

Anthony P. Gallo, CFA
Wells Fargo Securities, LLC
Oral Statement Wednesday July 11, 2012
The committee on Small Business
“Is FMCSA’s CSA Program Driving Small Business Off the Road?”

Good afternoon. My name is Anthony Gallo. I am honored to be here today. I am a Managing Director and the senior equity research analyst covering freight transportation at Wells Fargo Securities. I have been covering the transportation sector since the early 1990’s. I have held several other roles at Wells Fargo and its predecessors, including Co-Head of equity research.

I am not an expert on truck safety, small business or statistics, although as an equity analyst covering the highly fragmented trucking industry I am expected to have a certain proficiency and understanding in these areas.

My research is largely conducted in the context of providing investment ideas and strategies to institutional investors. I publish fundamental market research on the trucking, railroad and parcel segments within the broader freight transportation industry. My written testimony includes a list of the companies within my current coverage universe as well as important disclosures and an attestation that my research reflects my personal views about the subjects and securities or issuers discussed. The views I express today are my own and not the views of Wells Fargo.

In the normal course of our research, we examine regulatory issues that pertain to and influence our covered companies and the industry. In most instances, we are largely trying to determine how a specific regulation will disturb the economics of the participants in the industry and how it may shape or alter competitive dynamics.

Our interest in CSA was originally focused on two main dynamics. First, as CSA scores became public, we would have non-financial metrics of carrier performance. Secondly, a few industry consultants began to promulgate the idea that the CSA program would force a large number of unsafe drivers and unsafe carriers to exit the industry,

thereby creating a capacity shortfall. This, in turn, was expected to transfer pricing power back to the trucking companies versus shippers. The notion that new CSA regulations would create a shortfall in trucking capacity was even discussed on earnings conference calls of railroad companies, who were keenly aware of the implications and interested in capturing market share.

Since the release of CSA BASIC scores, we have published three research reports on the program and the prescribed rating methodology. Our first was on March 28, 2011; published shortly after the CSA BASIC scores were initially made public.

On November 4, 2011, we published our second research report titled “CSA: Good Intentions, Unclear Outcomes”. Our intent with this report was to examine CSA after it had been implemented and utilized for roughly a year. We expanded the dataset from the March report of roughly two dozen public carriers to 200 of the largest motor carriers. Using regression analysis on the data, we were unable to find any meaningful statistical relationship between a carrier’s assigned BASIC score and actual accident occurrence.

When we first regressed and analyzed the data and the results showed no meaningful relationship, we were a bit perplexed. After all, it is certainly intuitive to expect a higher accident occurrence, or crash rate, for a motor carrier that scored poorly on either the Unsafe Driving or Fatigued Driving BASIC. But that is not what we found. Rather, we found a wide variety of crash rates by carriers that did not coincide with their associated BASIC scores.

In our role as research analysts, we seek to understand what is behind the numbers. That is what we did for our “Good Intentions, Unclear Outcomes” report. In summary, we highlighted several aspects of the CSA program that we found to be problematic. We stated that we did not believe stakeholders should rely exclusively on BASIC scores in assessing carrier risk. We received a fairly robust response from industry stakeholders including; trucking company customers, legal professionals, freight brokers, etc., who heard about our report and we subsequently received numerous requests for copies.

On March 16, 2012, the FMCSA published a formal response to our November research report. In short, they disagreed with our findings. We looked deeply into the FMSCA responses, sought advice and perspective from industry experts and subsequently expanded our dataset to 4,600 motor carriers. We published our findings on July 2, 2012 in a report titled “CSA: Another Look With Similar Conclusions”.

Our 22 page report has been submitted as our written testimony. I offer the following summary conclusions from that report;

- First, we did not find a meaningful statistical relationship between the assigned BASIC scores for Unsafe Driving, Fatigued Driving, Driver Fitness or Vehicle Maintenance when compared to actual accident rates measured against either the number of power units or number of miles driven. Again, the dataset included 4,600 motor carriers.
- Second, we found unexplainable variances in enforcement by States. For example, in our dataset Indiana represented over 35% of all BASIC violations for exceeding the speed limit by 1-5 miles per hour. In another example, Arizona accounted for 24% of all the assigned BASIC notations for False Logbook violations.
- Third, we found a wide variety of inspection rates by carrier. The one pattern that we did observe was that small carriers, between 25-49 trucks, were inspected at greater than twice the frequency of the largest carriers when normalized for mileage driven or on a per power unit basis.
- Lastly, in the FMCSA’s response to our research report they refer to a University of Michigan Transportation Research Institute study that, in contrast to our work, did find high statistical correlations. We examined the UMTRI report, as well as examinations of the UMTRI report by others. One examination in particular, conducted by Dr. Inam Iyooob from Transplace.com caught our attention. Dr. Iyooob found that the correlations cited in the FMCSA response to our work did not hold when the 43,000 carriers in the study were ungrouped from the percentile ranking that UMTRI had done prior to the regression.

In concluding my comments I would like to offer some observations that we came across in our work that you may find helpful in your determination of CSA's impact on small truckers.

CSA is a federal program that is enforced at the State level but State inspection and enforcement protocols vary in unexplainable ways. Moreover, States reporting of inspections and crashes varies sufficiently enough that FMCSA actually has a rating system in place to grade States as "Good, Fair or Poor" in their reporting. Small carriers are likely to frequent a fewer number of States than larger carriers, thereby increasing their exposure to the vagaries of any one State. Secondly, according to the FMCSA, only 1/3rd of all inspections result in no violation being assigned. Small carriers appear to be inspected at greater than twice the frequency of large carriers. This has implications for productivity loss. Further, because two out of every three inspections typically result in a violation, the process can create a vicious cycle for the carrier. A threshold breach prompts more inspections, and two out of three inspections find violations, and so forth. Lastly, the customer base of the trucking industry appears to be struggling with the ambiguity inherent in the CSA BASIC percentile methodologies. Large carriers are using their favorable CSA scores in soliciting business and pointing out deficiencies at other carriers. It is not clear at this point the degree to which this will impact the small carrier community. However, it seems plausible to us that a logistics manager's self interest would prompt him to select a large carrier that is within each BASIC threshold, as opposed to the risk of choosing a smaller carrier that may be outside of any one BASIC threshold at a particular point in time. This could cause lost business at smaller carriers in spite of perhaps no increased risk of accident occurrence.

Thank you for your time and attention. I would be happy to answer any questions you may have.