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Regulatory Convergence in the Canada-United States Automobile Sector

David Porter

Brett Smith

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REGULATORY CONVERGENCE IN THE CANADA-UNITED STATES AUTOMOBILE SECTOR

Session Chair – David Porter
United States Speaker – Brett Smith

INTRODUCTION

David Porter

MR. PORTER: Good afternoon. I am David Porter. I am a visiting professor at Case Western Reserve University School of Law, and I just want to welcome everyone to this afternoon’s session.

Brett Smith is our next speaker. He is a group director for the Automotive Analysts Group, Center for Automotive Research in Ann Arbor, where he has been since 2000. Before that, he was at the University of Michigan’s Office for the Study of Automotive Transportation, which is called OSAT. For twenty years, he has divided his research efforts between automotive industry analysis and advanced power-train technology and strategy. He currently leads several research efforts on advanced power-train technology, including projects on energy storage, policy, and plug-in electric vehicle infrastructure issues. He is also program director for the Business of Plugging In, a conference held annually in Detroit. He has authored numerous reports, ranging from materials for education and training to aftermarket strategies. I welcome Brett to give his presentation.

1 Faculty, Case W. Res. U. Sch. L., http://law.case.edu/FacultyResearch/MeetOurFaculty.aspx (follow “Porter, David” hyperlink) (last visited Dec. 14, 2010).
MR. SMITH: Good afternoon, everyone. Thank you for the opportunity to be here. My research vice president, Sean McAlinden, intended to be here, but unfortunately Sean truly fell off his horse last weekend. The good news is he is okay, so we can joke about it. The bad news is I have spent this week going all over the Midwest and covering for Sean. I have gone through the industry, giving a background of just about every type of discussion you could have on the issues related to the industry. I am hoping to give you some of that background.

To give you a little bit of background about our organization, the Center for Automotive Research, as has been suggested, is a spinout from the University of Michigan. We spun out from the University of Michigan back in 2000. We are a not-for-profit organization. We still do, basically, the same work we did at the University.

At the University, we were too much like consultants for the academics. Now, in the not-for-profit world, we are too academic for the consultants, so we have had to find a niche in between the two of them.

The Center for Automotive Research focuses on a wide variety of topics in the automotive industry. We really pride ourselves on being a broad-based research group, funded by government (most of the time). Much of our financing is government focused. However, we get other foundation and other government work.
We have four research groups. I am the director of the Automotive Analysis Group. We also have the Labor and Industry Group. In addition, we have a Manufacturing, Engineering, and Technology Group and a Sustainable Transportation and Communities Group. Those cover the four areas. We try to bring that research together in different conferences and different forums, for instance, like this one.

We have a program in Northern Michigan every August, in Traverse City; the program includes management-briefing seminars where we bring 1,300 to 1,400 automotive folks together to talk about the auto industry.

Our job, in many ways, is to study the industry but it also entails taking opportunities, like this conference, to discuss the issues of the industry with the general public.

For twenty-seven years, we have joked around our office, unfortunately, that we have had to give the grim reaper speech. It has been a tough twenty-seven years overall in the auto industry. The last couple of years have been as tough as they come.

The "Big Leave" is what many have termed the mass exodus from Detroit of a substantial portion of the automotive industry. Approximately 117,000 people have left the Detroit Three in the last three years. That is an enormous amount. All were difficult for the communities and states in the region to deal with; however, it is also a starting point. There may be a positive end to this recession. The recession has led to a complete restructuring of most of the industry. It is now an industry that can compete globally on a permanent basis.

First, I would like to talk about macroeconomic trends that are affecting our industry. Some of those trends are turning. Some have not yet turned. We will move onto some other topics as we go.

Again, we think there is light at the end of the tunnel. We think there are actually some positive things happening in the auto industry. People are be-

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10 See Manufacturing, Engineering & Technology, supra note 2.
11 Id.
ing hired,\(^\text{15}\) and you see some positive information about it in the press. This week I saw reporting for two of the most disliked companies in our country due to the bailout: General Motors (GM) and Chrysler.\(^\text{16}\) There is a third company in Detroit that is pretty strong: Ford is a company that has truly turned around without government money.\(^\text{17}\) They are a company that has gone from having no product to boasting fabulous product, from no process to developing an incredible manufacturing process.

