Exhibit 23 - 1 of 2

THE COMPETITION TRIBUNAL

IN THE MATTER OF an application by the Director of Investigation and Research under Section 75 of the Competition Act, R.S.C., 1985, c. c-34 as amended;

AND IN THE MATTER OF a refusal to supply automotive parts for export by Chrysler Canada Ltd. to Richard Brunet;

BETWEEN:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

CHRYSLER CANADA LTD.

Respondent

===

AFFIDAVIT

Richard Schwindt
Associate Professor
Department of Economics
Simon Fraser University
Burnaby, British Columbia

For the Director of Investigation and Research

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THE COMPETITION TRIBUNAL

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CHRYSLER CANADA LTD.

Respondent

AFFIDAVIT OF RICHARD SCHWINDT

I Richard Schwindt of the city of Mt. Lehman in the Province of British Columbia, make oath and say as follows;

> I am an Associate Professor of Economics and was retained by the Counsel representing the Director of Investigation and Research to reply to the Report of Professor Ralph A. Winter. Attached hereto and marked as "Exhibit A" to this my affidavit is a true copy of my reply.
>
> The contents of "Exhibit A" and the findings expressed therein, are true to the best of my knowledge, information and belief.
>
> I make this affidavit pursuant to Rule 42(1) of the Competition Tribunal Rules.

SWORN BEFORE ME at
Clearbrook in the
Province of British Columbia
this 27th day of June,
1989.

A Commissioner for taking
Affidavits for British Columbia

Richard Schwindt

ERIC J. [illegible], B. COM., L.L.B.
[illegible] & Solicitor
[illegible] SOUTH FRASER WAY
[illegible]BROOK, B.C.

"EXHIBIT A" of Richard Schwindt dated 27th of June 1989 at Clearbrook B.C.

ERIC J. JANZEN, B. COM., L.L.B.
Barrister & Solicitor
2 - 32056 SOUTH FRASER WAY,
CLEARBROOK, B.C.
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In the Matter of the Director of Investigation and Research and Chrysler Canada Ltd.

Reply to the Report prepared by Professor Ralph A. Winter for Perley - Robertson, Panet, Hill & McDougall

Statement of: Richard Schwindt
Department of Economics
Simon Fraser University
Burnaby, British Columbia

Date: June 27, 1989

Professor Winter's rebuttal of my report of June 1, 1989 can be divided into two segments. In the first, he addresses specific issues bearing upon my definition of the relevant market. In the second he provides a broad economic analysis of the case. This analysis includes an explanation for the pricing behaviour of the Chrysler Organization,[1] an efficiency rationale for this behaviour, a statement on the appropriate goals of competition policy, and an assessment of the potential outcomes of the Competition Tribunal's decision in the matter.

Professor Winter's primary concern with my report is as follows.

> 19. In my view, the chief limitation of Professor Schwindt's report is its failure to address the principal economic issues raised by the Director's application, namely:
>
> a. Is the Chrysler Canada's "refusal to supply" Brunet anti-competitive, that is a consequence of market power on Chrysler's part, or does it represent a reasonable and efficient business practice by a firm competing without dominance in the relevant market?
>
> b. What would be the economic consequences for the autoparts market of prohibiting Chrysler's "refusal to supply" in this case? (Page 11)

Given Professor Winter's emphasis I will deal first with the general economic analysis of the case, and then with the specific market definition issues.

I. THE ECONOMICS OF THE CASE

The Pricing Behaviour of Chrysler

The critical datum in this case is that the product bundle offered to Brunet by Chrysler Canada differs from the product bundle offered by Chrysler U.S. That bundle is multifaceted, and each facet is important to Brunet. However, Professor Winter has chosen to focus on one element of that bundle--price. For a range of Chrysler autoparts the prices offered by Chrysler Canada are lower, often substantially lower, than prices offered by Chrysler U.S.

Professor Winter argues that the relevant market for the purposes of assessing the extent of Chrysler's market power is the market for automobiles (page 15). He further posits that prices of North American automobiles are lower in

[1] The Chrysler Organization refers to Chrysler Corp. and all its affiliates. In this report Chrysler U.S. refers to the parent company. Chrysler Canada refers to Chrysler Canada Ltd.

