



UNITED STATES OF AMERICA
 FEDERAL TRADE COMMISSION
 DALLAS REGIONAL OFFICE

COMMISSION AUTHORIZED

100 N. Central Expressway
 Suite 500
 Dallas, TX 75201
 (214) 767-5503

Office of the Regional Director

April 18, 1989

The Honorable Hugh D. Shine
 Texas House of Representatives
 P.O. Box 2910
 Austin, Texas 78769

Dear Mr. Shine:

The staff of the Federal Trade Commission is pleased to respond to your request for comments on the Committee Substitute for House Bill 675, containing proposed revisions to Articles 911b, 6675a-5i, and 6687-9b, Vernon's Texas Civil Statutes.¹ Those revisions would partially deregulate the tow truck industry in Texas, allowing easier entry and price competition within defined geographic areas. We believe that the proposals would benefit consumers by increasing choices, improving service, and reducing prices. Broadening this deregulation so that it applies across the state generally could further enhance benefits to consumers.

I. Interest and Experience of the Federal Trade Commission

The Federal Trade Commission ("FTC") is an independent regulatory agency responsible for fostering competition and safeguarding the interests of consumers. Section 5 of the Federal Trade Commission Act² prohibits unfair methods of competition and unfair or deceptive acts or practices. Through investigations of alleged violations of this statute, the staff of the FTC has gained experience in analyzing the effects of various trade restraints and the costs and benefits of these restraints to consumers. Upon request by federal, state and local governmental bodies, the staff of the FTC regularly assesses the competitive impact of legislative and regulatory proposals in order to identify provisions that may benefit consumers by promoting competition and reducing prices, and

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

² 15 U.S.C. § 45.

provisions that may harm consumers by impairing competition or increasing costs without offering offsetting benefits.

In recent years, the Commission's staff has studied the deregulation of trucking and has discussed the benefits of increased reliance on market forces at both the federal³ and state⁴ levels. Our activities in this area and in matters of competition policy generally have provided us with experience in analyzing the potential competitive consequences of trucking deregulation. We have not conducted a specific empirical study of tow truck deregulation in Texas. We are familiar, however, with the literature examining trucking deregulation nationally and in other states. While the Texas legislation covers only the tow truck industry, literature on the broader consequences of trucking deregulation may be useful.

II. State Regulation of Texas Tow Truck Operators

Under current Texas law, tow trucks are subject to the same regulatory scheme as most other motor carriers. House Bill 675 would distinguish tow trucks from carriers of other freight and

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

⁴ See Comments of the Federal Trade Commission Staff to West Virginia Delegate Rodney T. Berry on legislation to partially deregulate the tow truck industry (April 5, 1989); Comments of the Federal Trade Commission Staff to California Sen. Rebecca Morgan on legislation to repeal the Public Utilities Commission's authority to set contract carrier motor freight rates (Dec. 31, 1987); Comments of the Federal Trade Commission Staff to the Legislative Audit Council of the State of South Carolina on Possible Restrictive or Anticompetitive Practices in South Carolina's Public Service Commission Statutes (Sept. 29, 1987); Statement of the Staff of the Federal Trade Commission on Economic Deregulation of Trucking to House and Senate Transportation Committees, Washington State Legislature (March 7, 1985).

would effectively deregulate the operations of most tow truck businesses in Texas.

A. Regulation under Current Law

Currently, tow trucks for inter-city hire in Texas are regulated as specialized motor carriers under the authority of the Railroad Commission of Texas, pursuant to Article 911b, § 1(i), Vernon's Texas Civil Statutes. State-regulated towing generally involves long distances or the towing of heavy-duty equipment, such as construction vehicles or large trucks. Most towing in urban areas, including non-consensual towing, is regulated by local ordinance rather than by the State of Texas.⁵ The provision requires that tow truck operators obtain a certificate of public convenience and necessity before commencing operations and that they adhere to rates set by the Railroad Commission. A certificate entitles the holder to operate a tow truck business only within a defined geographical area. The Railroad Commission determines rates based on average carrier costs and an assumed fair rate of return. The rates are uniform throughout the state.

