt from the antitrust laws governing most other industries. There are several regional and commodity-related motor carrier rate bureaus.

Regular and Irregular Route Common Carriers: Common carriers are generally authorized either to carry only certain commodities between specified points or areas, or they are authorized to carry general freight over specified routes. Route-restricted carriers are called "regular route carriers" and commodity-restricted carriers are "irregular route carriers." There are many more irregular route carriers than regular route carriers, but they usually are small firms.

Suspension: A temporary action by the ICC prohibiting a new rate from going into effect until the Commission has decided on its lawfulness. Since suspensions are temporary actions, suspended rates may later be found lawful.

TL: "Truckload" shipments: (a) For ICC accounting purposes a shipment that weighs more than 10,000 pounds. It may be less than the physical capacity of the truck. (b) A shipment large enough to utilize the entire capacity of the truck.

Tab E

AGENCY VIEWS NOT REFLECTED

Federal Trade Commission

- Feels strongly that transition period should be 18 months to two years, rather than five years. Other agencies, however, believe three to five years is an appropriate time. This is an issue that can be resolved later.

Interstate Commerce Commission

- All staff level concerns addressed.

Treasury

- Urges structural changes in the options paper, including moving the options section to an Appendix and explaining them in detail. Insufficient time to re-structure paper, and details of options will be worked out later.
- Believes tone of Introduction and Arguments sections is too tendentious and often not persuasive to the reader who does not already favor deregulation.

Office of Management and Budget

- Believes bus deregulation should be addressed.DOT will prepare a bus options paper at a later date.
- Feels options were too complicated.
- Wants it clarified that a bill would be "one-shot" legislation, not one bill this session and, perhaps, another bill in a later session.

Labor

- Would re-structure the paper. Insufficient time.
- Sees paper as too anecdotal; fails to estimate cost savings for each of the options. DOT does not believe it can make a credible overall estimate of the benefits of deregulation based on the studies to date, let alone a separate estimate for each of the options. DOT believes that the savings are substantial, perhaps 10-15%, but better estimates will have to wait for further studies.
- Suggests a matrix showing those constituencies who would lose and those who would benefit, and by how much, and how to address the losses of each. DOT does not believe it can do such an analysis with estimates in the limited time available.
- Believes the argument concerning employment is confusing and inadequate. Later drafts attempt to address this concern.

Council on Wage and Price Stability

- Believes the length of the transition period should be discussed and should probably be less than five years. The five-year period is arbitrary and open for discussion; persuasive arguments will be made for both longer and shorter transition periods.
- Feels the relationship between rail and truck deregulation should be discussed. DOT agrees and plans to address the "bridge" issue as part of the package.

- o Believes a range of estimates could be derived for showing benefits.
- o Believes the "cons" of Option 1 do not do it justice because
  - lack of consumer support applies to all the options.
  - a deregulated system would adjust more readily than a regulated one.
  - the safety argument goes unrebutted as a "con."
- o Does not favor proposing compensation for certificate holders. DOT believes it a genuine problem which should be aired.
- o Believes a bus deregulation proposal should be included.

<u>Justice</u>

- o Believes "Structure of the Industry" should be an Appendix. Structure section is integral to paper in DOT's belief.
- o Would like to see a separate section on the cost of regulation. DOT has placed estimates throughout the paper but does not believe a separate section is necessary.
- o Believes Option 2 will elicit as much opposition as Option 1. DOT disagrees, but not by much.
- o Wants recommendations.

Labor

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EXECUTIVE OFFICE OF THE PRESIDENT
OFFICE OF MANAGEMENT AND BUDGET

DATE: 12/20/78

TO: Rick Hutcheson

FROM: Harrison Wellford

Comments on Brock Adams' surface transportation deregulation memo.

MEMORANDUM TO THE PRESIDENT

FROM: W. HARRISON WELLFORD

The attached memorandum is intended for the President's general information. It contains no agency recommendations. OMB will refrain from giving detailed recommendations until agency comments are received.

We would, however, emphasis three points that were included in our earlier memorandum on the truck and rail papers:

1) Rail legislation <u>must</u> move quickly; and
2) Trucking deregulation should be a relatively simple, "one-shot" attempt to achieve broad-based reform of the industry; and
3) DOT must be given a due date for its proposals on passenger bus deregulation. (The staff believes that proposals could be ready by the end of January.)

Attached is a copy of our earlier memorandum discussing these points.

EXECUTIVE OFFICE OF THE PRESIDENT

OFFICE OF MANAGEMENT AND BUDGET

WASHINGTON, D.C. 20503

file

DEC 11 1978

MEMORANDUM FOR THE PRESIDENT

FROM: W. Bowman Cutter
W. Bowman Cutter

SUBJECT: Brock Adams Memo Regarding Form of Surface Transportation Deregulation Options Paper

We are pleased to see that the Department of Transportation is making a concerted effort to meet your request for rail and trucking deregulation proposals. The rail and truck proposals should be drafted for simultaneous submission to the Congress very early in the next session. These proposals must be complementary and carefully coordinated.

In the rail area, FY 1980 budget decisions have been predicated on substantial deregulation of the industry. With regard to trucking deregulation, we believe that relatively simple changes on the statute governing trucking should be drafted quickly. Even such easily explainable amendments could move significantly toward deregulation.

We believe that surface transportation deregulation should be a major theme in your State of the Union Message to Congress, including deregulation of intercity bus transportation. The two largest companies, Greyhound and Trailways, support deregulation and consumers could see an immediate benefit through lower fares on certain routes. Such a bill would be a logical extension of airline deregulation and it could help build the momentum for rail and trucking deregulation. Since time is fleeting, DOT should begin to develop the proposal immediately.

We recommend that in your meeting today with Secretary Adams you indicate that December 22 is the latest possible date for the final DOT legislative recommendations on rail reform and December 29 for the options paper on trucking. In addition, we recommend that you direct the Department to begin work on bus deregulation.

Attachment

THE WHITE HOUSE

WASHINGTON

To Secretary Brock Adams

I look forward to receiving your proposals for deregulation of the rail and trucking industries. Deregulation of surface transportation will be an important theme in my State of the Union Message to Congress. I will need, therefore, to have your final legislative proposal on rail reform by December 22, 1978 and your options paper on trucking by December 29, 1978 so that both bills can be ready when Congress convenes.

I would also like my reform program to include deregulation of intercity bus transportation as a complement to our rail, truck, and airline initiatives. Time is short but we must be ready to present our proposals when the Congress returns.

The Honorable Brock Adams
Secretary
Department of Transportation
Washington, D. C. 20590

Office of the Attorney General
Washington, D.C. 20530

January 8, 1979

MEMORANDUM FOR THE PRESIDENT

Re: <u>Surface Transportation Deregulation</u>

The Justice Department has recently been asked to provide its views on the Options Papers on Surface Transportation Deregulation that have been prepared for you by the Department of Transportation.

We are vitally interested in this subject, especially trucking deregulation, which was the highest priority on the list of proposed legislation for the next Congress that the Department of Justice submitted to OMB. ICC economic regulation of this industry costs consumers literally billions of dollars each year. An exemption from the antitrust laws passed over the veto of President Truman allows regulated trucking companies to fix rates, which would be a felony in most other industries. Free enterprise and competition are stifled and inflation is increased under the current system.

I am concerned that DOT's paper as presently drafted does not adequately set forth for your consideration the merits of pursuing vigorously a strong deregulation program in this area. My concern arises from the fact that the paper makes no recommendation, even though virtually all participants in the inter-agency study agree that the public interest would be served best by comprehensive deregulation (option 1), rather than a less ambitious partial reform program (options 2 and 3). This omission may be partly motivated by concern that a vigorous reform effort will unduly antagonize the Teamsters, and thus place in jeopardy the Administration's effort to persuade them to moderate their wage demands in upcoming wage negotiations.