There are good things to talk about in Detroit and, generally, the auto industry in the Midwest. One of the things to be optimistic about is consumer confidence and sales. We are starting to see consumer satisfaction and confidence return.\(^\text{18}\) That is a good sign for sales, as it is one of the key indicators.

Looking at the Dow Jones indicator, we lost an enormous amount of wealth.\(^\text{19}\) Of course, we have gotten some of that back. However, we have not brought consumers back to a level where they are ready to jump in and buy automobiles in large volumes. Obviously, that is going to affect car sales for the next several years.

Another key factor used to assess car-buying ability is the strength, or in this case weakness, of the housing sector. You see some mixed results here. Certainly, you see the negative housing prices month-to-month for the period we just went through. However, in the last couple of months, you start to see that it is beginning to pick up.\(^\text{20}\) However, on the realistic side, it is nowhere near where it needs to be to support an automotive market similar to what we have seen in the past.

\(^{15}\) Chris Woodyard, "Automakers' hiring begins to look up," USA TODAY, Jan. 14, 2010, at IB.

\(^{16}\) See Press Release, Harris Interactive, Berkshire Hathaway Ranks #1 on Corporate Reputation, according to 11th Annual Harris Interactive U.S. Reputation Quotient® (RQ®) Survey (Apr. 5, 2010), available at http://www.harrisinteractive.com/vault/Harris Interactive_News_2010_04_05.pdf (indicating 9 of the 10 lowest ranked companies, including GM at number 54 and Chrysler at number 55, received government bailout money).

\(^{17}\) See id.


Gross Domestic Product (GDP) growth, historically, has had to be above three percent for the auto market to grow.\(^{21}\) We just recently returned to that level of growth. Again, we think there are things starting to happen in the automotive industry and the economy in general that make us think consumer confidence is up.

Used vehicle prices are also up.\(^{22}\) For a while, it was very easy to get a used vehicle, because there was no demand. The decision to buy a new car was less appealing because you could get such a great price on a used vehicle.

In terms of vehicles per household, we currently have just over two per household.\(^{23}\) Based on the data we have looked at, that number should hold steady for some time. That would potentially be a problem if not for one thing: we are adding many households. Household formation over the next ten or fifteen years is going to be very strong. That is a good sign for the industry.

Also, we notice in headlines this week that we continue to lose vehicle stock. We are taking older vehicles out of the market and putting new ones in. That is creating—we hope, we expect, we think—at least some inkling of demand going forward.

Remember, there is no substitute for vehicles. We love to talk about modern urban cities and the new way of living. Nevertheless, for a strong majority of people, the only way to get to work in the morning is by automobile. It is also interesting to observe that the percentage of Americans driving to work is the same now as it was in 1970.

We had a period from about 1995 where there was an enormous amount of sales,\(^{24}\) which led to a huge bubble in the automotive industry. We are often asked if we are going back to those bubble levels, at roughly 17 million, or if we are going to have to get used to a market more in the range of 12 to 13 million.

Realistically, we think that bubble was unique. We are going to be paying that back for quite awhile. Our forecast is that we may get back up above trend, maybe in two or three years, but it is going to take time to get there.


As I was driving over this morning, I was talking to one of my former employees who works on Wall Street. We discussed the idea that this industry used to have trouble making money at 15, 16, or 17 million units. Now, with the restructuring, they are talking about being profitable as an industry at 11 to 12 million units. That is lowering your profitability mark from 17 down to 12, which is a huge jump down for this industry. It was important that it happened. Part of the reason we see that trend right now is that we think there has truly been a fundamental change in the industry.

Regarding employment, we hear so frequently about the "jobless recovery," and in the automotive industry, that has definitely been the case. There has been a small rise overall in terms of manufacturing in the auto industry, but it has been a pretty slow one, and one that has us wondering where we are going.

IHS Global Insights, which forecasts average productivity estimates and unemployment, shows that employment is going back up. While employment may not return to the levels it was at before, it will eventually reach a fairly strong equilibrium.

It is interesting that, as we travel around the country, we find very different perceptions of the automotive industry. In the State of Michigan, we see a government that appears to want to get out of the automotive industry. Other states, certainly in the south, believe it is a great place to be and want more of it.

