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COMPETITION TRIBUNAL TRIBUNAL DE LA CONCURRENCE	
MAY 8 1989 <i>je</i>	
REGISTRAR — REGISTRAIRE	
OTTAWA, ONT.	#7

THE COMPETITION TRIBUNAL

IN THE MATTER OF an Application by the Director of Investigation and Research under sections 92 and 105 of the Competition Act, R.S., c.C-34, as amended:

AND IN THE MATTER OF the proposed acquisition by Asea Brown Boveri Inc. of certain assets and property comprising the electrical transmission and distribution business of Westinghouse Canada Inc., including those of its wholly owned subsidiary Transelectrix Technology Inc.

BETWEEN:

THE DIRECTOR OF INVESTIGATION AND RESEARCH

Applicant

- and -

ASEA BROWN BOVERI INC., WESTINGHOUSE CANADA INC., TRANSELECTRIX TECHNOLOGY INC.

Respondents

A F F I D A V I T

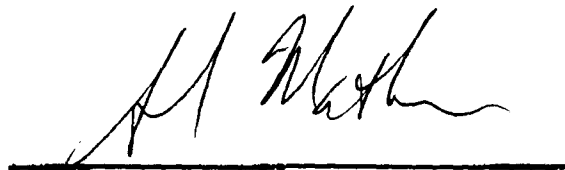
I, **PROFESSOR FRANK MATHEWSON**, of the City of Toronto, in the Province of Ontario, make oath and say as follows:

1. I am a Professor in the Department of Economics at the University of Toronto and a Research Associate in the Institute for Policy Analysis and as such have knowledge of the matters hereinafter deposed.

2. I was requested by the Applicant, Director of Investigation and Research, to prepare a report which analyses briefly the extent to which the tariff and anti-dumping relief contained in the settlement reflected in the Consent Order Impact Statement dated April 26, 1989 provide an effective remedy to any lessening of competition that might arise as a result of the acquisition by Asea Brown Boveri Inc. of the large transformer assets of Westinghouse Canada Ltd. as described therein.

3. Attached hereto as Exhibit "A" to this my Affidavit is a true copy of the report prepared for the Applicant pursuant to the aforesaid request.

SWORN before me at the)
City of *Toronto*, in the)
Province of *Ontario*)
this *7th* of May, 1989)



A handwritten signature in cursive script, appearing to read "J. Matheson", is written above a solid horizontal line.

V T Kennel
Commissioner for Taking
Affidavits

THIS is Exhibit "A" to the Affidavit
of FRANK MATHEWSON, sworn before
me on the 7th day of May, 1989

J T Kerrish
A Commissioner, etc

The Asea Brown Boveri Acquisition of the
Electrical Transmission and Distribution Operations of
Westinghouse Canada Inc.: An Assessment of the Trade Relief
in the Draft Consent Order

Professor Frank Mathewson, Ph.D
(Mathewson Economic Consultants Inc.)

May 7, 1989

Introduction

1. I was requested by the Director of Investigation and Research to prepare a report which analyzes briefly the extent to which the tariff and anti-dumping relief contained in the proposed settlement reflected in the Consent Order Impact Statement dated April 26, 1989 provide an effective remedy to any lessening of competition that might arise as a result of the acquisition by Asea Brown Boveri Inc. of the large transformer assets (40 MVA and over) of Westinghouse Canada Inc. as described therein.

2. The Bureau of Competition Policy (the Bureau) provided information on the nature of the business in this proposed acquisition as well as the Notice of Application, the Draft Consent Order and the Consent Order Impact Statement. As well, additional information on the nature of bids submitted by foreign competing suppliers in Canada, by Canadian firms on U.S. bids and on foreign competition in general was provided to the Bureau by counsel for the merging parties. Information as to the U.S. market for transformers over 40 MVA and the extent of import penetration into the U.S. market is based on a Woods Gordon Summary Report, commissioned by Westinghouse Canada Inc. (WECAN), which I understand is to be filed with the Competition Tribunal. These constitute the sources of firm and industry information for this document. Here, I analyze the likely competitive impact on the Canadian market from the proposed trade relief in light of the proposed acquisition.