I, of course, recognize that any choice of options will in the end reflect a balancing of interests, including the Administration's interest in obtaining a favorable wage settlement from the Teamsters. On the other hand, your commitment to substantial deregulation of surface transportation industries is clear as early as the Clinton, Massachusetts "town meeting" and as recently as your speech at the Memphis Mid-Term Conference. I am personally skeptical of claims that the Teamsters could be bought off by a compromise on regulatory reform unless, of course, the "compromise" amounted to a complete abandonment of your program in this area.

I believe any sort of meaningful reform will be strongly opposed by regulated trucking firms and the Teamsters. Thus, I would favor proceeding with the best program on the merits, since a strong political effort and public education on the benefits of deregulation will be necessary in any event. You should also be aware that the National Commission for the Review of Antitrust Laws and Procedures, which will be reporting to you later this month, will recommend comprehensive deregulation legislation.

As the attached, more detailed analysis by the Antitrust Division reflects, I believe a compelling case can be made that comprehensive deregulation of motor carrier transportation -- including phased, but rapid removal of ICC control over entry and rates and repeal of the antitrust exemption -- is the most desirable option in terms of your anti-inflation program and the public interest.

Respectfully,

Griffin B. Bell

Griffin B. Bell
Attorney General

Enclosure

DEPARTMENT OF JUSTICE COMMENTS
ON MOTOR CARRIER REGULATORY
REFORM OPTIONS PAPER

Trucking deregulation is an idea whose time has come. The present regulatory structure erected by the ICC costs the American public $6.5 billion to $15 billion per year. The nation's largest trucking firms had an average return on equity of 19.7 percent in 1977 and operating certificates have an aggregate resale value of $4 to $5 billion according to the American Trucking Association. Thus, contrary to this Administration's announced goal of reducing inflation, ICC regulation of motor carriers directly contributes to the inflationary pressures on the economy.

Moreover, there is a wealth of empirical as well as theoretical evidence supporting motor carrier deregulation. Canadian studies, the Australian and British experiences, and the exempt agricultural sector in the United States are all specific real world examples to refute any arguments raised in opposition to deregulation. This is a <u>much stronger empirical record</u> than ever existed in the airline deregulation debate.

The options paper submitted by the Department of Transportation supports the case for deregulation. It contains a generally accurate and thorough description of the issues involved. 1/ However, the paper is seriously deficient because it does not present a recommendation to the President on the preferred strategy for restoring competition to the industry although the inter-agency task force has carefully studied the matter and should be aware of the advantages and drawbacks of each option presented. DOT held over twenty meetings with carriers, shippers and public interest groups and heard groups such as the American Conservative Union, Sears and Lever Bros. support deregulation. Moreover, the President's National Commission For Review of Antitrust Laws and Procedures recently voted to recommend to the President rapid deregulation of the motor carrier industry.

Based on this extensive record, the Department of Justice is confident in making its recommendation.

1/ However, we do not believe the distinction set out in the second section of the paper, "Structure of the Industry", between truckload (TL) and less than truckload (LTL) is meaningful because: (1) the distinction becomes blurred when actual industry operations are examined; (2) an LTL-TL distinction makes it extremely difficult to draft a clear, easily comprehensible bill.

As the DOT paper reflects, there are essentially three different approaches that can be used: (1) comprehensive legislative deregulation; (2) partial legislative deregulation; (3) administrative reform. The common thread that cuts across each approach is the strong opposition that each will engender from the industry, labor and some shippers. When the benefits of each option are measured against the political costs that remain constant regardless of the option chosen, it is clear that comprehensive legislative deregulation is the only sound economic and political choice. This is the course we recommend the President adopt.

The first approach -- comprehensive deregulation -- is based on the economic fact-of-life that the trucking industry is competitively structured and that the unrestrained interaction of competitive forces would most efficiently allocate resources in this industry. This option would achieve the maximum level of competition for the industry, would be consistent with the Administration's other deregulation efforts to reduce the cost and level of government regulation, and would be a key part of the fight against inflation.

Under this approach, governmental control over entry and rates would be eliminated in three to five years, with substantial reform mandated in the interim, along the lines adopted in the Airline Deregulation Act. Rate bureaus would be abolished, and the ICC's power to directly control rates significantly diminished. Safety and insurance standards required for the protection of the public would be maintained under the jurisdiction of DOT.

This approach has the biggest payoff for consumers and shippers in terms of lower rate levels and greater rate/service choices. It also has a big payoff for small carriers and new entrepreneurs who previously have been denied the opportunity to compete in new geographic and commodity markets. This group would include the thousands of small businesspeople, including minorities, who do not have the financial resources necessary to manipulate the regulatory system to their advantage.

A comprehensive legislative deregulation proposal that phases in total deregulation while giving early entry and rate advantages to small and new carriers will create strong support among the 100,000 owner-operators and many shippers of all sizes. Some of the 11,000 Class III carriers may support such a measure as well. Moreover, the Business Roundtable as well as Trailways Bus Co. -- the second largest bus company in the nation -- recently endorsed this approach. Finally, claims that deregulation would "unfairly" erode the capitalized value of certificates can be disregarded as we are advised by lending institutions that they have already discounted subtantially the value of those certificates in response to recent ICC reform efforts.

The only disadvantage we can see to this option is that it is certain to provoke strong opposition from the larger carriers and the International Brotherhood of Teamsters. Some large shippers who rely on the rate notification and collective ratemaking provisions of the Act to predict competitors' transportation costs will also oppose this option. Although these shippers can gain lower shipping costs through deregulation, they seem content with higher costs so long as such costs can be passed on to consumers, and they can obtain the relative certainty that their competitors will not achieve a cost advantage.

However, indications are that any reform -- administrative or legislative -- would provoke equally strong opposition from these groups. Since no legislative approach will have easy sailing through Congress, the Administration might as well attack root causes first and compromise later if necessary. Therefore, the Administration stands little to gain in the way of diminished political opposition by supporting a less comprehensive approach, while on the merits, it sacrifices much.

Partial legislative deregulation may remove some regulatory restraints on competition in the industry but would leave the ICC with authority to regulate certain aspects of industry conduct. For example, this approach could impose the burden of proof on those who would oppose new entry or rate changes, and emphasize competitive factors as the criteria to guide the Commission's decisions. Other regulatory restraints such as backhaul and gateway restrictions, and those preventing exempt haulers from soliciting any regulated traffic could be eliminated or modified. Also, under this option, Section 5a would be repealed, or modified, and the ICC's power to suspend rates would be reduced or eliminated.

While this option recognizes that the trucking industry needs less pervasive economic regulation than at present, it also implicitly accepts arguments that the trucking industry is not an inherently competitive industry, and therefore, some ICC control over rates and entry is necessary to prevent specific potential abuses, such as undue rate discrimination.

Under this option, full deregulation is not achieved, the remnants of regulation continue to create needless costs for the shipping public, and the American taxpayer continues to support the burden of needless regulation. Further, and most importantly, this approach is likely to engender the same strong opposition from the major carriers and organized labor as would a more comprehensive approach. In short, partial legislative reform is a much less attractive approach. It entails high political costs as well as arbitrary and perhaps logically indefensible decisions as to which elements of the regulatory system are to be retained. Since this approach will not achieve maximum competition but will still generate stiff political opposition, it should be rejected, as the Administration's "going in" position.

Under the third approach, the President would forego legislative reform entirely, and instead use his appointment power to create a pro-competitive ICC that would press to the limit existing statutory authority to introduce competition into the industry. The main advantage of this approach is that once the President's people were in place, the Commission -- not the President -- would take most of the heat for deregulation efforts. The President, however, would be criticized by deregulation proponents for reneging on a publicly made promise to deregulate trucking and for back-pedalling in the fight against inflation.