What will drive this recovery is that we are now a low cost producer compared to some of the larger countries. We are still not a low cost producer compared to China and some of the very low cost countries, but compared to Europe, Japan, and Canada our costs are now very competitive. The major competitors are the Euro, the Japanese Yen, and, more appropriate for discussion in this room, the Canadian dollar. The exchange rates are bouncing around, and this is a real problem for Canadian suppliers. The Canadian

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suppliers no longer have the dollar exchange rate advantage they had for so many years. They are now losing business because, as the Big Three re-group, the production in this country is moving to the southern states.29

Certainly, the State of Ohio has done a fabulous job working with Honda. As you talk to folks from Ohio, they view Honda as a domestic supplier and manufacturer.30 In many ways, they are right. Honda has done a great job here. In essence, Honda is the northern-most of these new domestics.

It was much easier for a Canadian supplier to get across the border and service parts when most of the production was in Ohio, Indiana, Illinois, and Michigan.31 Now that we are putting another 1,000 to 7,000 miles on the delivery, it makes it much more difficult to service those parts in a timely manner.

Despite some in the State of Michigan wanting to get out of automotive manufacturing, we still see an enormous amount of manufacturing in the State of Michigan and, more generally, the United States.32 Remember, automotive manufacturing is still the largest manufacturing industry in the world.33 And it is still the largest manufacturing industry in this country.34 Although the industry has taken a hit and will continue to be a very competitive business, it still produces an enormous amount of employment and capital.

Earlier I joked about being the grim reaper. For years, as we traveled around the country, we showed a slide of all the closures in the country. Eventually, because there were so many closures, we had to show Michigan as a separate slide. In fact, we even had to dedicate an entire slide to Detroit, as so many of the closures were located there. Although it is Michigan that has suffered an enormous amount of closures, it is still incredible to realize


how much is still there. It is not near what it was twenty or thirty years ago, but it is still an extremely strong industry. And I think it is one that may, through all the turmoil and negative publicity, actually come out of this as fairly competitive. Why is that? Well, in large part, the government came to the rescue.

The question we ask those who want to get out of the automotive industry is why they would want to get out of an industry that their government obviously believes is so critical?

The federal government pumped $123 billion of taxpayer money into the automotive industry.\textsuperscript{35} Whether you agree with that or not does not matter. What matters is that the federal government has made it clear that manufacturing is still very important in this country.

The Department of Energy (DOE) received $25 billion, but gave out only $9 billion.\textsuperscript{36} There is still an enormous amount of money to be given out to support development of powertrain technologies. However, the government has stated that this money is only to go to companies that are viable. As a result, Chrysler and GM did not get any of this money because they have not been viable for the last two and a half years.\textsuperscript{37} Although, fairly soon, I think we will see GM and Chrysler both get a good chunk of this money.

There is also the DOE Recovery Act, which focuses on energy storage,\textsuperscript{38} and there has been an enormous amount of publicity about this over the last couple of years. Approximately half of the $2.4 billion the government has set aside for energy storage has gone to developing an advanced lithium-ion battery in addition to cell manufacturing infrastructure.\textsuperscript{39} It has certainly been a very important step forward, but one that entails a lot of risk as well. There are many folks lined up to get this money. The challenge for DOE is figuring out who is selling actual technology and who is merely claiming to do so. Because that has been a problem for DOE in the past, they have really slowed down and begun to investigate the areas in which this money would do the most good in helping to develop new energy storage technologies.

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As its name indicates, the DOE Recovery Act intended to spur job growth and combat unemployment. Most of the money given out so far has gone to areas, such as Elkhart, Indiana\textsuperscript{40} and Michigan,\textsuperscript{41} which have the highest levels of unemployment. The Act was aimed at technology development, but it was also focused on developing jobs during the recovery.

Michigan provides a good example of how the DOE Recovery Act has been used as a recovery fund, as the state received a substantial portion of the Recovery Act money.\textsuperscript{42} Obviously, the governor did a very good job lobbying for the money.

Four different companies are set to build lithium-ion battery cells in the State of Michigan. One is JCI/Saft-Johnson Controls. JCI is a Milwaukee-based company.\textsuperscript{43} Saft is a French battery technology company.\textsuperscript{44} Dow Kokam is based in Midland, Michigan.\textsuperscript{45} Another company is Kokam, which is a Korean battery company.\textsuperscript{46} We are seeing this type of partnership starting to form in America. The third company is LG Chem, which is an electronics company.\textsuperscript{47} LG Chem is supplying the Chevrolet Volt battery.\textsuperscript{48} The first Volt batteries are coming from Korea.\textsuperscript{49} However, a plant in Holland, Michigan will provide the next generation of Volt batteries.\textsuperscript{50} We will continue to see two systems develop: first, the manufacturing of batteries in Korea, and

