

DIRECTOR = [redacted] from D. Gillen to

CT-89/4

L. Waverman

THE COMPETITION TRIBUNAL

COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
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OTTAWA, ONT.	#63

IN THE MATTER OF an Application by the Director of Investigation and Research for an order pursuant to section 75 of the Competition Act. R.S. 1985, c. C-34, as amended requiring that the Respondent accept the Exdos Corporation as a customer for the supply of a product

BETWEEN

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

-and-

XEROX CANADA INC.

Respondent

AFFIDAVIT OF DAVID W. GILLEN

I, DAVID W. GILLEN, of the City of Kitchener in the Judicial District of Waterloo, make oath and say as follows:


1. I swore an Affidavit attaching my original report in this matter on April 23, 1990. Attached hereto as Exhibit "A" is a report which provides a reply to Professor Leonard Waverman's rebuttal to my report.

2. I make this affidavit pursuant to Rule 42 of the
Competition Tribunal Rules.

SWORN before me at the City of)
Waterloo, in the Judicial District)
of Waterloo this 28 day of)
May, 1990)



David W. Gillen



A Commissioner etc.

**In the Matter of the Director of Investigation and Research and
Xerox Canada Inc.**

**Reply to the Rebuttal Evidence of Professor Leonard Waverman,
Dated May 14, 1990**

David W. Gillen, Ph. D.

**Professor of Economics
School of Business & Economics
Wilfrid Laurier University
Waterloo, Canada**

for

The Director of Investigation & Research

May 28, 1990

1. Professor Waverman's rebuttal of my report to the Director can be divided into three main areas. He first speaks to specific issues bearing upon my definition of the relevant market. Second, he states I have improperly focused on the parts market and have ignored the truly relevant market which is the final reprographic consumer. Finally, he discusses certain issues surrounding vertical integration and the potential gains to XCI. In this reply to Professor Waverman I will not deal with the issues of vertical integration and efficiency. These are dealt with in the report submitted by Professor Wilson on behalf of the Director.¹

2. I organize my reply into two parts. First, I will deal with his specific comments on my market analysis. Second, I discuss Professor Waverman's comments on the relevant market and why his approach is not appropriate in this case.

I. Product and Market Definition.

3. Professor Waverman argues that my market definition is incorrect and logically leads to a series of overly narrow market /product definitions. He would have one believe there are 98 separate markets under my "relevant market" definition. This erroneous conclusion stems from a number of factors that Professor Waverman has misunderstood or has chosen to overlook.

4. In my report I make exclusive reference to the "product refused", not paper, not copiers but to the product refused, post 1983 copier parts. This does not point to an exclusive definition of the market. Rather I am limiting the scope of the parts under consideration to those which were refused and which constitute the base of the definition for the market.

¹ Affidavit of Professor T. A. Wilson, Report prepared for the Director of Investigation and Research.

The market which I have identified could easily have been termed the "Xerox copier parts market" if not so limited.

5. Professor Waverman states that I have argued, "a possible market is parts for copiers" (Waverman, page 2, paragraph 4) which is quite correct. He also states that I have argued, "within that market there are numerous relevant markets", including "new parts as opposed to used parts"; "parts for independent service organizations", "parts for end users", etc., (Waverman, page 2, paragraph 4). This is incorrect.

6. My report identified two relevant markets. The market for Xerox copier parts and a sub-market which is formed by the (large) subset of parts which can only be viably sourced from XCI. Although these markets may be viewed as narrow, it is the particular circumstances of this case that lead to this conclusion. They include the fact that parts are not interchangeable between Xerox copiers and other copiers, that parts are not available from other sources in adequate supply but only from XCI in its intermediate market, that parts are not sold exclusively in a bundled form with other products but are sold separately, and that they have a separate price and have been actively purchased separately. It is for these reasons, among others, that it is quite reasonable to define a market for Xerox copier parts as I indicate in my report.

7. Professor Waverman provides a lengthily quote from Areeda and Hovenkamp (p. 8) in an attempt to illustrate his point that products differentiated by brand name alone cannot reasonably be placed into separate markets. As a matter of general economic principle I do not disagree with Professor Waverman that there can be interbrand competition due to substitution between brands. What Professor Waverman has chosen to ignore is the set of circumstances in this case which does not allow the type of interbrand competition

discussed by Areeda and Hovenkamp because the copier parts are not technically substitutable for one another. This is more than mere differentiation.