More importantly, there are valid doubts as to the ICC's legal authority to deregulate substantially an industry which it has been assigned to pervasively regulate. A protracted legal battle will certainly follow if the ICC embarks on such an effort. Indeed, the ATA announced its intention to file suit immediately if the Commission adopts Chairman O'Neal's recent modest deregulation proposal to the Commission. The legal difficulties the ICC has encountered in expanding the commercial zones and in opening the tour brokerage industry to competition are portents of legal struggle certain to come if an administrative approach to deregulation is pursued. Substantial deregulation should not be allowed to hinge upon the vagaries and uncertainties of litigation. In this regard it must be remembered that most of the CAB reforms preceding the Airline Deregulation Act were under challenge in court, and the outcome was far from clear.

Agency reform should be viewed as a complement to rather than a replacement for legislative reform. The airline experience proved that a regulatory reform minded agency could make legislative reform easier to achieve by demonstrating the workability of competitive concepts. To achieve this level of support, however, will require a rapid infusion of competition proponents on the Commission. Recent actions show the current Commission unwilling to restore competition. First, in implementing the 4R Act, 2/ the ICC severely undermined important pro-competitive provisions. With respect to the "market dominance" provisions of the Act, for example, the ICC promulgated tests which snag nearly all rates in the web of regulation even in the face of a Congressional determination that because railroads faced intense intermodal competition, most rates should be deregulated. And when the railroads, DOT, and DOJ appealed this ICC decision to the U.S. Court of Appeals for the District of Columbia, the Court largely deferred to the presumed expertise of the ICC and let its anticompetitive decision stand. 3/

2/ Railroad Revitalization and Regulatory Reform Act of 1976.

3/ Atchison, Topeka & Santa Fe Railroad Company, et, al., v. Interstate Commerce Commision and United States, No. 76-2048, (D.C. Cir.), May 2, 1978.

Second, the ICC Task Force's 39 Recommendations are unresponsive to the President's call for substantial deregulation. While the 39 Recommendations address some of the ICC's more egregious procedural practices, major substantive changes are left for study. The Report itself issues a disclaimer, stating that "it has not proposed sweeping changes which would alter materially the present regulatory scheme." The 39 Recommendations do little, perhaps nothing, to cure the inefficiencies and distortions found in our national transportation system. If the 39 Recommendations are the best that can be expected from the ICC, then legislation is certainly needed.

The experience with comprehensive legislative deregulation of the airlines makes this approach not only theoretically sound, but also makes the benefits empirically demonstrable. Transportation economists from both the public and private sectors agree that restraints on entry and the lack of rate flexibility mandated by the Interstate Commerce Act have created an artificial market structure that costs the American consumer billions of dollars a year. Nothing short of dismantling the regulatory maze that has created this artifical structure will suffice to restore competition to the motor carrier industry.

Comprehensive legislative deregulation is the only way to ensure that substantial and permanent reform is achieved. Further, since the introduction of any legislation will generate very substantial industry and labor opposition, compromise will be inevitable. Therefore, the Administration's opening position should be comprehensive and forthright in its approach to the problem. Appointments of competition advocates to the Commission would be a valuable assistance to the effort.

ID ~~786444~~ 0987

THE WHITE HOUSE

WASHINGTON

DATE: 09 JAN 79

FOR ACTION:

INFO ONLY: THE VICE PRESIDENT
FRANK MOORE (LES FRANCIS)
CHARLIE SCHULTZE
STU EIZENSTAT
JIM MCINTYRE
ALFRED KAHN

SUBJECT: SHENEFIELD MEMO TO SECRETARY ADAMS RE DOT OPTIONS PAPER ON RAILROAD REGULATORY REFORM

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

\+ BY: +

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ACTION REQUESTED: YOUR COMMENTS

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

PLEASE NOTE OTHER COMMENTS BELOW:

ID ~~786444~~ 0087

THE WHITE HOUSE

WASHINGTON

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

PLEASE NOTE OTHER COMMENTS BELOW:

OFFICE OF THE SECRETARY OF TRANSPORTATION

WASHINGTON, D.C. 20590

January 8, 1979

TO: Mr. Rick Hutcheson
Staff Secretary

The attached options paper from the Department of Justice should be made part of the railroad regulatory legislation package sent to the President by Secretary Brock Adams last Friday, January 5.

I have also forwarded copies to Bill Johnston.

Linda Smith

Linda L. Smith
Director
Executive Secretariat

Attachments

United States Department of Justice

WASHINGTON, D.C. 20530

ASSISTANT ATTORNEY GENERAL
ANTITRUST DIVISION

0 5 JAN 1979

MEMORANDUM TO: Brock Adams
THE SECRETARY OF TRANSPORTATION

FROM: John H. Shenefield
Assistant Attorney General
Antitrust Division

RE: DOT Options Paper on Railroad Regulatory Reform

The attached comments are the Department of Justice's response to the Department of Transportation options paper on railroad regulatory reform. As you will see, we agree with the basic thrust of the DOT paper that unnecessary regulation should be removed. However, we have in some instances proposed different means of achieving that goal.

Under our proposal, the ICC's authority to regulate railroads would basically be limited to those situations in which a railroad does not have effective competition for the movement. In such cases, the ICC could regulate the maximum rate to be charged and enforce the common carrier obligation. All other ICC authority would be repealed.

Thank you for the opportunity to respond to your options paper. We look forward to working with you on this important subject.

U.S. DEPT OF
TRANSPORTATION

1979 JAN -5 PM 6:02

OFFICE OF SECRETARY
OF TRANSPORTATION
EXECUTIVE SECRETARIAT

DEPARTMENT OF JUSTICE COMMENTS ON RAILROAD REGULATORY REFORM OPTIONS PAPER

TABLE OF CONTENTS

I. INTRODUCTION

This will respond to the Department of Transportation's December 15 Options Paper on proposed reform of railroad regulation.

In recent years the Department of Justice has become increasingly concerned about the condition of this vital industry. While railroads were once a powerful and growing force in the American economy, they are today characterized by shrinking earnings, bankruptcies, and federal subsidies. A recent DOT study found that the rail industry, excluding Conrail, faces a capital shortfall between $13 and $16 billion over the period 1976 to 1985 if current operating conditions remain unchanged. This same study attributed a large share of the industry's difficulties to the intricate pattern of regulatory restrictions applicable under the Interstate Commerce Act, as administered by the Interstate Commerce Commission. We agree with DOT that a "zero-based" approach to railroad regulation should be followed, and have applied this approach in our analysis of railroad regulation.

The existing regulatory scheme was implemented for the most part in the late 19th and early 20th centuries, a time in which railroads occupied a unique and vital role in the provision of transportation services. With the exception of some limited barge traffic, railroads were the only form of common carriage available to the nation's shippers. On many routes only one railroad provided service; shippers on these routes had no choice whatsoever in the provision of transportation services. Railroads operating on such routes were therefore able to price their services monopolistically. On other routes, where more than one railroad competed for the traffic, railroads were accused of using predatory pricing tactics for the purpose of driving competitors from the market. Shippers argued that railroads had the power to dictate what traffic they would carry, and at what rate, and should therefore be brought under government supervision.

The Interstate Commerce Act created a comprehensive scheme of regulation to deal with the problems posed by the practices of the railroads. Under that scheme, which was largely in place by 1920, rates must be filed with and approved by the Interstate Commerce Commssion, which may suspend and investigate proposed rates for as long as seven months. The Act also establishes general standards to be used by the Commission in approving rates. Thus, rates must be "just and reasonable." Railroads are forbidden from unjustly discriminating, or from giving undue preferences or advantages. Nor can railroads charge a higher rate for a longer than for a shorter haul on the same line, in the same direction. Railroads can, with Commission approval, vote and agree upon collective joint rates in rate bureaus with immunity from the antitrust laws.