15). He further posits that prices of North American automobiles are lower in Canada than in the United States because of the drop in the value of the Canadian dollar and the volatility of the Canadian-U.S. exchange rate in the late 1970s and 1980s (page 20). In the pursuit of stable nominal (local currency prices) prices, and in response to competitive forces, Chrysler allowed real prices in Canada to decline *vis a vis* the United States.

While there may be elements of truth to this argument, I believe that there is a far more straightforward explanation for the observed pricing behaviour of Chrysler. Automobile manufacturers practice price discrimination between countries. This is hardly a novel finding.

> The (U.S.) automobile companies have jointly practiced price discrimination in different markets. The fleet pricing experience described provides one example. At times, fleet buyers have been able to buy virtually identical cars for prices that are hundreds of dollars below those that individual consumers were paying.
>
> The companies also have charged higher prices in Canadian markets than in U.S. markets for virtually identical cars. Prior to 1965, this had a cost basis, because Canadian models had shorter production runs. But since the United States-Canadian Automotive Agreement of 1965, the auto companies have been able to ship cars duty-free both ways across the United States-Canada border and, hence, have been able to rationalize their North American production. In effect, the United Sates and Canada have become a unified production area, with uniform costs to both areas. Yet Canadian prices have remained higher than U.S. prices. The causes of this difference probably lie in the higher import duty that Canada levies on imports from Europe and Japan and in a perceived smaller price elasticity of demand for cars in Canada.[2]

In the past, Canada was targeted as a high price market, while recently it has been identified as a low price market. T. Hazledine and I. Wigington found that in 1986, for their sample, the prices of low- and medium-priced North American autos (the biggest segments of the market) were 20 per cent higher in the United States than in Canada.[3] Apparently over the 1965 to 1986 period, the demand for North

[2] Lawrence J. White, "The Automobile Industry," in W. Adams, ed., The Structure of American Industry (New York, Macmillan Publishing Co., 1982, 6th ed.) page 157.

[3] T.Hazledine and J. Wigington, "Canadian Auto Policy," Canadian Public Policy, Vol. 13, No. 4, December 1987, pp 492.

American vehicles in Canada had become more price elastic relative to the United States. What caused this?

Economists recognize three important determinants of elasticity of demand.

-The number of good substitutes for the product.
-The proportion of the buyer's budget expended on the product.
-Whether the product is viewed as a necessity or a luxury.

There is to my knowledge no definitive study showing why elasticities changed. However there is some fragmentary evidence. Hazledine and Wigington note that the availability of more substitutes in Canada might provide part of the explanation.

> We have heard (unofficial) explanations of the lower Canadian prices as due to the 'more competitive' Canadian market (with Hyundai) but this does not seem adequate to explain all of the differential, though it should be a contributing factor.[4]

The importance of substitutes in explaining price differentials is reinforced by evidence from the Ford Motor Company of Canada, Ltd.

> The reason they (Canadians) are paying less is because of competitive pressure and a different make-up of the consumer so that the pressures of outside importers like Hyundai, who were first into Canada, and Lada and Suzuki, Renault and a variety that go back further, in the make-up of the composition of the marketplace which is a lot higher in low entry, low priced vehicles, means that in Canada prices have ben kept down by most manufacturers for them to be able to sell in Canada.[5]

T. Hazledine notes that Ford and General Motors have claimed that their lower price levels in Canada are due to differences in income levels in Canada relative to the United States.[6] Income levels are important to elasticity because, everything else equal, the smaller the income the larger the proportion of the budget expended on a given product.

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[4] Hazledine and Wigington (1987) p. 499.

[5] Evidence of the Ford Motor Company of Canada, Limited, in Proceedings before the Supreme Court of Ontario in Fournier Leasing Company Ltd. et al vs Ford Motor Company of Canada, Limited, et al, Court File No. 12010/86.

[6] T. Hazledine, "The Impact of Dumping by Hyundai on the Canadian Automobile Industry," report prepared for the Director of Investigation and Research, January 1988, mimeo.

