

*Respondent
(Rebuttal) from L. Waverman
to D. Gillen*

Original

THE COMPETITION TRIBUNAL

CT-89/4

**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**

B E T W E E N:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

| | |
|------------------------------------------------------------------|----------------------------|
| COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE | |
| F I L E D | D É P O S É |
| MAY 14 1990 <i>(J. S. MacNeil)</i> REGISTRAR - REGISTRAIRE | |
| OTTAWA, ONT. # 45 | |

- and -

XEROX CANADA INC.

Respondent

AFFIDAVIT OF LEONARD WAVERMAN

I, LEONARD WAVERMAN, of the City of Toronto in the
Judicial District of York, MAKE OATH AND SAY AS FOLLOWS:

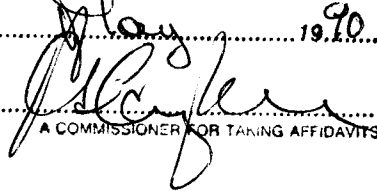
1. Attached hereto and marked as Exhibit "A" to this my
affidavit is a true copy of my reply to the report of David
Gillen.

SWORN BEFORE ME at the City)
)
of Toronto, in the Judicial)
)
District of York, this 14th)
)
day of May, 1990.)

Leonard Waverman

LEONARD WAVERMAN

[Signature]
A Commissioner, etc.

This is Exhibit A referred to in the
affidavit of Leonard Waverman
sworn before me, this 14th
day of May 1990.

A COMMISSIONER FOR TAKING AFFIDAVITS

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

**Reply to the Report prepared by Professor David W. Gillen for
the Director of Investigation and Research**

Statement of: Leonard Waverman
 Centre for International Studies
 University of Toronto
 Toronto, Ontario

Date: May 14, 1990

The Product Market

1. Professor Gillen's Affidavit of April 22, 1990, is designed "to provide a written assessment of economic issues surrounding the definition of the relevant market" (page 2, paragraph 1).

In paragraph 17, Professor Gillen states

"An economic market is defined as an area in which prices of qualitatively similar goods tend to equality with allowance for transportation or transaction costs."

In the absence of price data and elasticity of demand estimates, Professor Gillen suggests using qualitative measures for defining a market, including "the observed extent to which products are substituted for one another." (page 6, paragraph 17)

2. Professor Gillen's opinion is that "(p)ost-1983 Xerox copier parts in Canada which are used by XCI, Exdos and other ISOs in conjunction with their technical knowledge to service Xerox copiers constitute a relevant product market" (page 6, paragraph 16, underlining added).

Professor Gillen, by ignoring the degree to which final products (an imaged copy) are substituted for one another, erroneously concludes that the relevant product market is a

subset of Xerox brand parts.

3. Professor Gillen states "The end use copier customers demand the flow of copying services..." (p. 8, paragraph 21, underlining added). In my affidavit, I defined the relevant product market as the flow of copying services, or more precisely as:

"the provision of the services of imaged pieces of paper with a given set of cost and performance specifications, through the provision of reprographic equipment and the services, parts and supplies required to enable the equipment to produce copies on a regular basis with minimum interruption from equipment not working" (page 4, paragraph 9).

4. In an Appendix to this Submission, I list the many specific products/markets discussed by Professor Gillen in arriving at his overly narrow product definition -- XCI sourced new parts available to Exdos for post-1983 Xerox copiers. Professor Gillen argues that

- a) a possible market is parts for copiers;
- b) within that market there are numerous relevant markets --
 - 1) parts for XCI copiers as opposed to other brand-name copiers;
 - 2) new parts as opposed to used parts;
 - 3) within the category of new XCI parts, parts for Independent Service Organizations;
 - 4) within the category of new XCI parts, parts for Exdos;
 - 5) within the category of new XCI parts, parts for end-users;
 - 6) within the category of new XCI parts, parts for brokers (who purchase and recondition copiers);

- 7) within the category of new XCI parts, those available from XCI versus from individual parts manufacturers;
- 8) the same large number of "markets" for the various uses of used parts;
- 9) for every one of these many, many markets, the distinction between parts for "pre-1983" and "post-1983" copiers;
- 10) numerous markets for each other manufacturer.

In the Appendix, I demonstrate that Professor Gillen's arguments would imply that there are at least 98 separate relevant markets called copier "parts."

5. I reject the notion that Xerox parts for post-1983 copiers, used to service Xerox copiers, is a relevant market product for the purposes of the Competition Act. Professor Gillen's definition of the relevant product market is far too narrow for several reasons.

First, Professor Gillen classifies end-users and ISO's as distinct markets for copier parts because "end-users should not be considered part of this market because they are not in the same business as an ISO" (page 8, paragraph 22). Similarly, Professor Gillen concludes that brokers are in a different market than Exdos, since they are also not in the same business.