Apart from rates, the Commission regulates the type and quality of service performed by common carriers as well as the rates charged for such service. Unlike businesses in unregulated sectors of the economy, railroads are required to continue offering service over all their routes unless specific ICC approval to abandon service is obtained. Furthermore, the Commission is empowered to immunize from antitrust enforcement rail mergers and consolidations.

While comprehensive regulation of railroads may have once been necessary, much of this regulation has in recent years become antiquated and counterproductive because of a decline in the market power of the industry. This decline is largely the result of the rise of competition from other modes, much of which is no longer subject to any economic regulation. As recently as 1929, railroads accounted for 75 percent of all intercity freight ton miles, with motor carriers accounting for 3.3 percent, inland waterway carriers 1.4 percent, and pipelines 4.4 percent. */ Since that time, however, motor and water carriers in particular have been slowly but steadily cutting into traffic which was once the railroads' exclusive domain. At least in part to protect railroads from such intermodal competition, Congress in 1935 enacted a comprehensive scheme authorizing the ICC to regulate the motor carrier industry in substantially the same way as it regulated railroads. In 1940, the ICC was authorized to regulate certain types of domestic water transportation in much the same fashion, and for the same reasons. Nevertheless, the slow decline in railroad market share continued. By 1947, railroads were carrying only 65.3% of intercity freight ton-miles.

ICC regulation of motor and water carriers has not, however, remained as pervasive as that governing railroads. In the face of irrefutable evidence showing effective competition within each of those modes, Congress and the ICC itself have freed large sectors of those industries

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*/ Great Lakes shipping accounted for an additional 16 percent of all traffic.

from all regulation. Today, no more than 10 percent of all water carrier traffic in domestic commerce is subject to ICC regulation. In the trucking industry, only some 30 to 40 percent of all intercity movements are subject to ICC control. Of particular significance, important segments of the long-haul truckload sector of the trucking industry, which carries the traffic most conducive to movement by rail, are effectively deregulated.

This disparity of regulation gives trucks and barges a significant competitive advantage over railroads for substantial traffic. While trucks and barges are often free to lower rates on a moment's notice in response to changing economic conditions, railroads cannot change any rate without first encountering the cumbersome requirements of ICC regulation. Railroads, unlike nonregulated carriers, may have to suffer through proceedings lasting several months to show that their proposed rate changes are reasonable and non-discriminatory. Under these circumstances, it is no surprise that these other modes continue to make significant inroads into railroad traffic. By 1977, the railroads share of intercity freight ton-miles had dropped to 36 percent, with trucks rising to 23.8 percent and barges to 11.8 percent. Thus, while in many cases there might still be only one railroad over a given route, railroads now face competition from other modes for the lion's share of their traffic. It is this competition which can and should dictate the price and quality of rail services.

Congress recognized these changed economic conditions in 1976, when it enacted the Railroad Revitalization and Regulatory Reform Act (4R Act). That Act, which was intended to promote competition in the rail industry by granting railroads added pricing flexibility in competitive markets, has unfortunately not achieved its stated purpose. The 4R Act failure can be attributed in part, as is pointed out in the DOT paper, to the fact that the statute granted the ICC broad discretion to determine which rates should remain subject to maximum rate regulation. In addition, however, the 4R Act failure can be attributed to the fact that the statute was simply not as sweeping as was necessary. For example, retention of the antidiscrimination provisions of the Interstate Commerce Act gives the ICC an opportunity to continue regulating even those movements for which it does not exercise maximum rate regulation.

While the 4R Act has not been successful in its implementation, the underlying premise of that statute remains valid today. In those markets in which effective competition for transportation services exists, it should be the forces of the marketplace, and not the Federal bureaucracy, which determine the level of service and the rate to be charged. Only where railroads continue to possess some form of monopoly power is any continued regulation necessary, and then only that regulation which is absolutely necessary to protect shippers from abuse of this monopoly power. In formulating our proposals on railroad regulatory reform, we begin with this underlying premise, and attempt to build upon the lessons learned from the 4R Act experience.

As a result of our analysis, we recommend removal of substantial portions of the regulatory process which today threatens the very survival of the railroad industry as we know it.

II. MAXIMUM RATE REGULATION

Removal of unnecessary maximum rate regulation should be the cornerstone of any proposal to substantially deregulate the rail industry.

DOT has promulgated three basic options for gradual removal of varying amounts of regulation. We analyze each in turn.

Option A

Option A, under which all ICC maximum rate regulation would be removed after four years, assumes that railroads have effective competition for all their movements. According to our estimates, however, as much as 30% of all rail movements might still be classified as captive to individual railroads. This figure includes movements of significant commodities such as coal mined west of the Mississippi River, and automobiles moving over 1000 miles. Removal of maximum rate regulation would give railroads carrying these commodities the freedom to extract monopoly profits on such movements.

The question then becomes how to identify those markets in which maximum rate regulation should be retained, and what standard to use in determining the appropriate rate for regulated movements. The 4R Act attempted to deal with the first problem through use of the "market dominance" test, which prohibits the Commission from declaring a rate unreasonably high unless it first finds that the proponent carrier has market dominance over the movement. */ Market dominance is defined in the 4R Act as "an absence of effective competition from other carriers or modes of transportation, for the traffic or movement to which a rate applies . . ." Under the statute, the Commission was required to promulgate rules to be used in determining whether a carrier possesses market dominance in a particular case.

The rules promulgated by the Commission contain three separate presumptions of market dominance. By far the most significant of these is the "70%" test, by which a carrier is presumed to have market dominance if it has handled more than 70% of the involved traffic

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*/ The 4R Act essentially left the determination of the appropriate level of a given regulated rate up to the ICC's discretion.

or movement carried by all modes in the preceding year. The 70 percent figure is based on general antitrust principles, under which a firm with 70% or more of the relevant market is presumed to have monopoly power. Once it is shown that the railroad did carry more than 70% of the traffic, the burden of proof shifts to the railroad to show that it does have effective competition for its traffic. An ICC study indicates that under this test, approximately 45% of all railroad movements are presumed to be market dominant. */

With respect to the 70% test, it should be noted that the ICC also concluded in the market dominance proceeding that if two or more railroads discuss or agree on a rate in a rate bureau, the market shares of all those railroads should be added together to determine if dominance exists. Without rate bureau antitrust immunity, the study indicates that only 30% of all movements would be presumed dominant to one railroad. **/

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*/ The other two presumptions are the 160% test, and the equipment investment test. Under the former, which was recently suspended by the Court of Appeals for the Distrtict of Columbia Circuit until such time as the ICC reasonably explains the justification for its adoption, a carrier is presumed to have market dominance if its rate exceeds the variable cost of providing the service by 60 percent or more. Under the latter, a railroad is presumed to have dominance if the affected shippers or consignees have made a substantial investment in rail-related equipment or facilities which makes impractical the use of another carrier or mode. We believe that these latter two tests produce highly inaccurate results.

**/ See, The Impact of the 4-R Act Ratemaking Provisions, A Report to Congress as Directed by Section 202 of the Railroad Revitalization and Regulatory Reform Act of 1976, Interstate Commerce Commission, October 5, 1977, at 26-29.

The Department of Justice and the railroads challenged the 70% presumption on two grounds, both relevant here. First, we argued that while a presumption in favor of market dominance can be useful, a conclusive counterpresumption in favor of effective competition is essential.

