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IN THE UNITED STATES DISTRICT COURT

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FOR THE EASTERN DISTRICT OF CALIFORNIA

15

FRESNO DIVISION

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**CENTRAL VALLEY CHRYSLER-JEEP,
INC.; et al.,**

18

Plaintiffs,

19

v.

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CATHERINE E. WITHERSPOON,

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Defendant.

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23

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I, Reza Mahdavi, declare:

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1. I have been employed by the California Air Resources Board (ARB or

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Board) for the last 17 years. During that time my responsibilities have included: carrying out

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cost and economic impact assessments of air pollution controls on the California economy and

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business; managing extramural research contracts in the area of energy, economic, and financial

NO. CIV F-04-6663 REC LJO

**DECLARATION OF REZA
MAHDAVI IN SUPPORT OF
DEFENDANT'S MOTION TO
DISMISS**

Hearing: June 13, 2005
Time: 1:30 p.m.
Courtroom: One
Judge: Hon. Robert E.
Coyle

1 not demonstrated a real and present harm resulting from the proposed greenhouse gas regulatory
2 amendments (“proposed regulatory action” hereafter) at issue in this matter.

3 BASES FOR CONCLUSION

4 7. The declaration of Stuart H. Harden lodged under seal relies upon
5 fundamentally flawed assumptions, and therefore its conclusions cannot be used as a reliable
6 basis for a conclusion on real and present harm. Mr. Harden’s declaration suffers from the
7 general analytical flaw of relying on decreased model availability that will not occur. In
8 addition, Mr. Harden’s analysis makes several improper economic assumptions and
9 miscalculations, including failing to account for offsetting revenues in the dealer plaintiffs’ other
10 departments, failing to recognize that vehicle unavailability – if any – will be short-lived, and
11 failing to put potential sales losses due to model unavailability into the context of the dealer
12 plaintiffs’ historically volatile sales revenues that have unexplainably declined contrary to
13 statewide trends. I will discuss each of these below. Together, these render Mr. Harden’s
14 conclusions as to a reduction in the dealer plaintiffs’ net present value unreliable.

15 8. I have reviewed the declaration of Mr. Steve Albu that is being filed on
16 the same date as this declaration. Mr. Albu’s declaration concludes that the potential cost
17 increases to the manufacturers from the proposed regulatory action are much smaller than the
18 Plaintiffs allege, and will not result in substantially decreased model availability. This is
19 contrary to the declarations of Mr. Modlin (at paragraph 48) and Mr. Weverstad (at paragraphs
20 42 and 44) concerning decreased model availability, on which Mr. Harden’s spreadsheets and
21 statements rely (Harden Declaration paragraphs 5 and 6) to attribute decreased sales beginning in
22 2010 to the proposed regulatory action. Hence, there is no significant potential impact on
23 current value from the proposed regulatory action.

24 9. General Motors Corporation (GM) and DaimlerChrysler Corporation
25 (DCC) are profit maximizing corporations. Profit maximization mathematics and sound
26 economic analysis dictate that they will produce their models with higher profits before
27 producing models with lower profits. Neither GM nor DCC would embark on a compliance path
28 that is contrary to their profit maximizing goals and discontinue their most highly profitable

1 models and lose sales. According to the dealer declarations (Beck Declaration para. 8; Pistoresi
2 Declaration para. 8; Rosvold Declaration para. 9), the models that Mr. Weverstadt and Mr.
3 Modlin claim would be unavailable are the most profitable, and presumably command a high
4 price. Economic theory applicable to this industry would indicate that this is likely due to low
5 competitive pressures on price in that market segment, higher customer incomes, brand loyalty
6 (as is also stated in the dealer declarations (Gardner Declaration para. 7, Harrington Declaration
7 para. 5, Pistoresi Declaration para. 4, Rosvold Declaration para. 5, Wells Declaration para. 7)),
8 and marketing power through advertising of specific vehicle attributes. This is confirmed in
9 paragraph 31 of Mr. Weverstad's declaration, which, in discussing sales of a certain pickup
10 truck, relates that many customers select a bigger engine at a significantly higher price. These
11 model and market attributes indicate that GM and DCC are price setters in these market
12 segments, and can pass on increased costs to their customers due to the low price sensitivity of
13 their customers. Even if the customers were more price sensitive, the increased costs attributable
14 to the proposed regulatory action will be more palatable because the improved models will be
15 perceived as a better value due to operating cost savings. Given the ability of GM and DCC to
16 pass the cost of their investment for their most profitable vehicle models to their customers
17 through vehicle price increases, it makes no economic or business sense to suggest that either
18 will discontinue the highly profitable models of which Plaintiff dealers claim they will lose sales
19 and profits.