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\item \textsuperscript{40} See generally U.S. BUREAU OF LABOR STATISTICS, OCCUPATIONAL EMPLOYMENT STATISTICS: AREA FOCUS ELKHART-GOSHEN, INDIANA (2009), available at http://www.bls.gov/oes/highlight_elkhart.pdf.
\item \textsuperscript{45} Dow Kokam—Contact, DOW KOKAM, http://www.dowkokam.com/contactus.htm (last visited Dec. 14, 2010).
\item \textsuperscript{46} Kokam—Contact, KOKAM, http://kokam.com/english/about/about05.html (last visited Dec. 14, 2010).
\item \textsuperscript{47} LG Group—Company Profile, LG, http://www.lgcorp.com/about/overview.jsp (last visited Dec. 14, 2010).
\item \textsuperscript{48} See Tom Krisher, GM Picks S. Korea's LG Chem to Make Volt Batteries, USA TODAY (Jan. 12, 2009, 6:00 PM), http://www.usatoday.com/money/autos/environment/2009-01-12-volt-batteries_N.htm (noting that General Motors selected LG Chem to supply lithium-ion battery cells for its Chevrolet Volt electric vehicle).
\item \textsuperscript{49} See id. (noting that LG Chem is a South Korean-based company).
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then the transfer of that manufacturing into this country. There is a large cluster of this type of manufacturing starting to develop in Michigan. One of the questions we must ask, as we look at this, is whether we are developing too much capacity, too soon, for this technology? Can these companies supply the consumers’ requirements? Will they be at some kind of capacity to make it reliable in the near future?

This Administration’s golden child is the electric plug-in vehicle. The plug-in vehicle is viewed by many right now as “the answer.” It certainly is a fabulous technology. However, whether it is ready for primetime is an entirely different question.

If you look at the press, and what is out there in the general public, you start to get the feeling that these cars are going to be here tomorrow, and that they will be affordable. The reality, however, is that they are not yet at that stage of development. They are going to be here in a couple of months, and they will be somewhat affordable given the $7,500 tax credit to buy one. In addition, companies are trying to keep prices as low as possible, even in some instances below cost, in an effort to develop the technology.

I conducted a survey every year for the last decade, in which I ask a group of about twenty-five very knowledgeable powertrain experts, technology people, program people, and not-for-profit types what their forecast is for the next several years in terms of these technologies. Plug-in hybrid electric vehicles (PEHVs) include the Volvo, which has the generated motor, Prius with the bigger battery that you plug in, and the Nissan LEAF, which is all electric and does not have any other backup.

If you look at the group’s forecast, you can see how the perception of the media and general public does not match up with the actual numbers or

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54 Dean Murphy et al., Plugging In, 148 PUB. UTIL. FORT. 30, 31 (2010).
55 These figures are based on Mr. Smith’s survey of powertrain experts, technology people, program people, and not-for-profit types, wherein he asked what their forecast would be for the next several years in terms of these technologies. See Brett C. Smith, Dir., Automotive Analysis, Ctr. for Automotive Research, Presentation at the 2010 Canada-United States Law Institute Henry T. King, Jr. Annual Conference: Back on the Road: the Recovery of the U.S. Auto Industry 36 (Apr. 9, 2010), available at http://cusli.org/conferences/annual/annual_2010/presentations/Friday%20Session%203%20-%2020%20Smith.pdf.
with what experts are predicting. Assuming $2.50 a gallon gas, the group predicted there would be 22,000 of these vehicles sold in 2011.\(^{56}\) Even assuming $6 a gallon gas, the group predicted that sales would only be 74,000.\(^{57}\) Furthermore, the group projected sales of 169,000 and 518,000, respectively, in the year 2015.\(^{58}\) In the media, you get the impression that there are going to be millions of these vehicles sold.

What these projections tell us is two things. First, transitioning to PEHVs is not going to happen quickly. Certainly, it is a huge economic change in the way we measure energy. The second is, even if we do that, $6 a gallon seems like a really different paradigm. It is safe to assume that we are not going to be selling millions and millions of these vehicles any time soon. It is going to be a long, slow process getting to that point.