8. It is possible of course to have intermediate product markets where my analysis would not find a firm-specific market definable. For example, lumber from branded lumber companies (such as McMillan-Blodell) is an intermediate product but one cannot define a market for a particular lumber company because of substitution possibilities. This is quite different than the case at hand. Certain copier companies parts, as I understand it, may be interchangeable with those of competitors but this is not the case with Xerox copier parts. It would depend on the particular facts whether other copier companies' parts could be defined as a relevant market. It may or may not be the case for other companies as Professor Waverman suggests.

9. Professor Waverman states that I "classify end-users and ISOs as distinct markets" (p. 3, paragraph 5). Again he is incorrect. The issue as stated in paragraph 19 of my report is

"In order to define the "relevant product " and therefore the relevant market, four issues must be investigated: (1) whether a market can be defined separately for parts used by ISOs as opposed to end users as part of a service package; (underlining added)

The end user referred to was that customer who purchased not parts but a service package which is a bundle of parts, labour, reliability and other factors. I accepted in my report as given that an end-user who purchases parts directly from XCI is in a similar position in the market as an ISO (see, e.g. para. 24). The purpose of the analysis was to show that the "service package" end user (the dominant type of end-user in the copier market) is not in the same position as an ISO and that an intermediate market for parts can be validly defined. I conclude that they are not and that a separate parts market exists. As I stated, end-users are "not in the same business" and (ignored by Professor Waverman) the demand and supply side exhibit distinguishing characteristics. The end-users are not in the same business, and are at different points in the value or product chain. They choose not to

identify parts separately as part of the product package which is bundled together as rent (copier, parts, labour, etc.) or a service contract (parts, labour, etc.).

10. Having misconceived the issue, Professor Waverman sets up (p.4) what he claims is a clear example of how my reasoning would lead to hamburger meat sold to McDonalds and Loblaw's as being in separate markets. I would accept that these purchases are in the same market. In fact, his analogy provides an excellent illustration of precisely the distinction I make between intermediate markets and final markets. A consumer has the choice of going to McDonalds and purchasing a bundled product in the form of location, speedy service, uniform service quality, hamburger and condiments. This consumer is in the final consumer market. The same individual could also go to Loblaw's and purchase hamburger, take it home and prepare it himself. In this latter case he demands an input whereas in the former case he demands an output. In just the same way the end-user can purchase a bundled service contract from Xerox in which case he is not part of the parts market. Alternatively, he can purchase the parts and repair the copier himself. In this case he is part of the Xerox copier parts market. This is made quite clear in paragraph 24 of my report.

"... copier parts are an input into the supply of copier servicing by Exdos and other ISOs. ISOs and some customers who do their own servicing require only the parts and not the service technician from XCI. Parts, therefore, represent a separate market from service." (emphasis added)

Professor Waverman is clearly on the wrong turf.

Section II. Professor Waverman's Characterization of the Relevant Market

11. Professor Waverman states, "The relevant market should include that package of service commonly purchased by end-users; since XCI competes with other suppliers of photocopying services, the relevant market is not Xerox brand parts, but the market in

which XCI competes" (p. 5, paragraph 6). This is Professor Waverman's thesis and it suggests that relevant competition cannot exist in an intermediate market of a vertically integrated industry. He is suggesting you cannot have separate suppliers, demanders and prices established in such an intermediate market. Based on this logic there is not only no relevant parts market but no market for toner and presumably no market for any such intermediate input. Do we ignore the market despite the evidence of separate prices and specialized suppliers? Because General Motors and Ford compete in the final market for automobiles does this mean there is no definable market for captive parts for Ford cars? Professor Waverman would have one believe that the interaction between demanders and suppliers of intermediate goods is of no consequence, the prices established are irrelevant. Does this mean that for purposes of the Competition Act one can ignore the concentration of upstream assets in the hands of supplier such as an oil company who faces retail competition downstream? Surely not. In all of the examples cited the intermediate market is a real market, there is interaction between suppliers and demanders, transactions occur and prices are established.

12. Despite the position taken in his reply as quoted in paragraph 11 above, Professor Waverman, in his original report, stated "This application by the Director involves one portion of a chain of delivering product from a vendor to the final consumer." (P. 2, para 4) Yet he then proceeds to develop a definition of the relevant market which completely ignores this real and important fact. The value chain from copier manufacturer to consumer of copier services is more complex than Professor Waverman acknowledges.