In any case, the evidence is that in the past, and currently, automobile manufacturers practice price discrimination between Canada and the United States, and this discrimination is not cost based.[7] It is demand based. And, as every student in an introductory industrial economics course is taught, price discrimination depends upon the satisfaction of three conditions.

> For a seller to practice price discrimination profitably, three conditions must be satisfied. First, the seller must have some control over price---some monopoly power....Second, the would-be discriminator must be able to segregate its customers into groups with different price elasticities of demand or into discrete classes with varying reservation prices.....Third, opportunities for arbitrage--resale by low-price customers to high-price customers--must be constrained.[8]

Price discrimination explains why Chrysler motor vehicles are priced lower in Canada than in the United States. Because similar economic forces are at play in markets for automotive parts, price discrimination can also explain the differential in the prices of Chrysler automotive parts.

Having presented his explanation for price differentials, Professor Winter proceeds to hypothesize as to why Chrysler U.S. instructed Chrysler Canada to cut off supply to Brunet. He argues that Chrysler may have sought to centralize sales-for-export from North America through the U.S. parent in order to reap efficiencies in distribution. These efficiencies are attributed to a reduction in uncertainty and avoidance of disruptions in the distribution sector. Based upon his exchange rate explanation for price differentials, he hypothesizes a situation in which parts exporters change their source of supply, even their physical location, in response to changes in the Canadian-U.S. exchange rate. Restricting all exporters to deal only with the U.S. parent would of course eradicate such problems. I find this unconvincing. During the period that Canadian prices were lower than U.S. prices, U.S. exporters were neither flocking to Canada, nor petitioning Chrysler Canada, for supply. Further, Professor Winter does not identify any critical event in 1986 which rendered the extant system less efficient than U.S. centralized sourcing. Finally, the Director's Application does not ask that Chrysler Canada supply all North American exporters of Chrysler parts. It asks only that Chrysler Canada continue to supply the exporter which it helped to establish.

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[7] Currently about 85 percent of the North American vehicles purchased in Canada are manufactured in the United States. Hence the cost of production for the overwhelming majority of North American automobiles purchased in Canada are U.S. production costs.

[8] F.M.Scherer, Industrial Market Structure and Economic Performance (Chicago, Rand McNally, 1980, 2nd edition), page 315.

While I have not been privy to the internal decision making process at Chrysler, I believe there is a more compelling explanation for Chrysler's refusal to supply Brunet which is consistent with its price discrimination strategy.

In 1979 Chrysler U.S. was on the verge of bankruptcy.

> Chrysler has claimed that a large part of its problems has been caused by government regulation (air pollution and safety); that, as the smallest of the Big Three, it suffered diseconomies of small scale in meeting the costs of regulation. Unfortunately, Chrysler has never provided any hard evidence to support its claims. And it is clear that Chrysler made a number of serious management judgement errors, such as excessively cutting its engineering and designer staffs in the mid-1970s, delaying the introduction of subcompacts in the 1970s, and then initially declining to build its own engine plant for the subcompacts (Omni and Horizon) that it did produce. As noted, Chrysler has had a well-deserved reputation for being a poorly managed company, at least since the 1940s.[9]

Up to, and during the period of financial distress Chrysler had difficulty maintaining a reliable supply of parts for North American Chrysler vehicles in use outside of North America. Brunet, with the encouragement of Chrysler Canada, satisfied a small part of this need, particularly in South America.

Thanks to U.S. Government loan guarantees, "voluntary" export restraints on the part of Japanese producers, economic recovery in the United States, and management changes at Chrysler, the company returned to profitability by the mid 1980s. Management came to recognize that a small number of offshore accounts (i.e., Brunet's customers) had access to parts from the low-priced Canadian market. Obviously if these offshore accounts could be restricted to purchases from the high-priced U.S. market, Chrysler U.S.'s profitability would be enhanced. Therefore, Chrysler Canada was instructed to refuse to deal with Brunet. It may also be that Chrysler U.S. had become uncomfortable with this exception to a general corporate policy that foreign subsidiaries were to remain within their national markets.

Before leaving this discussion of Chrysler's pricing strategy several additional comments are in order.

