IN THE UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,	Docket No. CA 97-0701
Plaintiff,	Washington, D.C.
	May 19, 1997
v.	9:46 a.m.
STAPLES, INC.,	
and	
OFFICE DEPOT, INC.	
2200 Old Germantown Road	
Delray Beach, FL 33445	
Defendants.	

TRANSCRIPT OF TRIAL
BEFORE THE HONORABLE THOMAS F. HOGAN
UNITED STATES DISTRICT JUDGE

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(Computer-Aided Transcription From Stenotype Notes.)

P R O C E E D I N G S

THE DEPUTY CLERK: Civil action No. 97-0701. Federal Trade Commission versus Staples, Inc., et al.

Counsel, will you please stand and state your names for the record and whom you represent, beginning with the Plaintiffs.

MR. CARY: Good morning, Your Honor. George Cary on behalf of the Plaintiff, United States Federal Trade Commission. And with me for the United States is Robert Doyle, James Fishkin, Phil Broyles and Mel Orlans.

MR. KEMPF: Good morning, Your Honor. Don Kempf on behalf of the Defendants. With me at counsel table are Chris Curran and Mark Gidley, whom you already know, and my partner Teft Smith. I have three of my colleagues, Jim Basile, Eugene Assaf, and Mark Kovner, who you have met before. And I might as well take this time to introduce you to the two chief executive officers. The fellow on the far side of the table is Tom Stemberg, who is the founder and CEO of Staples, and he will be the CEO of the new combined company if we have a combined company. And on this side is Dan Fuente, who is the CEO of Office Depot, and he will be the chairman of the new combined company.

THE COURT: Thank you. All right, we are ready to proceed. I have met with counsel briefly in chambers and asked them if they had preliminary motions, et cetera.

Unless there was, at the opening statements I prefer not to take any preliminary matters up and move into the opening statements, because they are going to be somewhat lengthy and we have need to move forward.

So we are going to start with the opening statements this morning. I think they will be finished sometime after lunch. We will take a luncheon break at about 12:15, probably, for the parties' timing. In that range, depending where you are in your arguments or opening statements.

As I understand it, Mr. Cary is going to present the case on behalf of the Federal Trade Commission this morning, so I will hear from Mr. Cary first.

MR. CARY: Thank you, Your Honor. Good morning again. First I would like to start by recognizing the first row on the left here, which is the staff of the Federal Trade Commission which have dedicated themselves tirelessly to bringing this case to fruition here at trial today, since we filed the complaint.

Your Honor, the fundamental question that we are here to address in this case is whether the office superstores, Staples and Depot combined, will have the ability to raise prices after this transaction.

This is the central question in every merger case. In all of our 19 volumes of exhibits, all of the 60 volumes the Defendants have put in, not counting the three or four we got last night, all of the witnesses that will appear this week, and all of the material here in this courtroom is designed to answer that question. Will these companies have the ability through the exercise of market power to raise prices higher than they would have been without the merger if these firms continued to compete?

In most cases, answering this question involves a prediction. And the case law spells out that the prediction is generally based on defining the market, the market shares of the firm, the structure of the market, the nature of rivalry, the assessment of entry barriers and the like. In this case, Your Honor, we have much, much more than that In this case we have something that in 20 years of practicing merger law, both for the Government and in private practice, I have never seen to the extent, the richness that we have here. And that is real world evidence, direct evidence from the parties' own documents, from the parties' own pricing histories, that they have market power in cities where they face no superstore competition.

This evidence, that shows that where they don't face competition where prices are higher than where they do simplifies the Court's task in this proceeding. Because the prediction that Section 7 requires the Court to make requires no guesswork in this case. We can see what happens where they don't face competition. Less superstore competition means consumers pay higher prices. Let me go back though and start from the beginning, because the history of this industry is very important in understanding how we got to where we are today.