Under the ICC's test, if it is shown that a railroad has less than 70 percent of the traffic arising between two points, the shipper is still permitted to submit evidence showing that there is no effective competition for its traffic. Therefore, whether the 70 percent presumption is met or not, the ICC is faced with the possibility of conducting an antitrust-type market analysis every time a new rate is filed. The resulting administrative burden is potentially staggering. Furthermore, there is the risk that the Commission will find market dominance in many circumstances in which the traditionally accepted antitrust test of monopoly power has not been met. While the 70 percent presumption has resulted in removal of maximum rate regulation on substantial amounts of traffic, the lack of a conclusive presumption in favor of effective competition may have preserved ICC regulation in many cases where market dominance does not in fact exist.

Our second objection to the 70% presumption was that the Commission limited the types of evidence which could be considered to rebut a presumption of market dominance. In addition to showing, for instance, that the threat of private carriage prevents the railroad from being market dominant, a given railroad might in some cases be able to show that "geographic" or "source" competition also places a competitive check on its conduct. If, for example, two shippers manufacture widgets of identical quality, and attempt to sell them to a given customer for the same price, excluding freight, the manufacturer with the lowest transportation costs, and the railroad serving it, will presumably get the sale. Therefore, if the manufacturers are served by different railroads, those railroads are as a practical matter in competition with each other. This competition may well make maximum rate regulation unnecessary. Nevertheless, the Commission refused to permit railroads to submit evidence showing that such effective competition does exist.

Option B

DOT's Option B, the "verbal" test, would create a zone of reasonableness within which carriers could raise rates without restriction. Outside that zone, carriers would be free to raise their rates unless a protesting shipper showed that it has no reasonable alternative to shipping via the railroad proposing the increase. Option B requires the shipper to show, for example, that there is no potential competition from other modes, or private carriage. Once it is shown that market power does exist, and also that this power had been abused, the ICC would be required to calculate the costs of providing the service, and set the regulated rates at that percentage above variable costs necessary to assure a given rate of return.

Our most significant objection to Option B is that, like the Commission's market dominance presumption, it would require the ICC to do an antitrust-type market analysis each and every time a shipper protests a rate. This requirement would saddle the ICC with a staggering administrative burden, and would also give the ICC much more discretion than is necessary. Furthermore, we believe that it is unrealistic to expect a shipper to produce evidence that it has no potential alternative transportation services available. A shipper would have every incentive not to look for such alternative services, since the absence of alternatives would mean that a ceiling would be placed on its rate.

Option C

Under Option C, the "mechanical" test, the government would conduct a census of transportation every three years. This census would show the market share, by commodity, of each mode (rail, water, motor, and air) on movements between each pair of states. If the total railroad industry had less than a 70 percent market share of any commodity moving between the origin and a destination states, effective competition would be conclusively presumed. If the rail share were above 70 percent, the railroad could show that it nevertheless has effective competition, by relying on the same factors the Commission would consider under Option B. A standard similar to that in Option B for determining the reasonableness of a regulated rate is also included in Option C.

Option C attempts to deal with the objections we have to both the Commission's market dominance test, and also Option B, by identifying certain movements which can be conclusively presumed to have effective competition, without permitting the ICC to decide the question. Our objection to Option C, however, is that a census of transportation might arbitrarily group commodities together, even though the transportation conditions surrounding those commodities might be different. To take an extreme example, assume that under the census it were found that 75%

of all energy shipments between two states moved by rail, but a much smaller percentage of oil shipments moved by rail. Oil shipments would be presumed captive even though there was effective competition for movements of that commodity.

DOJ Proposal

In light of the objections we have to the market dominance test, as well as to DOT's three options, we have devised a different test. This test would, like Option B, establish a presumption of effective competition, which the protesting shipper or shippers would have the burden to rebut. This presumption could only be rebutted by showing, as shippers are permitted to do under the Commission's market dominance presumption, that the proponent railroad carries more than 70% of the traffic in the given commodity between this same origin and destination. But if such a showing were not made, under our test the Commission would have no power to conduct a further market analysis. The absence of market dominance would be presumed. Since the shippers at a given origin would have such information at hand, they would presumably not proceed with rate protests unless the requisite market share could be shown. This procedure would have the advantage of Option C, since under it the ICC would be effectively precluded from exercising any discretion unless the 70 percent threshhold were met, but would not permit a presumption of market dominance based on highly arbitrary data.

If it is shown that a railroad has over 70 percent of the traffic, under our test it would be presumed, but not conclusively so, that effective competition is not present. This is now the case under the Commission's 70 percent presumption. The railroad would be permitted to rebut this presumption by showing presence of the types of potential competition specified in Option B, but also could show the presence of geographic or source competition. While the ICC would thus be conducting an antitrust-type analysis in some cases, the number of such cases would be sharply curtailed.

As previously explained, the ICC has found that 55 percent of all rail movements would not meet its 70 percent presumption. Therefore, use of a conclusive 70 percent presumption would remove maximum rate regulation on that percentage of movements immediately. And if, as discussed later, antitrust immunity for rate bureau agreements were removed, fully 70 percent of all traffic would fail to meet the 70 percent presumption, and therefore would be conclusively deregulated under our proposal. This figure comports with our conclusion that at the most 30 percent of all rail traffic remains captive today. */

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*/ Along with rate regulation, it should be noted that the ICC also regulates the price for use of a railroad's cars, either by another railroad on interline movements, or by a shipper. Since the price charged is reflected in the total rate, we would retain such regulation only in those cases where the movement is rail captive.

We believe that our proposal would lead to removal of substantial amounts of maximum rate regulation, and would create much less of an administrative burden than either Options B or C. At the same time, unlike Option A, it would insure continued regulation where such regulation is needed to protect shippers. The success of this proposal is, however, dependent on other significant changes being made in the regulatory scheme. Apart from the rate bureau provision, the anti-discrimination provisions of the Act can and have been used to scuttle provisions for removing maximum rate regulation. In order to avoid this hazard in our proposals, we turn now to a discussion of these provisions.

III. DISCRIMINATION STATUTES

Sections 2, 3(1) and 4 of the ICC Act generally prohibit railroads from engaging in various forms of price discrimination among shippers. */ Since we agree with DOT's recommendation that section 4 be repealed, we will confine our discussion to the remaining provisions.

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*/ Section 2 prohibits undue discrimination among competing shippers who are shipping from the same origin to the same destination. Section 3(1) prohibits railroads from granting an undue or unreasonable preference or advantage to competing shippers shipping from different origins, or to any locality, port, gateway, or region. Section 4 generally prohibits railroads from charging more for a shorter than for a longer haul over the same line in the same direction.

Sections 2 and 3(1) give the ICC broad discretion to interfere in the ratemaking process, and also give the Commission the power, as DOT acknowledges in its paper, to effectively nullify any removal of its power to regulate the maximum level of rates. Furthermore, the vagueness of the discrimination statutes encourages widespread litigation by shippers, much of which is frivolous but at the same time expensive for railroads, the ICC, and society as a whole. Finally, the rigidity of these statutes discourages railroads from effectively competing with motor carriers and barges. In this way, the provisions have in recent years contributed to the declining profitability of the industry as a whole. For all these reasons, we recommend repeal of the discrimination provisions.

The Commission's broad discretion in enforcing sections 2 and 3(1) flows from the inherent vagueness of the concepts it is required to consider. Once it is shown that a railroad (or group of connecting railroads) which alone serves two shippers is charging those shippers different rates, the railroad can justify the difference in rates in one of two ways. First, the railroad could show that it offered a lower rate to one shipper for the purpose of "meeting competition" from carriers of other modes. If so, it need not offer a comparable reduction to other shippers. Second, if the railroad could show that its costs in serving one shipper were lower, a proportionally lower rate would be justified. Since these concepts are inherently imprecise, the Commission's rulings on these questions are of necessity somewhat arbitrary. This arbitrariness encourages shippers to file large numbers of frivolous discrimination cases each year, thus leading to added expense for the railroads and also the Federal Government. */

Apart from the litigation expense to railroads and the Commission caused by the discrimination provisions, these statutes have other costs as well. Since the involved principles are inherently vague, and since litigation is so costly, shippers can use the threat of a discrimination allegation as leverage in their negotiations with railroads, even if such allegations would be frivolous. Shippers thus are able to discourage railroads from lowering rates to competing shippers even when the railroad could do so without violating the Act.