We understand that such certificates of public convenience and necessity are granted only after a complex application process and a sometimes lengthy hearing before the Railroad Commission of Texas. The law requires notification to existing operators of an application to serve the same territory and provides incumbent towers with an opportunity to contest the new application. Tex. Rev. Civ. Stat. Ann. art. 911b, §§ 11, 12 (Vernon). This process appears to make it difficult for new operators to enter the tow truck business. In addition, it effectively eliminates most garages and service stations from using their wreckers in a separate business of towing for hire.

B. Regulation under Committee Substitute House Bill 675

The proposed legislation would ease entry requirements for many tow truck operators by eliminating the requirement of a certificate of public convenience and necessity for vehicles

⁵ Article 911b governs the towing of vehicles or heavy equipment, for compensation, on public highways between two or more Texas cities, towns, or villages. The statute is inapplicable to "wreckers" used as an adjunct to the operator's primary business, such as the operation of a used car dealership, repair or storage facility, or salvage yard. Tex. Rev. Civ. Stat. Ann. art. 911b, § 1 $\frac{1}{2}$ (Vernon). Also exempt from state regulation as motor carriers are operators of vehicles used in transporting property for hire entirely within or adjacent to the limits of a municipality. Tex. Rev. Civ. Stat. Ann. art. 911b, § 1(g) (Vernon).

operating within specified areas. Under its provisions, the Department of Labor and Standards would divide the State of Texas into "urban," "regional," and "combined urban and regional" operating zones. Within their zones, tow truck operators would be allowed to compete.

A tow truck operating within its zone would be subject to the jurisdiction of the Department of Labor and Standards. The Department's jurisdiction would not include, however, the authority to set rates nor to require a certificate of convenience for tow truck operations. Consequently, hearings may no longer be necessary, and an applicant could enter the towing industry in any particular zone without having to overcome the objections of competitors. Effectively, the bill would accomplish economic deregulation of most tow truck operators in Texas.⁶

For each tow truck to be operated within the State, the operator would be required to designate one or more operating zones and "urban" or "regional" status, pay an appropriate vehicle registration fee for issuance of an "urban" or "regional" license plate, and obtain a certificate of registration from the Department of Labor and Standards. Under the proposed legislation, as is now the case, the Department would promulgate and administer rules regarding minimum safety, insurance, and identification requirements. A tow truck could not be operated outside of its selected operating zone without the approval of the Railroad Commission. However, a registration certificate could be transferred at will to another vehicle operated by the same owner, and an operator could change the operating zone for a particular vehicle by applying for a new registration certificate.

The Railroad Commission would retain its jurisdiction to regulate as motor carriers the operators of all tow trucks authorized to operate for hire outside of registered zones or across zone boundaries. Accordingly, the Commission would continue to set uniform rates, conduct public hearings on new applications, and require certificates of public convenience and necessity for tow truck operators seeking authority to serve broad geographic areas. Therefore, under the proposed legislation, economic regulation would continue for the limited number of tow truck operators performing long distance intrastate towing for hire.

⁶ The certificates cost a nominal amount when procured from the state, but may be resold. If certificates have resold for significant sums, the holders of those certificates who purchased them in the secondary market would lose their investment. The state may want to consider some form of compensation to existing certificate holders for losses from unanticipated changes in regulation.