Trade Relief Reduction Remedy

3. I will focus on the nature of the trade relief proposed in the Draft

Consent Order and I will not comment on the proposed divestitures which are relevant only to the extent that the tariff reduction remedies are not achieved according to the agreed timetable. As stated in the Draft Consent Order (pp. 10-11), the relevant tariff reduction conditions are:

(a) by January 1 1990, approval will be obtained to remit the tariff for worldwide imports of transformers over 400 MVA into Canada for a period not less than five years;

(b) by January 1 1990, approval will be obtained to reduce the tariff on imports from the U.S. of transformers from 40 MVA to 400 MVA on a sliding scale, as specified, to zero effective January 1, 1992, 7 years ahead of the schedule specified in the Canada/U.S. Free Trade Agreement; and

(c) By June 16, 1989, the approval of Federal Pioneer Limited or the Minister of Finance will be obtained for the sliding scale tariff reductions specified in (b).

As well (see Consent Order Impact Statement, pp. 9-10), ABB will undertake not to directly or indirectly initiate anti-dumping proceedings in relation to the relevant classes of power transformers for a period of five years after the Consent Order.

The Issue

4. The Draft Consent Order recognizes that if there are gains in

efficiencies¹ to be realized from the acquisition of WECAN's transmission and distribution operations by ABB, the key to social efficiency is to guarantee a competitive market environment. This environment should be sufficiently competitive that there is no substantial lessening of competition as a result of the lessening of actual independent producers in Canada. That is, under competition, we would expect price not to rise and output not to fall materially as a consequence of the merger. The additional benefit of such a competitive environment is that competition guarantees that the immediate consumers of the output of this industry will realize lower costs as any cost-saving efficiencies are achieved.

5. The basic question is therefore the following:

To what extent will the combination of a tariff removal for each respective product class, temporary or permanent, together with an undertaking on the part of ABB not to initiate anti-dumping proceedings against any foreign supplier serve to offset any potential lessening of competition from the merger? In operational terms, the Draft Consent Order permits the merger to be completed and any efficiencies to be realized. The competitive environment created by the Order would enhance the likelihood that any cost-saving efficiencies would be passed along to consumers.

¹ Efficiency gains asserted by ABB (Canada) include cost savings from pooling technologies and research and development efforts, from combining and rationalizing utility sales forces, from reducing corporate overheads and from substituting domestic for foreign produced inputs. The discussion of efficiency gains in this report should not be taken to indicate that any cost saving efficiencies may or may not ameliorate any substantial lessening of competition that might flow from the proposed transaction.

6. The most significant barriers to foreign supply are import tariffs and the strategic use of anti-dumping legislation by domestic producers to impede the entry of foreign competitors into the Canadian market. Once these have been removed, the critical question is whether transportation and other costs (discussed below) are sufficiently low that foreign producers can effectively compete in domestic markets against domestic producers.

7. Taken together, in my view, the conditions set forth in the Draft Consent Order represent a reasonable and economically efficient check on the ability of the merged entity (ABB) to lessen substantially competition in the relevant classes of power transformers. Furthermore, it is my view that these conditions constitute a sufficient infusion of competitive pressure into the marketplace that a significant proportion of any cost saving efficiencies which may be realized from this merger will be passed along to the immediate consumers in the industry (primarily the provincially owned and regulated utilities). Whether any cost reductions that may be realized from the acquisition eventually flow from these utilities through to the ultimate consumers of electrical energy depends on the price setting policies of the provincial utilities; these price setting policies are responsive to the nature of the regulation that each of these power generators faces in their respective provinces.

8. The principal producers of power transformers 40 MVA and over in the

U.S. include McGraw Edison, North American Transformer and Westinghouse /ABB (joint venture). The accelerated tariff reduction in the Draft Consent Order replaces domestic competition with easier entry for these U.S. producers, in particular McGraw Edison, into the Canadian market. Enhanced entry by U.S. producers is a substitute for a reduction in the number of Canadian domestic producers. Other worldwide suppliers of power transformers include Alstom (France), Fuji Electric (Japan), General Electric Company (U.K.), Hawker Siddeley (U.K.), Hyundai (Korea), Jeumont Schneider (France), Mitsubishi Electric (Japan), NEI/Ferranti Packard (U.K.), Prolec (Mexico), Siemens Electric Ltd. (West Germany) and Toshiba (Japan).