12 years ago, Staples and Office Depot created a new industry. Their concept was to provide a unique combination of a broad selection of consumable office supplies together with low prices throughout the country. As Mr. Stemberg, the founder and president of Staples, has described it, they created the idea of a supermarket for office supplies carrying under one roof the broad array of consumer office supplies that a consumer or business might need to purchase.

When we talk about consumable office supplies, that is a term that the companies employ in their documents. That is a term generally recognized in the industry to describe things like pens, things like Post-it tabs, file folders, the variety of items that one would need to operate a business. Others soon emulated this idea of carrying that broad array deep inventory under one roof. And many other firms entered the marketplace.

Today there are only three left out of the 21 firms that started out in this industry. There are three left. And today, we are seeing two of the three, the two biggest, the two most aggressive, the two lowest priced, that are threatening to merge and to eliminate the competition that was between them.

Competition between these firms has led to a rapid expansion of their businesses throughout the country, and it has led to lower prices generally for consumers. The business records and the testimony is replete with the evidence of the benefits of competition here. This intense competition grew and grew, and as each of these firms moved into each other's markets they found themselves coming up against each other more and more in head-to-head competition. And that direct competition as they faced each other in each of their towns with the other has led to lower and lower prices. It also has led each of them to strive to accomplish greater efficiencies so they could effectively compete, and that has driven down prices further.

But over the last few years Staples has struggled to keep more of its cost savings it generated from its suppliers and from the efficiencies it implemented in higher profits, rather than passing those cost savings on fully to their consumers. They have attempted to increase their gross margins and not lower prices to the same extent as their costs have gone down.

In 1996, this last year, Staples management began to realize that the competitive pressure from Office Depot would require them to reconsider that strategy. Staples realized it had to lower its prices to remain competitive with its aggressive rival, Office Depot. Office Depot was expanding into new territory and offering lower prices than Staples. And Staples said, in 1996, "We can't let this go on. We have to adjust our prices to meet this competition." But in coming to that decision, they were not blind to the fact that this would have a dramatic effect on their prices. In reviewing the situation, in deciding whether to pursue lower prices in response to Depot and to sacrifice their profits as a result, they realized that they had another choice. Their other choice was to eliminate their aggressive competitor through merger, to acquire their aggressive competitor and leave themselves in a position where this competitive pressure was alleviated. And that is what brings us here today, Your Honor.

Staples' own documents tell this story. Staples own documents describe the fact that their gross margins were increasing, that their profits were increasing as a result, but that Office Depot was not following the same approach.

Let's start, first, Your Honor, by showing you a document out of the company's records where they recognize that their own gross margins are increasing at a rate greater than their costs.

MR. SMITH: Can we get a number, so you can cite the number for us.

MR. CARY: I believe it is PX 14. I'm sorry, 15. This is out of the Staples strategy update plan, Your Honor.

As you can see, Staples realized that their gross margin has increased steadily by about 900 basis points over five years. 900 basis points, in other words, 9 percent their margins had increased. The second point says this implies the prices have risen greater than cost by about 15 percent. And it shows along the bottom 1991, 1992, 1993, 1994, and 1995 how their gross margins on office supplies had steadily increased.

But the company also realized this steady increase in gross margins could not persist so long as Office Depot was out there undercutting prices. And in the next business document you will see that the company stated in their merchandising memo that they had had a dramatic rate increase over the last five years, in part due to our policy on all non-PSI and invisible items that are priced over the competition. In this memo, Betsy Pete, an officer of Staples, realized that their policy of charging higher prices on what they call non-PSI; that is, non-price-sensitive items, had resulted in their prices being higher than their competition. Their competition being Office Depot.

Let me digress a little bit, Your Honor. The companies divide their product line into what they call price-sensitive items, PSIs. Those are items that consumers know the prices of because they see them in advertisements, they buy them more frequently. They then have a large selection of items called non-PSI items that people buy less frequently and are less aware of the prices. And on items that consumers are less aware of prices, Staples had elevated their prices over this period of time. Finally, they have invisible items which is their term for products they don't think the consumers know the price of at all.