III. Arguments Advanced in Support of Continued Regulation

Trucking regulation originally was intended to help protect the regulated railroads from competition from the then-unregulated and expanding trucking industry. It also was designed, in part, to support the trucking industry by restricting competition during the depression of the 1930's.⁷

In our experience, those who support continued regulation of motor common carriers usually advance four major arguments: preventing predatory pricing, forestalling destructive competition, maintaining safety, and ensuring service to small communities. As discussed below, however, a number of empirical studies on trucking have concluded that none of these rationales supports the contention that continued regulation of common motor carriers is either necessary or desirable.⁸

A. Predatory Pricing

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

The conditions necessary for successful predatory pricing may not exist in this market, however. One such condition is high entry barriers, which may take the form of government regulation. High entry barriers prevent a return of competitors when the predatory firm raises prices above the competitive level to recoup its losses. Thus to the extent that a threat of predatory pricing exists, entry regulation exacerbates the problem, and increases the necessity of state price controls to avoid this threat. Barriers to entry for local towing will no longer exist if the proposed legislation is enacted.

⁷ Nelson, The Changing Economic Case for Surface Transport Regulation, in Perspectives on Federal Transportation Policy (James C. Miller III, ed. 1975).

⁸ See generally Weinstein & Gross, Transportation and Economic Development: The Case for Reform of Trucking Regulation in Texas, Center for Enterprising, Southern Methodist University (Feb. 1987); D. Breen, *supra* note 3; D. Owen, Bureau of Economics, Federal Trade Commission, Deregulation in the Trucking Industry (May, 1988).

The revised registration requirements will permit new tow truck operators to enter urban and regional markets quickly when existing operators raise rates above competitive levels.⁹ The absence of entry barriers makes detailed regulation of prices less necessary, assuming predation was more than a remote threat. Moreover, because trucks are highly mobile and can be transferred quickly, the costs of entering (and exiting) a particular geographic area are apt to be relatively low. If the predator tries to raise its prices to noncompetitive levels, other firms should enter or re-enter the market, taking business away from the predator and forcing prices back to competitive levels. Predation is therefore unlikely to be profitable and motor carriers are not likely to attempt it.

In 1987, the General Accounting Office joined the Interstate Commerce Commission, the Motor Carrier Ratemaking Study Commission, and the Department of Justice in concluding that predation is unlikely to occur as a consequence of trucking deregulation.¹⁰ In Matsushita Electrical Industrial Co. v. Zenith Radio Corp.,¹¹ the Supreme Court stated that "predatory pricing schemes are rarely tried, and even more rarely successful."¹²

Predatory pricing remains at least a theoretical possibility.¹³ However, this possibility does not seem to us to justify the type of entry restrictions embodied in the current

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

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

¹¹ 475 U.S. 574 (1986).

¹² Id. at 589-90, citing R. Bork, The Antitrust Paradox, 149-56 (1978); Areeda & Turner, Predatory Pricing and Related Practices Under Section 2 of the Sherman Act, 88 Harv. L. Rev. 697, 699 (1975); Easterbrook, Predatory Strategies and Counterstrategies, 48 U. Chi. L. Rev. 263, 268 (1981); Koller, the Myth of Predatory Pricing -- An Empirical Study, 4 Antitrust L. & Econ. Rev. 105 (1971); McGee, Predatory Price Cutting: The Standard Oil (N.J.) Case, 1 J. L. & Econ. 137 (1958); McGee, Predatory Pricing Revisited, 23 J. L. & Econ. 289, 292-94 (1980).

¹³ J. Tirole, The Theory of Industrial Organization, Cambridge: MIT Press, 1988, chs. 8 & 9.

Texas regulations.¹⁴ In any event, firms that attempt to engage in predatory pricing also would be subject to public and private antitrust enforcement actions.