20 10. Mr. Harden's analysis also improperly assumes that none of the alleged
21 new vehicle sales will be offset by increased activity in other, typically more profitable, dealer
22 departments. That is, no adjustment is made in other parts of his analysis as a result of the
23 alleged change in behavior of potential new car buyers. Due in part to customer loyalty
24 (Gardner Declaration para. 7, Harrington Declaration para. 5, Pistoresi Declaration para. 4,
25 Rosvold Declaration para. 5, Wells Declaration para. 7), a certain percentage of these supposed
26 lost buyers would still benefit the dealer in one of several ways; buying other new vehicle
27 models, seeking service of their existing cars for longer; or buying used cars (see, for example,
28 the Rosvold Declaration at paragraph 5). All of these compensating behaviors affect the dealers'

1 profitability, and therefore their current value. Mr. Harden's analysis considers none of these
2 behaviors. This error is especially important in the case of the dealer plaintiffs, as Mr. Harden's
3 spreadsheets indicate that the dealers' other departments generate significantly more profit per
4 dollar of revenue than their new vehicle sales departments.

5 11. As one example of the flawed logic in failing to acknowledge offsetting
6 dealer transactions, economic principles dictate that one of the more likely outcomes of a new
7 vehicle sales loss will be that sales of vehicle(s) similar to the discontinued model(s) will go up.
8 If, for example, model X is discontinued, consumers will probably buy similar models. Because
9 of brand loyalty and marketing power, discontinued models will probably be substituted with
10 other similar models from the same manufacturer, say model Y, because their customers need the
11 vehicles. The impact on the dealer profits would not be the loss of all profit from discontinuing
12 model X, but rather the loss – if any – from the difference in profits between model X and the
13 substitute model Y. Given the low price sensitivity of the customers and other market
14 characteristics that exist for model X identified in paragraph 9 above, consumers will likely be
15 willing to pay up to the high prices they were paying for model X to buy model Y. The
16 economic principal of demand says that if the demand for a normal product increases, its price
17 will increase (other factors remaining the same). Addition of customers of discontinued model X
18 to the existing market for model Y will increase the total demand for model Y. The higher
19 demand will translate into higher prices. The price increase for model Y means the profit loss
20 (the difference in profits on X and Y) should indeed become smaller than it was initially
21 assumed. Using Mr. Harden's methodology of income approach to valuation (Harden
22 Declaration paragraph 8) the much lower profit loss (income) of the dealers means the impact on
23 the dealer plaintiffs' business worth or valuation should be very small.

24 12. The dealer plaintiffs' financial data, as presented by Mr. Harden, indicate
25 that historically there have been reasons for decreased sales unrelated to any regulatory structure,
26 and therefore his methodology cannot reliably attribute future sales decreases to the proposed
27 regulatory action. New vehicle sales declined for Entities A, B, and C from 2000 through 2003
28 and bounced back in 2004, and for Entity D declined from 2000 through 2004. This trend is not

1 in line with the sales trend of new vehicle dealers in California during the same period. The State
2 Board of Equalization annually publishes reliable data on statewide taxable sales by type of
3 business. Economists generally rely on this data. According to that data, new vehicle sales in
4 California increased in 2001 by 9.5%, in 2002 by 6%, in 2003 by 5% compared to the previous
5 year, respectively. For 2004, data is only available for the first quarter, but that data suggests
6 2004 was also a good year for new car sales.