Professor Gillen's definition of an economic market (quoted in paragraph 2 here) says nothing about "the same business."

Applied to the meat market, for example, Professor Gillen's reasoning would imply that hamburger meat (even that in pre-formed patties) sold to McDonalds and Loblaws would be in separate markets (even if both Loblaws and McDonalds paid the same price), since McDonalds and Loblaws are not in the same business as each other. However, standard economics reasoning would aggregate the hamburger meat market and not distinguish between Loblaws and McDonalds' purchases as separate markets.

Second, Professor Gillen ignores facts that are important to his definition of markets. For example, all purchasers of parts for post-1983 Xerox copiers pay the same retail price; Professor Gillen's market definition (quoted in paragraph 2 here) would then place these purchasers in the same market.

Third, and most importantly, any discussion of the relevant product market must move beyond the fact that Xerox brand copiers require Xerox brand proprietary parts and discuss the relevance of this fact for Competition Policy. This Professor Gillen does not do.

The relevant product market should include all those "qualitatively similar goods" from the vendors' or end-users' (consumers') perspective which compete with each other. By examining only Xerox parts (actually a subset of Xerox parts), Professor Gillen has ignored the competition among suppliers

for the provision of photocopying services. This competition for end-users provides competitive discipline in the market for parts. Hence, XCI's means of distribution for Xerox brand parts does not raise Competition Policy issues.

6. If we ignore the multitude of markets in Professor Gillen's Report, we are still left with the fact that XCI does sell parts for post-1983 copiers to end-users for service, and does announce retail prices for parts.

It is tempting to say that this means that XCI sourced Xerox brand parts is a relevant market, and since parts for a Xerox 1038 copier are different from parts for a Xerox 9500 copier, the relevant market is parts for a Xerox 1038. If Xerox improves the 1038 copier by producing a new proprietary part in March 1990 -- then by Professor Gillen's argument "a new relevant market" is created: March 1990 Xerox 1038 copiers (a market in which Xerox is the sole supplier). This indeed is the track that Professor Gillen follows. In my opinion, it is not a track that is economically meaningful in examining competition issues, a subject to which I now turn.

The relevant market should include that package of services 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.

Competition Issues

7. Professor Gillen does not define what a relevant market is. He defines many markets, but the issue is their relevance for the Competition Act.

A relevant market must be considered within the purposes of the Competition Act. The goals of the Act are provided in my affidavit (paragraph 2). The economic principles behind the meaning of relevance rest on estimating the degree of competition faced by the supplier. The goal of Competition Policy is to ensure the availability of final products at competitive prices. Competition Policy achieves this by protecting the degree of competition in the Canadian economy.

In this case, competitive discipline for XCI in the parts market is provided by competition in the end-user market for photocopying services (an imaged copy). In short, to assess the extent of competition in the parts market and the impact of a decision in this case on that competition, we must consider as a relevant market the package of services purchased by consumers.

8. To argue that the relevant market for Competition Policy purposes is "parts for March 1990 Xerox 1038 copiers" is inappropriate. Xerox 1038 copiers compete (in a package with

service and parts) with a number of other Xerox copiers and numerous copiers produced by many other firms. XCI has little market power and therefore the "control" over the distribution of Xerox proprietary parts for a Xerox March 1990 1038 copier or for all Xerox copiers cannot be anti-competitive.

9. Such an overly narrow market definition as that made by Professor Gillen in this case will invariably define a supplier as facing "insufficient competition" even when that supplier has no market power. As Professor Gillen states, "By definition, there is insufficient competition for [Xerox] parts since they are unavailable from other sources" (page 13, paragraph 16, underlining added). However, Xerox as a provider of photocopying services faces competition from many other suppliers. As I stated above, the relevant competition is not that for Xerox proprietary parts, but among the providers of photocopying services, of which there are many.

To argue that the market is Xerox parts ignores the manner in which consumers make decisions. End-users (those who want photocopying services) are not indifferent to the prices of Xerox parts since ultimately that price, whether explicit or implicit, is a component of the cost per copy. Competition among providers of photocopying services in the cost per copy provides discipline in the market for parts.

10. Philip E. Areeda and Herbert Hovenkamp (1989 Supplement to Antitrust Law: An Analysis of Antitrust Principles and their Application, Little, Brown and Company) examine the issue of differentiated products and relevant markets as follows.

"The most immediate constraints on the prices of regular Coca Cola are the prices of other widely advertised colas. These prices in turn are constrained by the prices of widely advertised cola beverages without sugar or without caffeine, by similar private brand products, by some other flavored and highly promoted sodas, and then by soda beverages generally. These prices may even be affected by the prices of fruit juices, milk, pop, wines, beer, and perhaps even gin or cognac.