B. Destructive Competition

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

Conditions conducive for destructive competition are not likely to exist in the motor carrier industry in general, nor, we believe in the tow truck industry in particular. Fixed costs constitute only a small percentage of total costs, which include such variable costs as labor and fuel expenses. Trucks also are highly mobile assets which may readily and easily be transferred from less profitable to more profitable uses or geographic markets in response to fluctuations in demand, suggesting that costs specific to a particular location or geographic region are apt to be relatively small. Therefore, it is unlikely that destructive competition will occur.¹⁵

C. Safety

Another argument that has been advanced is that deregulation will have an adverse effect on safety in the trucking industry, because carriers facing stiff competition will neglect

¹⁴ The possibility of predation might, under certain circumstances, justify the imposition of minimum prices. However, to justify economically minimum price regulation in a specific industry, more than a general theoretical possibility of predation should exist. It would be desirable to also show that the conditions conducive to predation exist in the industry. Further, since minimum price regulations can hurt consumers if the minimum price is set too high, it would also be desirable to show that the expected benefits from setting minimum prices more than offset the expected costs.

¹⁵ See A. Kahn III, 2 Economics of Regulation 178 (1971) in which the author states, "[D]oes trucking have the economic attributes of an industry subject to destructive competition? It would be difficult to find one less qualified."

maintenance, delay replacement of vehicles, and overwork drivers. This argument carries little weight with respect to tow truck regulation in Texas because safety regulation is the responsibility of the Department of Labor and Standards rather than the Railroad Commission. The Department of Labor and Standards does not participate in economic regulation of tow truck operators. We believe in any event that reduced safety is not a necessary consequence of economic deregulation. In fact, a recent study of truck safety in California, conducted jointly by the California Public Utilities Commission ("CPUC") and the California Highway Patrol, was "unable to prove the hypothesis that CPUC economic regulation of trucking is significantly and positively linked to improved highway safety."¹⁶

D. Preserving Service to Small Communities

Some proponents of trucking regulation have argued that deregulation will result in loss of service to smaller communities. This argument has a certain amount of appeal in Texas because more than 2,500 cities and towns have populations of less than 25,000. Studies of the effect of trucking deregulation at the federal and state levels have not, however, revealed any significant deterioration in service to small communities.

A series of surveys conducted between 1980 and 1985 by the U.S. Department of Transportation found that a large majority of shippers in rural areas reported either no change or an improvement in the quality of service after partial deregulation of interstate trucking by the Motor Carrier Act of 1980.¹⁷ These findings are consistent with those of a 1982 Interstate Commerce Commission study, which found that federal deregulation had resulted in lower prices, less damage, and often more service options for shippers in small communities.¹⁸ Similarly, in a survey following deregulation of intrastate trucking in Florida, 65 per cent of respondents in small communities expressed a

¹⁶ California Public Utilities Commission & California Highway Patrol, AB 2678 Final Report on Truck Safety, Joint Legislative Report, 3 (Nov. 1987).

¹⁷ Pub. L. No. 96-296, 94 Stat. 793 (1980). See U.S. Dept. Transp., Third Follow-Up Study of Shipper-Receiver Mode Choice in Selected Rural Communities, 1982-3 (1986); U.S. Dept. Transp., Fourth Follow-Up Study of Shipper-Receiver Mode Choice in Selected Rural Communities, 1984-5 (1986).

¹⁸ Interstate Commerce Comm., Small Community Service Study (1982).

preference for deregulation, with 30 per cent expressing no preference.¹⁹

IV. Benefits of Deregulation

Enactment of Committee Substitute House Bill 675 would allow Texas consumers to enjoy the benefits of increased competition among tow truck operators within the zones established by the new legislation. Ease of market entry and freedom to set competitive rates may result in lower rates and improved service.

Evidence of the benefits to consumers produced by trucking deregulation can be gleaned from the experiences of other states. California, for example, experimented with partial economic deregulation of general freight trucking from 1980 to 1986. During that time entry was virtually free, and rates, though regulated, were flexible.²⁰ The result was lower rates with no loss in service.²¹

Experiences of other states also attest to the economic benefits of intrastate trucking deregulation. A study of trucking in New Jersey, for example, concluded that deregulation has worked well in that state.²² According to W. Bruce Allen, one of the study's authors, shippers were satisfied with the available service, rates were about ten percent lower than they would have been under regulation, and intrastate carriers have prospered.²³

¹⁹ Beilock & Freeman, Motor Carrier Deregulation in Florida, 14 Growth and Change 31-41 (1983).