7 13. This positive sales trend should be heightened in the San Joaquin Valley.
8 The Valley is California's 4th largest region in terms of jobs and 3rd largest measured by
9 population according to Center for Continuing Study of the California Economy (CCSCE).
10 CCSCE provides reliable projections of the California economy and counties annually.
11 Economists generally rely on CCSCE data. According to that data, the Valley experienced job
12 growth of 2.8% between 2000 and 2003, way above the California average of -0.6% and the
13 national average of -1.2%. CCSCE projects that the Valley will have job growth of 18.7%
14 between 2003 and 2012, slightly below the California average of 21.8% but above the national
15 average of 15.0% during the same period. Therefore, while Mr. Harden's data may be accurate,
16 they represent a period of declining sales for dealerships and are not representative of future
17 sales trend in light of the economic trend. This contrary trend adds to the unreliability of Mr.
18 Harden's calculations regarding future trends.

19 14. For each Plaintiff dealership, Mr. Harden's analysis predicts sales declines
20 unrelated to a specific change in fleet mix sold, rendering those predictions incapable of scrutiny
21 and evaluation. His analysis assumes a certain decline in new vehicle sales in 2010 and 2011.
22 However, no information is provided on the sales mix for these entities, either before or after
23 applying the proposed regulatory action. Though these sales drop assumptions are the primary
24 driver for Mr. Harden's analysis, one cannot determine how these substantial sales declines are
25 estimated. Without knowing each entity's current sales mix, by model, and the mix of vehicles
26 that Mr. Harden assumed each Plaintiff dealer would sell following the proposed regulatory
27 action, one cannot examine the reliability of the estimated sales decreases. Therefore one cannot
28 rely on the conclusory numbers presented in Mr. Harden's spreadsheets.

1 15. Mr. Harden estimates a change in the value of a plaintiff dealership by
2 comparing the value of the dealership with and without the proposed regulatory action for the
3 year (2012); this is the year after the end of the analysis period (2005-2011). This method does
4 not provide an accurate picture of the dealership value for the duration of the analysis because it
5 does not account for changes in income during the same period. A more accurate method of
6 estimating dealership value is to compare average values of a dealership with and without the
7 regulation during the whole analysis period. An averaging method is more accurate because it
8 takes into account the variability of the business's income stream, which is important because
9 the value of a business is based on the stream of income it will earn over the long term. Using
10 the average income method to estimate a dealership's enterprise value, and again assuming that a
11 short-term sales loss is plausible (contrary to Mr. Albu's declaration), I for example found that
12 Mr. Harden has overestimated the decline in the value of Entity A by approximately 80%.

13 16. Mr. Harden's spreadsheets indicate that the Plaintiff dealers' sales and net
14 income have fluctuated dramatically over the years. For example, sales of Entity A declined by
15 30% between 2000 and 2003 before recovering in 2004 to nearly the 2000 level. During the
16 same period, net income for Entity A declined by 93%, then rose by 1,712% in 2004 as
17 compared to 2003. Mr. Harden estimates a decline of 89% in net income for Entity A between
18 2009 and 2011. This decline is not significantly different from the decline in net income that
19 Entity A experienced between 2000 and 2003. The analyses of the other dealer Plaintiffs show
20 similar results. Given the historic volatility of the Plaintiff dealerships' sales and net revenue,
21 there exists a significant uncertainty so wide that one cannot as an economic principle attribute
22 short term sales or net income losses entirely to the proposed regulatory action.

23 17. Using Mr. Harden's income approach to valuation, I calculated the value
24 of dealerships from 2000 to 2004. The results show that the value of a dealership changed
25 dramatically from year to year. For example, the value of Entity A changed from \$4,790,734 in
26 2001 to \$161,232 in 2003, representing a decline of about 97%. Given this parallel historic
27 volatility of the Plaintiff dealerships' valuation, there exists a significant uncertainty so wide that
28 one cannot as an economic principle attribute projected losses of the magnitude I have calculated