One might describe the broadest range of substitution as a "market" and each increasingly narrow grouping as a "submarket" -- all the way down to a submarket for Coca Cola alone. This use of "market" and "submarket" may seem comprehensible to the layman, who can readily see that the products constraining a defendant's prices lie along a spectrum. At one end are nearby sellers of the same physical products; at the other are remote makers of tangential substitutes. At any point along the spectrum one could speak of a submarket...

But talk of markets and submarkets is both superfluous and confusing in an antitrust case, where the courts correctly search for a relevant market -- that is, a market relevant to the legal issue before the court..." (page 431-432, underlining added).

"Product differentiation presents two issues that invite courts into "submarket" confusion. Products differing in brand name may be physically identical, as with aspirin; physical differences may be substantial, as with Rolls Royce and Ford, or almost trivial, as with canned peas. Brand recognition may be substantial, as with beer, or modest, as with retail sugar or salt. In all events, differentiated products are not perfectly interchangeable for consumers. Unlike a perfectly competitive firm, a producer of a successfully differentiated product can raise his price above that of his rivals without losing all of his sales. In that sense, each producer has greater power over price than a perfectly competitive firm would and therefore some market power, however small. The

legal problem is immediately apparent: is the degree of power inherent in each differentiated product sufficient to make each brand a separate market for, say, monopolization purposes? The answer is almost uniformly negative. The policy reason is that our legal rules limiting a monopolist -- in, for example, exclusive dealing or promotional pricing -- cease to make sense when applied to every producer of a differentiated product. The economic reason is that the differentiated product usually faces intense competition from other brands. At its present scale of operations, one gasoline producer competes aggressively to retain or gain customers who are almost equally susceptible to other brands. It would be rare indeed to put one major brand in a separate retail gasoline market that did not include other major brands. (page 434)

11. Xerox's use of proprietary parts does not, of and by itself, create a relevant product market -- Xerox brand parts.

The product market analyzed to an economist must be relevant to Competition Policy and to the manner in which business decisions are made.

I contend that the relevant product market is the provision of photocopying services, for it is in that market that end-users, consumers, decide which machines and brands to use and, therefore, which parts indirectly to consume. It is competition in the end-user market that disciplines prices charged by XCI and the creation of proprietary parts in an intermediate market does not in any way reduce the discipline provided by this competition.

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". While Xerox brand parts are not interchangeable with other brand parts, this does not infer that the "parts market" would be non-competitive. As Professor Gillen points out, the demand for parts is derived from the demand for photocopying services (page 8, paragraphs 21 and 22). Copiers and the provision of photocopying services are interchangeable among different brands. The competition among suppliers of photocopying services assures that the derived market for parts is also competitive. In economists' language, the elasticity of derived demand (for parts) depends on the elasticity of demand in the end-user market (the provision of imaged copies).

12. Professor Gillen states "Exdos Corporation was formed in 1983 to deal with the management, disposal and servicing of pre-1983 Xerox copiers" (page 4, paragraph 9).

Professor Gillen does not comment on the nature of the contractual relationship between Exdos and XCI for post-1983 copiers and parts. Professor Gillen assumes that there was an agreement for XCI to supply Exdos with post-1983 parts. Where Exdos was acquiring post-1983 parts from XCI but not through a formal, detailed contract as was the case for pre-1983 parts, this would not -- and could not be expected -- by

Exdos to be reliable secure supply. Accordingly, the "conditions of supply" discussed by Professor Gillen (page 10, paragraph 28) do not hold equally between pre-1983 and post-1983 technology parts.

13. The Reports of Professor Gillen and Messrs. Banks and Levigne argue that Exdos is "substantially affected" by the assumed XCI actions. The analysis does not convincingly demonstrate a) that Exdos has suffered greatly to date, and b) that its assets and know-how are sunk and specific to post-1983 Xerox equipment and would not easily be transferable to the business of used copiers in other brands (Exdos has taken on a second brand of copier which already represents 10 per cent of its business).

Vertical Integration and the Potential Harm to XCI and Society

14. Professor Gillen does not consider how an Order to supply under Section 75 might affect the revenue and profits of XCI, the efficient structure of vertical integration in the industry, and hence consumer welfare. Professor Gillen argues that "These parts are absolutely necessary for Exdos to service its customers and therefore be a vigorous business competitor" (page 11, paragraph 31). I contend that an Order to supply Exdos with current technology parts makes XCI a less vigorous competitor in the market for copying services by altering a competitively chosen product delivery system -- vertical integration. An Order to supply Exdos would be a

gain to Exdos, but a loss to XCI and Society.

The selective vertical integration into the distribution of some parts or products together with the distribution of other products through ISOs, is a standard business practice -- not only among the other manufacturers in the market for photocopying, but in other markets as well. The practice is not the consequence of a lack of competition. To the contrary, competition forces firms to adopt the distribution system that gets goods to the final consumers at the lowest cost and best quality. The specific means by which selective vertical integration achieves this are outlined in my affidavit.