On the way there, we sometimes forget about the other technologies. For example, we forget about hybrids. Remember, the Toyota Prius has been on the road for about thirteen years, and it still comprises only two to three percent of market share.\(^{59}\) Prius is a fabulous vehicle. Ford Fusion is also a fabulous vehicle. They do many good things. However, many consumers still look at them and conclude that the cost equation is just not where it needs to be. Not to mention, the cost equation becomes even less appealing to consumers when you add another $5,000-10,000 for the battery that is required for an electric vehicle.

We asked those we surveyed what they thought about the hybrid, and where that market might go. They felt that in 2011 there is going to be a pickup in hybrid sales and that we are going to get up to about five percent. We are headed over three percent this year, and we will probably get to about three and a half to four next year. So, there is room for growth.

When the panel of those surveyed assumed six-dollar-a-gallon gas, they projected the market share for hybrids would be twenty percent of the market in 2015.\(^{60}\) That is a fairly large bump going forward, but that is not the complete market. We are still looking at a very diverse market. It is not just about electric vehicles. As you can see on the bottom of this slide, there is a continuum of technologies available to improve automotive energy efficiency, from gasoline and diesel engine adjustments on the left to plug-in vehicles (hybrid and plug-in hybrid) on the right.\(^{61}\) These technologies are placed on the continuum in accordance with their cost for one percent reduction.\(^{62}\)

\(^{56}\) Id.
\(^{57}\) Id.
\(^{58}\) Id.
\(^{60}\) SMITH, *supra* note 55, at 38.
\(^{61}\) Id at 39.
\(^{62}\) Id.
In other words, the technologies on the left are much less expensive, much quicker to implement, and much more cost-effective.\textsuperscript{63} The panel did not even consider the plug-in electric vehicle, because the costs are too high for too long. Until the year 2017, it does not even come into play because it would simply be too expensive.

The Administration realizes that in the short-term hybrids and plug-ins will not be cost effective. While it recognizes the need to shift to electric vehicles, and has set a long-term goal to do so,\textsuperscript{64} it also recognizes the need to develop short-term answers for getting better fuel economy. This, of course, involves developing strategies for working with technologies on the lower-end of the cost spectrum.

If you look at these different options, there are fairly high costs going forward. But, as consumers, we have an incentive to change, and we are going to change very soon.

With that, I would like to wrap up. I want to spend some time answering questions. Are there any questions?

\textbf{DISCUSSION FOLLOWING THE REMARKS OF BRETT SMITH}

MR. GROETZINGER: Before General Motors went into bankruptcy, they predicted they would lose tremendous market share if they had to do so.\textsuperscript{65} Fortunately, they came out very quickly. I wonder whether that prediction came true at all and whether the statistics are different in the United States and Canada.

MR. SMITH: Our director, senior vice president of research, and a couple of our researchers were at General Motors (GM) and started talking about bankruptcy three years ago. The executives responded that they would never consider that because you cannot go through bankruptcy as a car company. The perception has always been that a car company cannot go into bankruptcy and survive. Obviously, that was not the case.

As you mentioned, the key factor was that no one ever imagined a company could go through bankruptcy so quickly. Obviously, it was driven by a gentleman in the White House with some experience in bankruptcy law.\textsuperscript{66}

\textsuperscript{63} \textit{Id.}
\textsuperscript{66} See Bill Vlasic, \textit{Obama is Said to Drop Plan for 'Car Czar' to Fix Detroit}, N.Y. TIMES, Feb. 15, 2009, at A1 (stating "Mr. Obama is designating the treasury secretary, Timothy F. Geithner, and the chairman of the National Economic Council, Lawrence H. Summers, to oversee a presidential panel of the auto industry.").
He did a wonderful job from a distance shepherding them through the process.

They lost and continue to struggle with market share. But they did not lose it to an extent anywhere near what we thought they would. In fact, they remained—if not for that two-month period where market share died significantly—fairly close to the trend they were on before going into bankruptcy. It has actually been much better than we anticipated.

Although they are still losing market share, it is important to remember that sales drive market share. Sales can be driven by consumer pull or vehicle manufacturer push, i.e., lowering the price to incentives. GM has been good about restraining itself on pricing and maintaining a reasonable profit per vehicle. In that sense, they have done a good job; however, it has come at the expense of losing some market share in the past few months.

I think the biggest challenge remaining for GM is that people perceive them as one of the most disliked companies in the country, largely due to the bankruptcy and government investment. As we move forward, however, I think this perception will slowly dissipate. GM does have a pretty darn good product, as good as anybody else in the world in many aspects. People do not realize that. GM may not see a significant increase in market share, but we are going to see them level off solidly in the next year or so.