13. If it were the case that Xerox controlled the entire distribution process from manufacture to final consumer and there was therefore only one transaction, Professor Waverman's definition of the relevant market might be correct. There would be no intermediate markets because there are no demanders and suppliers, there are no prices

established for parts except for the "administered" prices for intra-firm transactions. These are not market prices.

14. However, the fact of the matter is XCI encouraged the development of an intermediary, Exdos. Without this direct encouragement other ISOs also entered that market and obtained parts from XCI. ISOs found that there was an economic opportunity available by servicing Xerox brand copiers by offering service contracts and parts. There is a transaction which takes place between Xerox and a number of customers for parts alone. There are demanders, suppliers and transactions taking place. There are prices established in a market. There is a market for parts which lies between the copier manufacturer and the final output of copier services. I therefore reject Professor Waverman's notion that one can ignore the Xerox copier parts markets. It ignores the reality of active intermediate markets.

15. Professor Waverman states, "Xerox as a provider of photocopying services faces competition from many suppliers" (p. 7, paragraph 9) and "Professor Gillen does not hold that XCI has any market power in the market for photocopying services. XCI then has little market power in any market for parts" (p. 10, paragraph 11) and "In economics language the elasticity of derived demand (for parts) depends on the elasticity of demand in the end-user market..." (p. 10, paragraph 11). He argues here that XCI has little market power in the market for photocopying services and therefore cannot have market power in any upstream markets.

16. I first would only note that examination of the data set out in Professor Waverman's original report suggests that it is by no means clear that Xerox has no market power in the copier market. In certain segments of the market, particularly the high end, XCI does not face competition from many suppliers as Professor Waverman claims. Therefore not only

can one question Professor Waverman's lack of recognition of valid intermediate markets but even accepting his thesis one can also question that end use competition affects the relevance of intermediate markets.

17. Second, to say the 'elasticity of derived demand (for parts) depends on the elasticity of demand in the end-user market' (emphasis added) as Professor Waverman does, implies that the end-user market is the determinant of prices in the intermediate market. This suggests there is one transaction between copier manufacturer and final consumer and this is incorrect. His assertions ignore the existence of a Xerox copier parts market, an intermediate market to produce a service package that involves competition between XCI and ISOs and that parts are generally bundled with labour and other products in the end use market. There are certainly linkages between demand in the end-user market and the demand for parts but these linkages are in my view insufficient to conclude that the markets are indistinct. Some consumers of McDonalds hamburgers may chose to buy the hamburger meat for home consumption . If the price of fast food burgers rises and there is a weak impact on home consumption it does not necessarily place fast food and raw hamburger in the same market.

18. I agree with Professor Waverman when he states, "A relevant market must be considered within the purposes of the Competition Act". I do not however agree that the market defined by Professor Waverman is the relevant one for the various elements of Section 75 as applied to this case. The objectives of the Act are to "...maintain and encourage competition in Canada in order to promote the efficiency and adaptability of the Canadian economy... in order to ensure that small and medium sized enterprises have an equitable opportunity to participate in the Canadian economy and in order to provide customers with competitive prices and product choices" (Competition Act, 1.1).

19. To satisfy the elements of section 75 of the Competition Act does not require that competition has been effected. The section focuses on the analysis of the effects on an individual business, one that may exist at any stage in the production process and include intermediate markets. The purpose of this section of the Act on this basis appears to be to promote consumer choice and efficiency through the promotion of competitors in the marketplace. In the case at hand the refusal to supply Exdos will remove a competitor from the marketplace.

20. The impact on competition goes beyond the immediate effect of lack of choice for users of Xerox copiers in their selection of a service representative. It also eliminates any competition in the buy-back market. This has two effects; it reduces the resale value to current copier owners and thereby raises the net cost to them, and it could permit Xerox to remove machines from the market more cheaply. Without an effective market for used machines, there will be less competition in the price sensitive market segments such as are currently served by Exdos.

21. The objectives of consumer choice and equity are served by a market definition which ascribes importance to the intermediate market. An order to supply Exdos would permit the objectives of the Act to be realized. Exdos would be maintained as a competitor in the downstream market for service contracts; a market in which it competes with XCI. It would also promote consumer choice in the downstream market as well as meeting the small and medium size firm opportunity goal. For the reasons described in Professor Wilson's report competition in the intermediate product market may also be important for efficiency reasons.

22. The foregoing considerations suggest that the market definition I have proposed is indeed the more relevant one to the apparent objectives in this section of the Act.