The document goes on to say, as you can see, at this point in time Office Depot worked on much lower margins. And today their aggressive market pricing indicates that is probably still true.

So, Staples recognizes that Office Depot is undercutting prices. Staples recognizes they let their own prices grow relative to costs. And what did they do in response to this? Ms. Pete recommended, We've got to drop our prices. This is in July of 1996, shortly before this merger was announced.

Now, let me say one more thing about the slide. During the defense case you are going to hear repeatedly the only thing that drives prices is efficiencies. The competition has no impact on prices. You will hear that refrain throughout. When you hear that refrain, remember this document. Because what this document says, Your Honor, is that Office Depot didn't have lower prices because they had lower costs. This document says that Office Depot had lower prices because they worked on lower margins. They were willing to accept a slightly less profit in order to drop their prices. And it is that price competition that led Staples to decide they needed to drop their price too, in order to remain competitive.

But again, Your Honor, market share and competition don't come without a price. And that price is that it will have an impact on your profits. And that price was also well known to Staples. Staples knew by matching the prices that Office Depot was offering in the marketplace, they would have to lower their prices and accept less in the way of profits.

Again, their business documents tell the story. This again is the Staples 1996 strategy, PX 14, I believe. And what this document says is pricing parity; in other words, matching Depot's lower prices in the marketplace, will be achieved over the course of the next four years. The total impact on margin; that is, profit margin, is 100 basis points. 60 basis points for existing Office Depot market overlaps. That is where they compete today. We will take a hit in our profits where we compete today. 40 basis points for future Office Depot overlapping markets. Staples is growing. Office Depot is growing. They are moving into the same cities. They are coming head-to-head more and more and more. They no longer have the noncompetitive markets that they used to have. They anticipate the result will be a hit on their profits. Additional margin erosion of 50 basis points is assumed for increasing competitive pressure as market approaches saturation and there is an increase in three-player markets.

Again, Your Honor, this is a theme that we will hear throughout. The parties will argue that everybody in the world competes that sells office supplies. But in their business records they repeatedly recognize three-player markets, which they define as Staples, OfficeMax, and Office Depot. In other words, only the superstores. They realize the competitive pressure that the superstores put on them and they don't acknowledge that for other firms.

Your Honor, the next document tells the same story. Again, the company recognizes that they are offering higher prices in their overlapping markets and they are assuming they will have to reduce their prices to match it. Staples existing higher prices in ODP -- Office Depot overlapping markets, is assumed to be reduced to parity level by '98. Currently, 1.3 percent higher prices in the 46 percent of Staples markets where the two firms compete.

Competitive pressure as three-player markets increase to 76 percent of overlap. Office Depot's impact on New York and New Jersey stores of 169 basis points used as a proxy. We will go back to this New York story, because it is also very instructive as to how these firms compete and what happens when they compete.

Finally, in the 1996 strategy update, the same observation is made. Additional margin erosion due to competitive pressure in lowering prices closer to parity with Office Depot. All of this occurred in the immediate months before the decision was made to acquire Office Depot. In fact, it was this document that the top executives of Staples were reviewing and thinking about and mussing about and worrying about when the idea came to them, let's buy Office Depot.

So, the company, Your Honor, effectively had two choices. They were faced with the choice of lowering their prices, lowering their profits, or acquiring Office Depot. And they chose to acquire Office Depot.

The choice they made is the reason we are here, and it brings us back to the ultimate question in this and every other merger case. What will be the effect on prices? The key fact of this case, Your Honor, is that where Office Depot and Staples compete, their prices are 5 to 10 to 15 percent lower than where they don't compete. The remarkable consistency of this evidence is the key to this case. All of this evidence directly answers the ultimate question in the merger case. Will prices likely be higher after the merger than they would have been without the merger?

Now, I would like to go back to the beginning of our investigation of this case and explore some of the other evidence that we have developed in analyzing the likelihood of price increases here. Back in the beginning, when we received the original filing by the parties, we did what we always do. We go out and we collect third-party industry information, in an effort to figure out what the industry is about and to get our sense of what is there and whether an investigation is warranted.