*/ DOT's Option C would abolish the current ICC Act discrimination statutes, and instead make railroads subject to the Robinson-Patman Act. Since the Robinson-Patman Act permits these same two justifications for price differentials, our comments on the adverse effect of the current statutes are equally applicable to Option C.

Furthermore, and most importantly, the discrimination statutes have stifled railroad initiative in ratemaking -- and have thereby contributed to the decline of railroad fortunes vis-a-vis motor carriers and barges -- since these statutes discourage carriers from attracting new traffic by selectively lowering rates. Thus, if a railroad has substantial competition from trucks or barges on one route, but not others, it might in a competitive system choose to lower rates on the one route alone. In so doing, it would hopefully attract new traffic, which would more than compensate it for the reduction in rates on existing traffic over that route. By seizing the initiative and lowering its rate before the competing trucks or barges do, the railroad would be able, at least in the short-run, to attract traffic which might otherwise move via other modes, or in the long-run to preserve traffic which might shift to other modes. It is through this dynamic process that a competitive system produces the most efficient allocation of resources, at the lowest possible cost. In such a competitive system, true economic discrimination cannot occur. Any differences in rates charged competing shippers are attributable to differences in either costs or competitive circumstances. */

*/ It should be noted that, even in those cases where rates would continue to be subject to maximum rate regulation, any differences in rates would be attributable to differences in costs, since the ICC would regulate such rates based on the cost of providing the service.

With the discrimination provisions in force, however, railroads are inhibited from taking the initiative in this way. If a railroad wanted to lower its rate on the one route, it might also have to lower its rate on the other routes, for which it had no competition, thus producing a needless decline in revenue. Even if it were not required to do so, the threat of a discrimination proceeding might force it to do so. It is only after its truck or barge competition on the first route, most of which is unregulated and thereby not subject to any discrimination provisions, has lowered its rate that the railroad is permitted to respond by lowering its rate on that route alone. In such cases, the railroad can meet, but not beat the rate of its competitors. But by that time it is the trucks and barges, not the railroads, who have seized the initiative and stand to gain the competitive advantage. The railroads are instead scrambling to prevent loss of their traffic to those other modes, rather than pricing services so as to attract new traffic. As a result, it has been estimated that between 60 and 75 percent of all railroad rate changes are dictated by truck competition.

DOT attempts to deal with the stifling effect of Sections 2 and 3(1) by providing that if a railroad faces different competitive circumstances in serving different shippers, it can charge them different rates. A railroad would therefore apparently not have to wait until a truck or barge lowered its rate on a route before it could selectively lower its rate on that route. In addition, DOT would, as Sections 2 and 3(1) do now, permit different rates based on different costs of providing service. */ In this way, the DOT proposal is intended to produce the same results as would be expected absent any discrimination statute, but with the added expense and distortions caused by the regulatory oversight mechanism.

While DOT is correct in stating that, in the absence of discrimination statutes, railroads would be free to discriminate based on "personal whim", there is little incentive for rational railroad managers to make non-economically motivated pricing decisions, and we have seen no evidence of such actions. The few cases in which real discrimination

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*/ Under Option A, enforcement of this new standard would remain with the ICC for five years, and then would be enforced in the Federal courts by the Department of Justice, the Federal Trade Commission, or private parties. Under Option B, enforcement of the new provision would remain with the ICC indefinitely.

might arise hardly provide adequate justification for the elaborate bureaucracy needed to enforce any discrimination provision. Since these statutes, even as revised by DOT, produce little tangible benefit, and since the existence of inherently vague discrimination statutes threatens the success of any proposal to remove maximum rate regulation, we recommend that these statutes be repealed.

IV. RATE BUREAUS

The Supreme Court has held that collective ratemaking agreements among railroads constitute price-fixing in violation of the Sherman Act. Georgia v. Pennsylvania Railroad Co., 324 U.S. 439 (1945). In the wake of that decision, Congress, over President Truman's veto, enacted Section 5a of the ICC Act (now codified as 49 U.S.C. § 10706), empowering the ICC to grant antitrust immunity for the collective activities of all common carriers. We believe that as railroads are given increased freedom to price their services without being subject to ICC regulation, the antitrust laws must play an important role in insuring that rates are not raised above a competitive level. Therefore, we recommend that Section 5b be repealed.

Associations of railroads formed for the purpose of regulating rates have existed since the late 19th century, */ and railroads and shippers have long thought rate bureaus essential. The railroads rely upon the bureaus to secure some of the benefits of cartel pricing -- to exchange information, reduce price competition, and to maintain rate structure stability and uniformity. The shippers rely upon the bureaus to maintain rate relationships among shippers, and to provide rate stability.

These justifications have been seriously called into question, and the 4R Act imposed various restrictions on the activities of railroad rate bureaus. For example, rate bureaus are now prohibited from voting or agreeing on

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*/ In 1889, for example, many of the railroads operating west of the Mississippi River formed an organization known as the Trans-Missouri Freight Association. One of its functions was to establish and maintain reasonable rates among member carriers. Rates were established by a committee and any member railroad violating the established schedule was subject to a penalty. While a member railroad could withdraw from the association on giving 30 days notice, it was bound to the fixed rates as long as it maintained membership. A somewhat similar arrangement was entered into by nearly all of the Eastern railroads.

any single-line rate (a rate for a movement by a single carrier between the origin and destination). Voting and agreement by railroads on joint-line rates -- involving two or more connecting carriers -- is limited to those carriers which can "practicably participate" in the movement under consideration. While these reforms were a small step in the right direction, they have had little impact on the anticompetitive effect of rate bureau activities. For example, the ICC still permits competing carriers to engage in certain discussions concerning single-line rates, even though such carriers cannot formally vote or agree on these rates.

We believe that only by removing the ICC's discretion to grant antitrust immunity for any price-fixing activity can Congress hope to achieve the benefits of competitive pricing for rail services. The underlying principle of a competitive system is that consumer welfare is maximized when individual firms compete without collusion. If individual firms are permitted to establish price-fixing agreements, prices necessarily rise above the competitive level and society as a whole suffers a deadweight loss, (i.e., a misallocation of resources with no countervailing societal benefit). For this reason, the Sherman Act forbids price-fixing among competitors in any form. As railroads are given increased freedom to price their services without regulatory restriction, application of the antitrust laws is necessary to help insure the effective functioning of the competitive system.

DOT's Option A would essentially continue the current scheme, the one significant change being that antitrust immunity for general rate increases or broad tariff changes would be removed. */ Option A is based on two significant assumptions, neither of which has merit. First, it is assumed that absent antitrust immunity railroads would not be permitted to agree on joint rates. This assumption is erroneous. Any group of railroads forming an interline route can formulate a joint rate between any two points without violating the antitrust laws. Since two connecting carriers do not compete on their joint movements, nothing in

*/ Option A would also require all railroad rate bureau meetings to be open to the public. This requirement has already been imposed by the ICC administratively.

the antitrust laws prohibits them from agreeing on the joint rate for that particular movement. While those two carriers may compete on other routes between the two points for which the joint rate is made, no antitrust immunity is needed so long as those two carriers limit their discussion and agreement to that particular joint rate.

The second significant assumption underlying Option A is that rate bureaus enable railroads to make rates quickly and effectively, assuring railroads the ability to respond promptly to changes in market demand. We believe the opposite is the case.