9. There are several factors that suggest a significant enhancement of competition that will occur through tariff removal aided by undertakings not to initiate anti-dumping proceedings for five years by the major Canadian supplier (ABB).

10. Even with the tariff barriers to imports from developing countries (tariffs are 10 per cent) and developed countries (tariffs are 15 percent), foreign companies have supplied product and bid even more frequently at levels close to the transaction prices in the market. The data on bids indicate that, for example, Prolec (Mexico) was a successful bidder on two 75 MVA, 138kV-25kV power transformers to B.C. Hydro in November 1988. In this bidding, the second lowest bid came from Hyundai (Korea). Both of these bids were lower than the domestic producers (TTI, ABB and Federal Pioneer in that order). While these transformers fall at

the lower range of the power levels of the transformers at issue in the merger, foreign bidding and supply is nevertheless indicative of willingness to compete in Canada.

11. Other examples of lower class transformers include bidding by ABB (U.S.) for the supply of two 25 MVA, 138kV-12.47 kV power transformers to the New Brunswick Electric Power Corporation. If we correct for exchange rate movements, the U.S. firm's bid was approximately seventeen per cent above the lowest bidder. This is almost all accounted for by the fifteen per cent tariff that was then in effect.

12. An example of a recent purchase of larger units is the tender in early 1989 by B.C. Hydro in which McGraw Edison was successful. These units were two 400 MVA, 230 kV phase shifting transformers, valued at approximately seven million dollars.

13. In addition, Hydro Quebec invited bids in the last four months for a significant order of three 370 MVA, 735 kV single phase power transformers from three of the European suppliers referred to above.

14. Nor is the trade flow only in one direction. Canadian manufacturers have been successful in the U.S. market. The U.S. tariff is currently 2.1 per cent. For example, there are two cases where the buyers were U.S. utilities, the units purchased were large (500 - 560 MVA's) and the bidders include ABB (Canada) as well as U.S. firms.

15. There is no way of knowing the quantitative significance of these cases. The critical but missing measure is the percentage of bids for the relevant market segments quoted or won by foreign firms. The presence of U.S. bidders in Canada and Canadian bidders in the U.S. nevertheless suggest that the transportation costs for U.S. firms to reach the Canadian market are not a significant factor.² Removing the tariff and the undertaking by ABB not to initiate anti-dumping proceedings against foreign suppliers will lower the cost of bidding in Canada. This will increase the competitive presence in Canada of foreign supply.

16. When discussing the U.S. market for power transformers, the Woods Gordon Summary Report (p. 5) estimates that imports of transformers over 40 MVA (from Europe and Pacific Rim countries) currently account for twenty per cent of the U.S. market. This U.S. experience occurred with a U.S. tariff level of approximately two per cent. If the U.S. experience generalizes, then, with the reductions in the tariffs that are part of the settlement, foreign producers could achieve a similar market presence in Canada.

17. According to the Report on Business of the Globe and Mail (P. B13, May 4, 1989) Federal Pioneer Ltd., the other Canadian manufacturer of power transformers from approximately 40 MVA to 400 MVA, plans to focus

² The parties themselves claim that Japanese and European suppliers are disadvantaged because of transportation costs only to the extent of an increment of 1.5% of the sale price of the transformer. If accurate, this number represents a small order of magnitude even recognizing that these units are expensive pieces of capital.

on the U.S. market for its future growth. (See also the 1988 Annual Report of Federal Pioneer Ltd.) This company indicated that in the next five to six years, it will double its exports with about eighty per cent going to the U.S. This speaks to the anticipated import and export of power transformers between Canada and the U.S. This will only be enhanced with any accelerated reduction in tariffs between the two countries.

18. My prediction is that the changes specified in the settlement mean that we can expect an enhanced numbers of bids from foreign sources. Even if these bids are unsuccessful in the sense that contracts are awarded to the Canadian suppliers, their presence will serve the critical role of disciplining Canadian producers to submit efficient bids that reflect their production costs.