One of the first pieces of information we got was a document prepared by Prudential Securities. This is a securities firm that analyzes the office superstores market, follows the market. And what we found was that Prudential Securities had done their own survey of prices among office superstores. This is something that they had done right before I think the merger was announced. And what they did was they compared Staples' prices in a town called Paramus, New Jersey; what they called a two-player market, where Staples and Max competed, with the prices in nearby Totawa, New Jersey, where Staples and Max also competed with Office Depot, a so-called three-player market. Again their term, not mine. Both towns were in New Jersey. One was 25 minutes from the other.

And what Prudential Securities found, having collected a basket of office supplies that they were using as their measure, was that Staples' prices were 5.2 percent lower in the three-firm market where Staples competed with Depot, than they were in the two-firm market. Now, this is a striking observation, because in the two-firm market, Staples was not there alone. Staples was competing with OfficeMax. But when you add Depot into the mix, when you add Depot as the third player in the market, Staples prices go down 5.2 percent. As you will see, Your Honor, as we get further into it, where they have a monopoly, where they are the only superstore in the town, their prices drop even more dramatically when the Office Depot enters.

During our investigation we also heard from consumers. And one of the consumers sent us a couple of advertisements from his home town; one from Leesburg, Florida, where he lived, and the other from nearby Orlando, Florida. And what these advertisements showed was that Office Depot's prices where they are forced to compete with Staples are significantly lower than where they don't have to compete. Office Depot is the only office superstore in Leesburg, Florida. But in Orlando, Florida, they compete with both Staples and OfficeMax.

Your Honor, these are the ads that this consumer sent us. As you can see, he wrote across the top Leesburg, Florida, Daily Commercial, Orlando, Florida, Sentinel. These ads show the effect of competition among office superstores. As you can see, in Orlandó, Florida, over on the left at the top corner, a box of Xerox paper cost $17.99. In Leesburg, where Office Depot faces no superstore competition, the very same box of Xerox paper is $24.99.

On the bottom right-hand corner, a box of pens in the competitive market where they face Staples head-to-head, 5.75. In a market where they face no competition, Leesburg, the prices are $7.49.

If you look at the file folders right next to the pen, $1.95 where they compete with Staples, $4.17 where they face no competition.

Prices are higher where they are not forced to compete, Your Honor. Staples is no different from Depot in this respect. Here we have an advertisement from the Charlottesville, Virginia, Daily Progress, February, 1997. On the right we have an advertisement from the Fredericksberg, Virginia, Freelance Star, same day. Same advertisement in terms of the pictures, the products offered.

But again, let's look at the prices. If you look at the bottom right-hand corner you will see some laser labels. In Charlottesville, Virginia, the laser labels cost $21.55. Charlottesville is a market where Staples competes with Office Depot. In Fredericksberg, Staples has no superstore competition. There is a Wal-Mart there, but no office superstore there. $26.99 for the same box of labels.

In the middle column there, over on the left, you will see some Post-it notes; $3.99 where they compete in Charlottesville, $5.79 where they don't compete.

As Your Honor is aware, the product market that we allege in this case is the product market for consumable office supplies sold through office superstores.

If you look at these ads, Your Honor, you will find that for non-consumable office supplies, for things like computers, the prices are very similar between these two stores, the Charlottesville store and the Fredericksberg store. Charlottesville, for example, the computer is advertised at $1299. The computer in Fredericksberg, exactly the same price. That is because these stores face competition with respect to computers. But when you get to the consumable office supplies, the reason for being for these stores, the concept that put these stores into business and made them huge successes, when you get to the consumable office supplies where customers want to do one-stop shopping, they want to go to a place where they know they can find what they need. If they have a filing system set up with green folders, they want to go to a place where they know they can find green folders. If they have an accounting system that uses red fine-tip pens, they want to go to a place where they can find red fine-tip pens. And they don't want to run all over town. When it comes to those products, these companies offer a service of one-stop shopping that allows them to charge higher prices where they face no competition from somebody else offering the same kind of service. That is what the case is about.