Rather than promoting effective responses to other modes, the cumbersome procedures followed by rate bureaus may be part of the reason why railroads often lag behind other modes in making rate adjustments. As has been shown, some trucks and most barges in competition with railroads are unregulated, and therefore not permitted to set their rates collectively. These competitors are thus able to alter their rates quickly and effectively in response to changing market conditions. But rate bureaus, which are the accepted method of setting rates in the railroad industry, do not operate so efficiently. If a carrier wishes to initiate a new rate, it normally makes a proposal to the bureau's traffic committee, which determines for itself if the rate would be reasonable, non-discriminatory, and otherwise comply with the Act, and then notifies other carriers and affected shippers. Public hearings are then held, after which all carriers participating in any interline routing between the two points vote on the proposal. By the time this process, which often takes as long as a month, runs its course and the rate is filed with the ICC, the benefits to be gained from the lower rate may well have been captured by the unregulated carriers.

Absent rate bureaus, any single line carrier or group of carriers forming an interline routing between two points could simply establish a new rate for that routing, and direct that the new rate be filed with the ICC. By fostering the added layer of railroad rate bureau regulation, Option A does not promote effective adjustments to changes in market conditions, but instead can be expected to help continue the inflexible pricing practices which are so characteristic of the rail industry.

For similar reasons, we object to DOT's Option B. Under this option, authority to grant immunity would be transferred from the ICC to the Department of Justice. DOJ could grant immunity only where railroads could not set a particular type of joint rate without violating the antitrust laws, and only where DOJ determines that the importance of such joint rates outweighs any anticompetitive effect. Apart from the regulatory burden this proposal would impose on the industry as well as the Department, we can envision no circumstances under which such immunity would be granted.

DOT's Option C would remove antitrust immunity altogether, but would require DOJ to issue advisory guidelines specifying those circumstances in which joint rates can or cannot be made without raising antitrust issues. Such a requirement is unnecessary since the Department's business review procedures even now provide the means by which private parties can obtain a statement of the government's enforcement intentions with respect to proposed transactions.

In conclusion, substantial amounts of competition exist within the rail industry itself. Only by insuring independent pricing by all carriers will the competitive system produce an efficient, non-discriminatory rate structure at the lowest possible cost to society. For these reasons, we urge that antitrust immunity for collective ratemaking by railroads be repealed outright.

V. MINIMUM RATE REGULATION

DOT proposes that the ICC's current power to regulate the minimum level of rates be repealed, and that a new standard be substituted. Under this standard, carriers would be permitted to reduce each rate by a certain percentage each year without restriction. For larger reductions, the Commission would be empowered to reject the rate if it found the rate to have been set at an unreasonably low level for the purpose of destroying a competitor. While this proposal would place new restrictions on the ability of the ICC to unnecessarily interfere in the ratemaking process, it would still grant the Commission a large measure of administrative discretion. Since we believe that no minimum rate regulation is needed, given the structure of transportation industries today, we recommend outright repeal of this authority.

As previously noted, the ICC was originally granted power to regulate rates because of predatory ratemaking tactics used by railroads in the late 19th and early 20th centuries. On routes where more than one railroad provided service, it was alleged that individual carriers engaged in "cut-throat" competition in order to drive their competition from the market. Once accomplished, the surviving railroad would then be free to raise its rates to monopolistic levels. In order to prevent such predatory tactics, the ICC was empowered to find that a proposed rate is below a just and reasonable minimum, and to declare what that minimum rate should be.

As intermodal competition became more effective, the ICC began using its minimum rate power to hold many rail rates at an artificially high level, and thereby protect motor and water carriers from railroad competition. This practice, known as "umbrella ratemaking," contributed significantly to the decline of the rail industry. While railroads could carry certain traffic, especially traffic moving over long distances, for lower costs than either trucks or barges, the ICC's umbrella ratemaking practices prevented them from passing those cost savings on to the shippers in the form of lower rates.

The 4R Act attempted to erase umbrella ratemaking by establishing specific standards to be used by the ICC in judging whether rates are unreasonably low. These standards are based on the cost to the proponent railroad of carrying the traffic, not on rates charged by carriers of other modes. Under the 4R Act no rate can be found unreasonably low if that rate contributes or would contribute to the going concern value of the proponent carriers. A rate which exceeds the specific cost incurred by the carrier in providing the service is presumed to so contribute.

While the 4R Act may have instituted a reasonable standard for minimum rate regulation, we believe that minimum rate regulation is not necessary at all in the rail industry. As a general rule, the 4R Act rate floor is the same floor which would exist in a competitive market -- no rational carrier would transport a shipment for a rate that did not cover the specific cost incurred. The only exception to this general rule would be in those cases in which carriers engaged in below cost predatory pricing tactics in order to gain monopoly power. Since such tactics are highly unlikely in today's economic climate, we see no reason to continue the ICC's wasteful regulation of minimum rates. Should the unlikely actually occur, the Sherman Act would serve as an adequate basis to terminate the conduct and prevent its recurrence.

Predatory tactics can only be successful in those markets in which high barriers to entry exist. In such markets, a firm might be willing to sell its product at below cost prices on a short term basis in order to drive its competitors from the market. Having done so, it would be free to raise prices to a monopoly level because of the absence of competition. However, this danger is not present in those markets where high barriers to entry do not exist. In those markets, a firm which succeeded in driving its competitors out of business, and then attempted to raise its rate above a competitive level, would invite renewed competition. As has been shown, railroads today face significant competition from motor carriers and barges, much of whose traffic is unregulated. Since there are no significant barriers to entering either of those industries, railroads would have little to gain from using predatory pricing to drive such intermodal competition from the market.

Even in those markets where a railroad's competition is from other railroads, and not other modes, predatory pricing tactics are unlikely. Apart from the fact that such below cost pricing would be unlikely to drive railroads out of the market in the short term, and would thus be quite expensive, the surviving railroad would be subject to ICC maximum rate regulation since it would then have no effective competition for its traffic. Regulation would presumably prevent the railroad from capturing the monopoly profits which are the raison d'etre of any predatory pricing scheme. Furthermore, even if a railroad left the market because of its competitor's predatory tactics, it could easily reenter once rates were raised. We believe that, given these facts the ICC should not have the opportunity to use its minimum rate power to examine a carrier's costs and motives each time one of its rates is protested as being too low. Since that regulation imposes costs on society without producing any countervailing benefits, we recommend that it be repealed.

VI. COMMON CARRIER OBLIGATION

The common carrier obligation requires railroads subject to ICC regulation to provide and furnish transportation upon reasonable request. This obligation prevents carriers from skirting the regulatory system by refusing to provide service. For example, assume that the ICC sets a rate which a carrier concludes is too low for it to make a profit. Absent the common carrier obligation, the carrier could refuse to provide service. If no one else serves the involved shipper, that shipper would have no service, perhaps until it agreed not to protest the railroad's submission of a higher rate.

DOT would continue to enforce the common carrier obligation on all traffic, while attempting to introduce some flexibility to the obligation. While we agree that the obligation is needed in those cases where no effective competition to a railroad exists, such as the example above, that obligation serves no purpose where effective competition does exist. In the latter case, the ICC would not regulate the rate under any of the proposals, so there is no danger of a shipper being at the mercy of a carrier wishing to avoid a regulated rate. If a carrier, for whatever reason, decides not to provide service, competing carriers would step in to fill the void. Therefore, we recommend that the common carrier obligation only be retained in those cases where, pursuant to the test outlined in Section II, it is found that effective competition does not exist for the movement. */

*/ In order to avoid reimposition of a common law common carrier obligation, we recommend that the statute specifically state that there will be no common carrier obligation unless effective competition is not found to exist.