Potential Limitations and Their Mitigation

19. The Draft Consent Order requires the parties to seek a remission for not less than five years (beginning January 1, 1990) on a worldwide basis of the Canadian import tariff on power transformers over 400 MVA. The realities of this market are that there is a lag between placing an order and receiving shipment of the transformer. These lags will be sensitive to the capacity of producers. If capacity utilization is high, delivery lags will be extended. Current lags are in the order of eighteen months. The length of these lags effectively shortens the remission period.

20. For a foreign producer to 'do business' in another country where they have never been present or are currently inactive, that producer may

have to incur sunk entry costs. These include relation-specific assets such as establishment of sales personnel, costs of informing consumers about the specific product, first-time contract co-ordination, design issues peculiar to specific customers and so on. The question is whether a five-year guaranteed worldwide remission of Canadian tariffs on extra large transformers (over 400 MVA) is sufficient to encourage (non U.S.) foreign producers to participate in the Canadian power transformer market in light of these factors. (Tariff reductions for U.S. produced transformers will be permanent.)

21. Do the 'buy-local' policies of some provincial utilities represent a non-price sensitive demand force in the Canadian market?

An Assessment of the Limitations

22. I have two comments on the five-year remission for the extra large class of power transformers (over 400 MVA). First, the possibility of achieving a permanent tariff reduction is conditioned by current Canadian negotiation strategy with respect to unilateral tariff measures.

Remissions, rather than permanent removals, allow greater flexibility to deal with future developments in the industry. Further, the Director (see Consent Order Impact Statement par. 20, pp. 12-13) will monitor market conditions and will support renewal of this tariff remission order if competitive conditions require. In addition, the opportunity for a permanent reduction exists in the on-going multilateral negotiations.

23. Second, while sunk initial costs of entering markets, especially

information costs, can be deterrents to exit and therefore deterrents to entry, this is a sophisticated market and these initial sunk costs are likely to be small. Foreign manufacturers already present in Canada will have incurred any sunk entry costs. Foreign manufacturers actively selling other electrical products to utilities and other customers in the Canadian market, who may not be soliciting orders for transformers at the present time, may have incurred already many of these entry costs. There are a relatively limited number of producers even throughout the world and they are well known. Further, buyers are technically informed utilities whose transformer demands are homogeneous and relatively stable through time.

24. Does the possible price insensitivity represented by the 'buy-local' policies of some provincial utilities represent a competitive impediment potentially exploitable by the merged firm? To the extent that 'buy-local' policies impact the market, they would have done so prior to the merger. If, for example, Ontario Hydro was more disposed to satisfy its large power transformer needs from TTI prior to TTI's acquisition by ABB, then Ontario Hydro would be no more or less price sensitive after the acquisition than before.

Conclusions

25. The combination of expeditious tariff removal, hopefully permanent, for all foreign suppliers, plus an undertaking from ABB not to initiate anti-dumping proceedings constitute, in my view, an enhancement of competitive pressures in the market for large power transformers (40 MVA

and above). This increment in competition could possibly represent a positive enhancement of competition even relative to the pre-merger market. In addition, removal of the 'non-compete' restriction on CGE and reduction of the 'non-compete' restriction on WECAN (as referred to in the Consent Order Impact Statement, p. 9 and pp. 17-18) only adds to the list of potential suppliers of power transformers in Canada.

26. Asking the parties themselves to secure the agreement of firms within the industry to support tariff reduction sensibly places the burden on the merging parties who will realize any benefits from the merger to use some of these anticipated gains to secure competitive improvements.

27. The existence of well-recognized competitors and the existing trade in transformers across borders, documented mainly for smaller power classes, nevertheless shows that distance, and therefore transportation cost, is not a significant barrier to entry into the Canadian market. The presence of foreign suppliers into the U.S., who have realized twenty percent of the U.S. large and extra large power transformer market, with lower U.S. tariff levels, reinforces this conclusion. In Canada, some foreign firms were successful even with a fifteen percent tariff and concern over potential anti-dumping proceedings; their enhanced presence with these barriers reduced should promote competition in this market in Canada. Cost-saving efficiencies plus enhanced competition constitute the ingredients for private and social efficiency.