²⁰ Carriers were permitted to change rates, after a short waiting period, without having to show the change was cost-justified. There was no waiting period to match a competitor's rate.

²¹ M. Simmerson, "Analysis of The Impact of Deregulation of the General Freight Trucking Industry," Investigation No. 84-05-048, California Public Utilities Commission, 20-21 (Aug. 10, 1984) (based upon survey by CPUC of 239 general freight carriers and survey by California State University, Hayward, Institute of Research & Business Development of 596 shippers.)

²² W. Bruce Allen, S. Lonergon & D. Plane, Examination of the Unregulated Trucking Experience in New Jersey, U.S. Dept. of Transportation (July 1979).

²³ W. Bruce Allen, Statement Before the National Commission for the Review of Anti-Trust Laws and Procedures (January 22, 1979).

In Florida, deregulation occurred so quickly that truckers and shippers had no opportunity to prepare for it. Nonetheless, according to one study, a year after deregulation 88 percent of shippers, as well as a surprisingly high 49 percent of truckers, supported it. Most shippers thought that service levels remained constant and that rate fluctuations had posed no difficulties. Only a few shippers converted to private carriage;²⁴ many more such shipper conversions might have been expected if predatory pricing had resulted in a large reduction in the number of truckers or if "destructive competition" had caused service quality to diminish.²⁵ Likewise, a 1982 Department of Transportation study²⁶ found that 90 percent of Florida shippers believed that post-deregulation service was at least as good as service before deregulation and 30 percent reported improvements. A majority of these shippers (58 percent) perceived that deregulation had held down rates. Finally, economists Blair, Kaserman, and McClave found that Florida's deregulation of intrastate trucking led to a 15 percent average reduction in motor carrier rates.²⁷

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

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

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

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

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

concerned about the loss of the asset value of their certificates of convenience and necessity.²⁸

In Maryland, intrastate household goods movers were not regulated. A study conducted in that state in 1973-1974 revealed that the then-regulated interstate household goods carriers charged 27 percent to 67 percent more than unregulated intrastate carriers for comparable moves.²⁹

Oregon deregulated the shipping of certain building materials in 1980. The results of this action were examined in two separate surveys by the Legislative Research Office of the Oregon Legislature.³⁰ All parties surveyed agreed that deregulation increased the number of carriers in the market. According to one survey, almost all shippers and most of the truckers with prior authority to carry these products believed that trucking rates had decreased. None of the groups surveyed believed that general rate levels had increased as a result of deregulation.

Thus, it appears that deregulation of intrastate trucking has frequently resulted in lower transportation charges with no corresponding reduction in service. The partial deregulation of the tow truck industry proposed in Committee Substitute House Bill 675 may also provide substantial benefits to consumers by increasing the number of competitors, improving service, and reducing towing rates within specific geographic zones. However, because the bill preserves Railroad Commission authority over statewide towing operations and tows which require the crossing of zone boundaries, the deregulation would be incomplete. Retention of Railroad Commission authority to restrict entry and fix rates under those limited circumstances may have anticompetitive effects. The Legislature therefore may wish to consider deregulation of all tow truck operators in Texas.

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

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

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

V. Conclusion

A significant body of evidence suggests that deregulation of trucking services lowers rates and improves service. We believe that the proposed amendments to Articles 911b, 6675a-5i, and 6687-9b constitute an important step in moving to a more competitive tow truck industry in Texas. They may result in significant benefits for consumers and competition, as entrepreneurs will be free to add needed urban and regional service without waiting long periods of time for Railroad Commission approval. The Legislature may also, however, wish to consider extending the benefits of economic deregulation to all tow truck operations in Texas.

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

Sincerely,

A handwritten signature in cursive script, appearing to read "Thomas B. Carter", written in dark ink.

Thomas B. Carter
Director