VII. ABANDONMENTS

The abandonment problem represents yet another example of the way in which the Interstate Commerce Act has stifled managerial discretion and thereby prevented railroads from adapting to changing economic circumstances. The basic railroad plant was put in place between 1900 and 1920, well before motor carriers and barges began competing effectively with railroads, and well before the large scale shift of industries out of New England and the Northeast to the South. As a result of these shifts in demand, large parts of the existing railroad plant have become unprofitable and obsolete.

In an unregulated environment, railroads in these circumstances would have been free to cut back unnecessary services and retain services for which sufficient demand existed, thereby preserving their overall profitability. However, under the Interstate Commerce Act, railroads are prohibited from abandoning lines without first obtaining the approval of the Interstate Commrce Commission. To do so, the applicant railroad must convince the Commission that the proposed abandonment would further the "public convenience and necessity." In determining whether to permit abandonment of a particular line, the Act requires the Commission to measure and balance not only the interests of the railroad in reducing its costs, but also the interest of shippers and communities served by that line.

As a result of these requirements, abandonments are authorized only after long and costly ICC proceedings, often taking up to 15 months to litigate. Due to the expense involved in processing such applications, as well as the uncertainty of result, railroads often propose only the most noncontroversial abandonments, which means that railroads continue to provide unprofitable services to shippers and communities who are not paying the full cost of their transportation services. Because of these factors, various experts have estimated that the abandonment restrictions impose a cost of two to four billion dollars annually on the railroad industry. */

DOT proposes three options for dealing with the abandonment problem. Under DOT's Option A, there would first be a transition period during which carriers could give 240 day notice of intent to abandon. During this period, if a shipper, city, state or anyone else makes an offer of subsidy that would cover the full costs of operating and maintaining the line, including an adequate rate of return, that offer must be accepted. Determination of whether an offer meets this test, if a dispute arises, would be made

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*/ It should also be noted that these factors impose costs on the taxpayer as well, since the Federal Government provides subsidies to railroads to insure that certain unprofitable service is continued. Lines for which abandonment has been authorized, or for which future abandonment applications are contemplated, are eligible for various forms of assistance from the Federal Government, as well as State and Local Governments and shippers or other affected persons.

by the ICC or by commercial arbitrators. After the transition period, carriers could abandon lines upon 240 days notice, except that the carrier must offer to sell the line at net liquidation value to any financially able person who offers to use it to provide rail transportation.

Under Option B, the current system would remain in effect for three years, after which a railroad could give notice and then either sell the line at net liquidation value, or it could be required by the ICC to continue to operate the line if a subsidy meeting the test outlined in Option A is provided. Option C would adopt the basic structure of either Option A or B, but limit each proposal to rail lines that are not generating revenues sufficient to cover the full cost of providing service.

We agree with DOT that railroads should be required to provide a 240 day Notice of their intent to abandon.

However, we do not agree with DOT that a railroad should be required, as an alternative to abandonment, to accept a subsidy which the ICC or an arbitrator determines is adequate to cover the railroad's cost, or to sell the line at net liquidation value. While railroads would of course be free to accept such offer in a deregulated environment, they should be permitted to use their own managerial discretion to determine whether an offer is adequate.

In a deregulated environment, railroads would determine which lines are unprofitable, and would take steps -- such as rate adjustments -- in hopes of making such lines profitable. If it were determined that a given line is and will continue to be unprofitable in the future, the railroad would then announce that it plans to abandon that line unless adequate offers of assistance are made. State and local governments, or shippers, who are interested in continuation of service could then negotiate with the railroad to determine how much assistance is needed to make the operation profitable, or how much the railroad would sell the line for. If the interested parties offered enough assistance to make the service profitable for the railroad or to pay it for the value of the line, it can be assumed that rational railroad managers would accept such offers. Therefore, the question of whether or not an offer is adequate should be determined in the negotiations between the railroad and interested parties, not by the ICC or arbitration.

For these reasons, we recommend that, with the exception of the 240-day notice requirement, all abandonment restrictions be repealed.

VIII UNIFICATIONS, MERGERS, AND ACQUISITIONS OF CONTROL

In unregulated industries, mergers and other acquisitions are governed by Section 7 of the Clayton Act, which prohibits such mergers where, in any line of commerce in any section of the country, the effect of the merger may be to substantially lessen competition or tend to create a monopoly. Under the Interstate Commerce Act, however, the ICC is empowered to immunize railroad mergers from the scope of Section 7 if it finds the merger to be in the public interest. While the ICC is required to consider any anticompetitive effect of a merger in making this determination, this factor need not be decisive. Perhaps because the ICC has often not given competitive considerations the weight they deserve, DOT has proposed three options in this area.

Option A would make railroad mergers subject to Clayton 7. */ As will be shown, we believe that none of the advantages of railroad mergers need be sacrificed through use of the Clayton 7 Test. Since use of this test would also remove the ICC's discretion to approve mergers in spite of their anticompetitive effects, we recommend its adoption.

Railroad mergers are essentially undertaken for three reasons. First, carriers may well perceive various efficiencies resulting from the merger of their operations. But while the ICC has in the past approved clearly anticompetitive mergers on the grounds that such efficiencies would result, various studies have shown that these anticipated cost savings are often not realized, many times because

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*/ As DOT points out, Clayton 7 contains a specific provision encouraging mergers among connecting, non-competing common carriers. That provision states that nothing in Section 7 shall prevent a railroad from extending its lines, through stock acquisition or otherwise of another common carrier, where there is no substantial competition between the two common carriers. We have concluded that there may be rare cases in which such mergers may have anticompetitive effects without producing any countervailing benefits. This results from the fact that these are generally economies of density in rail transportation. For example, assume that Railroad I can connect with either Railroad II or III on a given movement, and that half of its traffic is given to each. If, as a result of a I-II merger, more of this traffic moves via Railroad II, Railroad III's per unit costs may rise, forcing a higher rate on the I-III movement. The merged carrier would then be able to raise its rate to that level. While these circumstances may or may not exist in a given case, we do not believe that a court should be precluded from even considering them. Therefore, we recommend that Clayton 7 be amended to delete this provision.

of protective conditions imposed by the ICC. Furthermore, it has been found that expected efficiencies are often offset by inefficiencies elsewhere in the merged system.

The second incentive for mergers is that they enable a carrier to reach markets which it currently does not serve. However, carriers could always reach new markets through use of trackage rights agreements. If a carrier wished to use another carrier's line, it could negotiate for the right to use its track rather than merging with that carrier. */

Finally, railroads might merge because, absent a merger, one or both of the companies could not survive. Such mergers would be adequately protected, however, by the "failing company" defense to Clayton 7.

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*/ It should be noted that since such an agreement increases, rather than decreases competition, carriers would be free under the antitrust laws to enter into such agreements, with or without a grant of antitrust immunity from the ICC.

Under DOT's Option B, DOT itself would identify "important" rail-bound markets. The ICC would continue to apply the current test, but would be prohibited from approving any merger that would reduce the number of rail competitors in such markets to one. This option is unacceptable because it would impose a rigid standard which may not be appropriate in many cases. For example, in some markets intermodal competition may well make more than one competitor unnecessary. While this option would permit DOT to make such a market analysis, we believe that courts, applying accepted antitrust principles applicable to the rest of our economy, are most qualified to make such determinations.

Option C would apply the new airline merger test, under which a merger found to violate the Clayton 7 test could not be approved by the ICC unless it found that the anticompetitive effects of the merger are outweighed by the probable effect of the transaction in meeting conveniences and needs of the public which are not satisfiable by a reasonably available alternative having less anticompetitive effects. We have been unable to conceive of any situations in which a merger would meet such significant transportation needs and conveniences without also coming under the "failing company" defense to Clayton 7. As we read this language mere efficiencies,even if they could be proven, would be insufficient.

For these reasons, we recommend application of the Clayton 7 test to mergers involving railroads.