1. I cannot accept that the relevant market in this case is the market for automobiles. Professor Winter (pages 15-16) asserts that when deciding upon

[9] White (1982) page 177.

an automobile purchase, consumers factor in future expenditures on parts and service. If it is assumed, as Professor Winter does, that automobile markets are competitive, then excessive parts charges will be reflected in a lower vehicle price. In other words, well informed consumers would expect to pay less for vehicles known to have expensive service/repair records. An equally plausible assertion is that consumers are not well informed about the discounted value of the future stream of repair and service charges for specific vehicles. If they were, few Chevettes would ever have been sold, and few vehicle recalls would ever be necessary.

Furthermore, it should be noted that consumers only directly bear certain repair costs. For example, most new car purchasers also purchase third party and collision insurance. The cost of "crash parts" which are a subset of captive parts, are in large measure paid for directly by the insurer. Third party liability premiums are not usually a function of the insured vehicle, rather they are a function of the cost of repair of the general vehicle population. Collision premiums are a function of the cost of repair of the insured vehicle and represent one more element to be factored into the well informed consumer's purchase decision.

2. Because I do not accept that the relevant market in this case is the market for automobiles, the discussion bearing upon Chrysler's position in automobile markets is irrelevant. Notwithstanding this, I cannot accept Professor Winter's assertion that there is a "world market" for automobiles (page 18). Concentration measures based on world automobile production (Figure 1) ignore barriers to entry, product differentiation, barriers to trade, and industry conduct. Following from this, I cannot accept Professor Winter's statement that his discussion of Chrysler's share of the world automobile market establishes that Chrysler is a competitor without much market power (page 18).

Efficiency Issues

I do not believe that an "efficiency gains" argument constitutes a defence under Section 75 of the Competition Act. Nevertheless, Professor Winter introduces this issue and concludes that "the evidence supports the position that Chrysler's decision was a means of reducing costs in the distribution sector" (page 26). Yet no evidence (as opposed to hypothesis) has been provided to show that Chrysler Canada's refusal to supply Brunet was predicated upon the pursuit of economic efficiencies. Furthermore, I cannot agree with Professor Winter that the fact that General Motors Corp. and Ford Motor Corp. centralize their sales-for-export through their U.S. parents is evidence that centralization is economically efficient. This may be profit maximizing behaviour, but it is not necessarily cost minimizing behaviour.

While I do not accept that centralizing sales-for-export through Chrysler U.S. was efficiency enhancing, I think a strong argument could be made that decentralizing sales-for-export through Chrysler Canada did result in efficiency gains. Many of Brunet's reasons for sourcing through Chrysler Canada were attributable to the comparative efficiency of that organization *vis a vis* its parent. For example, accuracy in the filling of orders, reliable delivery schedules, delivery of undamaged goods all point to a high level of efficiency on the part of Chrysler Canada. In effect, it can be argued that the refusal to deal with Brunet will result in a reduction in the efficiency of the worldwide Chrysler parts distribution system.

Competition Policy Goals

Professor Winter assumes that the dominant criterion in assessing competition policy is economic efficiency (page 25). This may be true from an economist's perspective, but I would point out that international "rent shifting" has long been an integral part of most nations' competition policy. Witness the almost universal exemption in anti-trust legislation for export cartels.

Assessment of Policy Initiatives

Professor Winter raises the possibility that an order to supply Brunet would result in an increase in the price of Chrysler autoparts in Canada (page 27). I would argue that this is a most unlikely event. Because Brunet does not sell into the United States his activity does not directly threaten price differentials between the two countries. At issue is whether it would profit Chrysler U.S. to raise prices in the entire Canadian market in order to reap additional returns in the rather limited offshore markets served by Brunet. This does not seem plausible.

II. MARKET DEFINITION ISSUES

Professor Winter addresses three issues raised in my report: geographical market definition, product market definition for aftermarket parts, and the specificity of Brunet's assets to Chrysler Canada.

Geographical Market Definition

Professor Winter argues that the geographical market, on the suppliers' side, should include both Chrysler Canada and Chrysler U.S. (page 7). The argument hangs largely on a novel approach to delineating a geographical market proposed by

Landes and Posner.[10] They propose that if a distant seller makes some sales in a local market, then all its sales should be included as part of the local market when calculating market share.