MR. CRANE: In Ontario, I run into people all the time who describe the automotive industry as a smoke stack industry, and yet when you look at the data, it is one of the most knowledge-intensive industries in our economy. If you look at rankings of expenditures on research and development by the major industries, it is right up at the top, or very close to it.

The technological improvements in the automotive industry in the last fifteen or twenty years has really been quite phenomenal when you think about it. Now, my wife and I sell our car once every ten years because they are

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67 See David Welch, *GM Pushes for Buzz, but Market Share Fizzles*, BLOOMBERG BUSINESWEEK (Apr. 1, 2010), http://www.businessweek.com/autos/autobeat/archives/2010/04/gm_pushes_for_buzz_but_market_share_fizzles.html (stating “[t]he bottom line is that GM’s market share fell to 17.6 percent, down from 18 percent this time last year and well off the 18.7 percent pace the company has set for this year.”).


lasting so long. That is a big difference from the planned obsolescence of the 60s and 70s.

But what I wanted to ask you was, will these new fuel efficiency targets, which have been announced, require very much more investment in technology advancement to reach those targets, or are they pretty close to having the technology to reach those targets now?

MR. SMITH: You bring up three wonderful points, and let me get to that last question at the end. Remind me if I get lost.

First, it is undeniable that management in the auto industry has been bad for a long time. Even the auto industry recognizes this fact. I know people at the big companies that come to me and say they sit in meetings with these people and do not know what they are thinking. While there are good people working in the system, the system—especially in the larger companies—became so structured that the message never got through to management. That was a big part of the problem.

In addition, you make a good point about the automotive industry being a very high-tech industry. Many people do not believe this to be true. Everyone thinks you are just bending metal and pounding it out. In fact, there is an enormous amount of research and engineering that goes into manufacturing cars. The State of Michigan has an incredible amount of research and development in the automotive industry. It is second only to California in terms of research and development investment.70

An area of technology that is critically important is the electrification of the vehicle. In many ways, that is truly cutting-edge technology. There is a program at the University of Michigan called the Engineering Systems Group,71 which looks at the chemistry, electronics, and grid in the vehicle as one entity. Compared to what most people think of the automotive industry, that is pretty hi-tech.

We have to refine the turbine combustion engine a lot to get it to where we need to be. In other words, we must create the electricity of the vehicle—whether hybrid, plug-in hybrid, or hydroelectric. All of that is going to cost a lot more money than we have right now. The real argument becomes, how much is it going to cost?

The Administration just released their estimate that it will cost around $1300.72 After analyzing it, they figured it would be a less than $800-900 per


72 See generally Federal Tax Credits for Hybrids, U.S. DEPT. ENERGY,
vehicle cost. However, the industry will tell you that is a significant underes-
timate. Some would say that it will cost two or three times that amount. In
reality, it will probably be more than $600-700 per vehicle, but probably less
than $3,000-4,000 per vehicle. We are going to be paying more for the same
size vehicle. If we switch to smaller vehicles, that tends to change the equa-
tion a little bit. However, in terms of what we are driving now, we are going
to have to pay significantly more to get better fuel economy. This is not nec-
essarily a bad thing.

MR. CRANE: May I just add a quick follow up? You did not refer to
fuel cell technology. I just want to know whether that has become marginal-
ized out of discussion, or it is just too far down the road in terms of adoption?

MR. SMITH: There are two or three answers to that. The politically in-
correct answer is that that was the previous Administration’s pet project, not
the current Administration’s. The other is that fuel cells have always been
ten years out. Actually, I know the person who brought fuel cell technology
to General Motors in the 1960s, and he told me that when they brought it and
showed it to the executives, they said it was ten years out. Then ten years
later, they came back and said they thought they figured it out, and in ten
years, they were going to do it. There were about nine companies in the 80s
who tried and then forgot about it. In the late 90s, they brought it back out
and said they thought they were almost ten years out. When I talk to them,
do you know how far away it is? Ten years.

MR. HERMAN: I have two questions. First, you did not address the role
of a parts sector. It seems to me that the parts sector is as much involved in
this as the assembly sector. The Detroit Three are assemblers. The parts
sector is a Canada-United States industry. I would like you to address it, if
you could, in a Canada-United States context.

Secondly, I would like to return to the issue of assemblers moving to the
southern United States, which seems to be a fairly risky proposition for Can-
ada-based part suppliers. Can you comment on that? Is that really a limiting
factor, or are freight rates so low that it does not matter that much?