Parts and service are part of a package of delivering copying services in a system which allows firms to recapture the investments on technology development. There is a welfare loss to consumers generally through an Order under Section 75, which results in substituting inefficient distribution systems for efficient systems.

Leonard Waverman
May 14, 1990

**APPENDIX "A" to
Reply to the Report prepared by
Professor David W. Gillen**

Prof. Gillen's Market Definitions

GENERAL

para 17 "An economic market is defined as an area in which prices of qualitatively similar goods tend to equality with allowance for transportation or transactions cost."

SPECIFIC QUOTES FROM GILLEN -- underlining added, comments in brackets

para 16 1) "Post-1983 Xerox copier parts in Canada which are used by XCI, Exdos and other ISOs in conjunction with their technical knowledge to service Xerox copiers constitutes a relevant product market."

para 18 2) "One possible market definition here is the product refused in this case which is Xerox copier parts for post-1983 Xerox copiers".
(note this is different from 1) because 2) refers to Exdos only)

para 31 "Post-1983 copier parts sourced from XCI is therefore a definable product market."

para 19 3) "whether a market can be defined separately for parts used by ISOs . . ."
(note all ISOs)

para 19 4) ". . . as opposed to end users as part of a service package;"
(end users a separate market)

para 22 "End users should not be considered part of this market because they are not in the same business as an ISO."

para 19 5) "whether parts and service are distinct and separable products"
(parts and service separate markets)

para 24 "Parts, therefore, represent a separate market from service."

- para 19 6) "... other companies" copier parts (i.e., different brands)
(other brands a separate market)
- para 25 "Xerox copier parts represent a class of products because other copier parts are not substitutable with Xerox copier parts."
(no references to who purchaser is)
- para 20 7) "... non-end-use buyers of used Xerox copiers, such as firms who broker machines."
(brokers are another separate market)
- para 23 "Again an intermediate market for Xerox copier parts sales can be established on the basis of the customers' derived demand in this segment."
(this segment is non-end-user buyers)
- para 25 8) "Xerox copier parts are not substitutable between pre-1983 Xerox copiers and post-1983 Xerox copiers . . ."
(pre and post '83 separate markets)
- para 26 9) [and not substitutable] within the different models of copiers either pre-1983 or post-1983 Xerox copiers . . ."
(each model a separate market)
- para 25 10) ". . . parts are not fully substitutable between machines"
(each machine (model?) a separate market)
- para 27 11) ". . .cannibalization of used machines yields parts which are not physically identical to XCI parts because they are used."
(used parts a separate market)
- para 28 12) "Exdos purchased 'a bundle of characteristics' from XCI in the form of service and parts."
(a market is a bundle of characteristics)
- para 28 13) "The conditions of supply were also quite different."
- para 30 "Reliability, quality, transportation costs and transactions costs are all elements which distinguish these sources from XCI."
- para 28 14) "The parts were new Xerox copier parts."
(new parts a separate market)
- para 30 15) "...The single source of parts at XCI and a potential for having to transact with hundreds of different sources of parts supply..."
(a single source is a separate market)
- para 31 16) "...XCI appears to be the only viable source..."
(viable source is a separate market)

Therefore there are at least 98 separate markets, as follows.

- 1) viable (i.e. XCI) sources for post-1983 models for ISOs
- 2) non viable sources for post-1983 models for ISOs i.e. different conditions of supply -
- reliability, transport costs, transaction costs
- 3) viable sources for pre-1983 models for ISOs
- 4) non-viable sources from pre-1983 models for ISOs
- 5) viable sources for post-1983 models for end users
- 6) non-viable sources for post-1983 models for end users
- 7) viable sources for pre-1983 models for end users
- 8) non-viable sources for pre-1983 models for end users
- 9) viable sources for post-1983 models for brokers
- 10) non-viable sources for post-1983 models for brokers
- 11) viable sources for pre-1983 models for brokers
- 12) non-viable sources for post-1983 models for brokers
- 13) XCI use for internal use post-1983 models (refurbishing)
- 14) XCI use for service (post-1983)
- 15) XCI use for sale to brokers (post-1983)
- 16) XCI use for sale to end-users (post-1983)
- 17) XCI use for internal, pre-1983 models
- 18) XCI use for service, pre-1983
- 19) XCI use for brokers, pre-1983
- 20) XCI use for end-users, pre-1983
- 21)* Canon . . .
- 32) Toshiba . . .
- 43) Sharp . . .

- 54) Mita . . .
- 65) Minolta . . .
- 76) Konica . . .
- 87) Kodak **

* For non-XCI suppliers, I assume only one "market", i.e. no distinction between new and older technologies.

** This list does not include all suppliers of photocopying equipment.