Brunet did make some purchases in the United States before Chrysler Canada's refusal to deal. However most of these were through the Interparts programme which offered attractive prices for bulk orders. The fact that on some occasions Brunet's orders qualified for this programme cannot be used as evidence that Chrysler U.S. was a viable alternative for Brunet. In fact, Landes and Posner allow for several qualifications to their proposal, one of which is relevant here.

> The first (qualification) is to require that they (the distant seller) have had nonnegligible sales in the market for a continuous period of several years. This is necessary to deal with the case where distant sellers make sporadic or insignificant sales in the market in question because of unusual perturbations of demand or supply.[11]

Brunet could only sporadically qualify for the Interparts program hence his dealings with Interparts could be viewed as falling within the context of this qualification.

Professor Winter further argues that physically substitutable products are in the same geographical market unless geographical distance and directly related costs preclude their substitution. Apparently this means that only transportation and related charges set markets apart geographically. I find this too restrictive. For example, two small, adjacent countries might produce a homogeneous product, say milk. Country X operates a supply management scheme which precludes the importation of country Y's milk. Neither distance nor distance related costs separate these markets yet, to my mind, X and Y are separate geographical markets.

The further argument that some of the characteristics which distinguish the Chrysler Canada product bundle from the Chrysler U.S. product bundle are simply reflections of a difference in price is unconvincing. In effect, those elements which raised Brunet's cost of doing business could only be viewed as a price increase if they resulted in equivalent cost savings for Chrysler U.S. However, it is not at all clear that Chrysler U.S. saved resources by offering unreliable delivery schedules, making multiple deliveries, making unauthorized substitutions, shipping inaccurate, damaged or incomplete orders resulting in higher claims, or imposing erratic trade terms. In fact it would seem that many of these practices would result in higher costs for both Brunet and Chrysler U.S. Even with respect to delivery point, it was

[10] W.M. Landes and R.A. Posner, "Market Power in Antitrust Cases," Harvard Law Review, Vol. 94, No.95, March 1981, pages 937-996.

[11] Landes and Posner (1981) page 967.

not unambiguously less costly for Chrysler U.S. to insist on delivery in the United States. For those parts produced in Canada, transportation and handling charges could have been saved by delivering directly in Canada.

Product Market Definition for Aftermarket Parts

Professor Winter takes issue with my conclusion that from the perspective of Brunet there were no close substitutes for Chrysler aftermarket parts (pages 9-10). I agree completely with Professor Winter that for the ultimate consumer there are substitutes for Chrysler aftermarket parts, although I do not know of their availability or acceptability in the markets Brunet served (e.g., Peru, Columbia). But this is not the issue. Brunet's customers sought only Chrysler parts from him. Whether they viewed other aftermarket parts as substitutes for Chrysler parts is irrelevant because they did not seek these parts from Brunet. This is understandable because Brunet had expertise in procuring Chrysler parts in Canada for export. He had no particular expertise in sourcing generic aftermarket parts.

The Specificity of Brunet's Assets to Chrysler Canada.

Professor Winter allows that "supplier-specificity of assets can be an important dimension of market definition because it limits a buyers (*sic*) ability to switch to alternative suppliers, and may lead to a narrower market definition" (page 10). However, he argues that these assets were not specific to Chrysler Canada as opposed to Chrysler U.S.

There is no question that some of these assets were not specific to Chrysler Canada. For example, his knowledge of offshore markets for Chrysler parts could be worked using parts sourced in the United States. However, other of his assets, such as his knowledge of Chrysler Canada's ordering, delivery and handling systems, parts numbers, and prices, and his knowledge of the Canadian transportation system and Canadian customs procedures could only be fully worked when sourcing from Chrysler Canada. Indeed, what distinguished Brunet from other exporters was in part his ability to quickly and accurately fill orders. This in turn resulted from his access to supply from Chrysler Canada.

To source from the United States and operate in Canada puts Brunet at a competitive disadvantage. An alternative would be for Brunet to move his business to the United States. In this circumstance he would only forfeit those assets specific to Chrysler Canada. However, I cannot believe that Parliament intended that a remedy for refusal to deal could be the removal of a Canadian business to a foreign country.