MR. SMITH: Frankly, the parts industry is one of the things we talk
about in our organization and with others in the industry as still being a ma-
ajor problem. The parts industry has not consolidated as much as we thought
it would over the last twenty-four months. We thought there would be much
more rationalization. Clearly, the parts sector was, and is, too big.

If you look at it historically, in the 1980s many Japanese companies came
in and added to North American capacity. In addition, European companies
added to North American capacity. Those companies are all still here, as is
much of the old North American capacity.

http://www.fueleconomy.gov/feg/tax_hybrid.shtml (last modified Jan. 25, 2011) (giving val-
ues for federal hybrid tax credits).
We think there still might be a rationalization group in the supply place, and that could be a real problem because you are going to get cost pressures from a healthy supplier who would normally bid in a reasonable plus profit.

Rates are going to get competition from these other suppliers that have access capacity or just want to stay in business. That is how the assembly plants and manufacturers got in trouble, too much capacity. We got rid of the assembly plant capacity in North America. However, we have not done as good a job in the parts sector as a whole, which will continue to be a structural challenge.

Concerning the American automotive industry moving south, the Canadian industry is absolutely scared to death of the hollowing out of the core auto industry. Parts suppliers that were traditionally servicing the Detroit-based manufacturers are now looking for other partners. Ontario is very fortunate because they have Toyota and Honda in the region. They have some familiarity with those companies. However, the problem is they do not have familiarity with BMW, Volkswagen, Nissan, Kia, Mercedes, and other companies located primarily in the Southern United States. It is tough in this market to sell to a company located down there. The Canadian parts suppliers are starting to feel that in a significant way.

Obviously, the hope is that the core does not go away, and that it eventually rebounds. Canadian parts suppliers are always going to service the core. However, the southward movement of the automotive industry is a real challenge for Canadian parts suppliers. Freight is going to be an issue. Frankly speaking, if I am a car company and have a Canadian supplier and Mexican supplier, I am probably going south. So, that is the cold hard truth.

MR. MCILROY: My question arises from an announcement made last Friday in Ottawa in which Canada said they were going to adopt continental regulations for fuel efficiency. My understanding is that those regulations initially came from California and then the Province of Quebec adopted them. The Province of Quebec basically told the federal government of Canada that these should be the standards for Canada. Ottawa said there was no way they were going to go back. However, two months later, they adopted the regulations. How are regulations for fuel efficiency and other issues being developed in the United States? They seem to be coming out of the states. Where do they come from? Do they come from the States and Washington adopts them?

MR. SMITH: In a room full of lawyers, this is probably one of the most difficult legal and constitutional battles in the industry. I have four minutes...
here, and I will see if I can do this without getting into too much trouble. This is a very dangerous area.

Historically in the United States, for three and a half decades, the Environmental Protection Agency (EPA) and the International Highway Transportation of Safety worked together to create a fuel economy standard, a minimum requirement for the fleet of vehicles.\(^74\)

MR. MCILROY: That covers all of the United States?

MR. SMITH: Yes, that covers the United States. It is one law for the entire fifty states. In essence, that was a fuel end. That was a fuel end for how much you are burning.

California looked at this and decided that carbon dioxide is a pollutant and, therefore, they could monitor pollutants going out. It was not considered a pollutant in the initial laws. However, the EPA ruled two years ago that it is a pollutant. This permitted California to have a greenhouse gas emissions law,\(^75\) which, in essence, is nothing more than a fuel economy law, because it reduces emissions out as well as reducing the input of fuel. Therefore, California's law was able to pass muster. Then, fourteen other States, plus Canada, said they liked the law. At that point, the Obama Administration added that it felt the car companies should have just one law to follow. California had to accept this law until 2016, after which, they will have the opportunity to write a new law. California has already begun to write that law. In many ways, it is good that California pushed the issue. We now have a national standard for fuel economy, which, curiously enough, is very close to the California carbon dioxide law.

MR. MCILROY: So it goes California, Washington, Ottawa?

MR. SMITH: Yes, but it is driven by the California Resource Board, and they have really forced the hand of the Government by bringing the EPA case to the Supreme Court and arguing it was a pollutant.\(^76\)

MR. MCILROY: Thank you.

MR. SMITH: I think that ends my time.

MR. UJCZO: Please join me in thanking Brett.

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