Again, this term "consumable office supplies" is one that the companies and other companies use consistently in their business. Now, these pieces of information, and other pieces of information just like them from public sources and from some inquiries that we made, led us to conclude an investigation was warranted. But we didn't understand the full extent of the problem until we got a response to our investigative requests of the parties. That is when we got the massive volume of company documents, which is the central piece of evidence in this case, Your Honor.

What we found was that these companies track each other obsessively. They follow each other's pricing obsessively. They have internal documents that record the pricings of the other firms in the marketplace obsessively. And what those internal documents show, Your Honor, is that they understand exactly what these documents that I put up on the screen up until now show. They understand that prices are higher where they are not required to compete with each other and prices are lower where they are forced to compete with each other. That was true in 1995, when you look at their documents. It is true in 1996, when you look through their documents. And it is true today. Tomorrow, it might be true or it might not be true. Tomorrow it could be the 43 additional markets, if these parties merge, will be markets where Staples and Depot do not compete and where they will be allowed to raise their prices.

Let's go to the first set, Your Honor, of pricing documents that we looked at when we received the response to the parties' document requests.

Your Honor, this document is typical of the kind of documents they keep in their files on a routine basis to track their own pricing and to compare their own pricing to that of their competitors. What this document shows, first on the left-hand axis is a pricing index. It comes up the side. What it does is, it sets a base level of one in the Los Angeles market, presumably the most competitive market where all three superstores compete. And then what it does, it tracks their pricing in various price zones across the country to show how those prices compare with the prices in Los Angeles, until you finally get all of the way to the end where they have what they called their non-competitive zone. The "non-competitive zone" is the term that Staples has chosen to describe those markets where they face no superstore competition, where there is no Depot and there is no Max. As you can see, Your Honor, the prices there are 14 percent higher than in the competitive zone. The index value is 1.142, relative to an index value in Los Angeles of one.

There is another zone on here we will describe in more detail in a minute, called their Club zone. And that is the third one from the end here. The Club zone is a zone where they face no office superstore competition, but they do have warehouse clubs; Sam's, BJ's, Price Club type of outlets in that area. What this graph shows is that where they face the clubs, they have slightly lower prices than where they don't face the clubs, the difference between 13.4 percent and 14.2 percent. But compared to what they have to do to meet prices where they compete with Office Depot, there is another 13 percent that Office Depot drives their prices down where they compete directly with Office Depot.

Again, the question in this case, as in every case, is who constrains the pricing? And the answer is, superstores constrain the pricing of other superstores within a very broad range. Once they elevate their prices by 13 or 14 percent, they may start to run into competition from other outlets, but that is an awful lot of price increase that the consumers have to pay before they get to that.

What we did with these documents, we took these documents and compared them with another document we have, PX 70. PX 70 is a book that Staples calls their pink book.

This is a book where they track which competitors are in which market. Again, they update this thing routinely. They are obsessed with the question whether Office Depot is opening in their markets. The pink book describes what cities Office Depot is in, what cities OfficeMax is in and what cities Staples is in. What we did was we took that pink book and we asked the question for Los Angeles, what superstores are there. For Sarasota, what superstores are there? For Cincinnati, what's there, et cetera. If we found Office Depot in the market, we took our crayon and colored in the line red. If the pink book said Office Depot is not there, we took a blue crayon and colored in the line to show that Office Depot is not there.

Having conducted this exercise, the next picture will show you what we found. What we found is when Office Depot is in the market, prices are low. When Office Depot is not in the market, prices are higher. And where these stores face no competition at all, the prices are the highest of all. Now, we have taken these charts that we have colored in and we have provided to Your Honor the underlying document, which we put on the screen, and the colored-in version in PX 3. So we have the colored-in version. Right behind it we have the underlying document, so Your Honor can verify each and every point on each and every graph.

And it is throughout PX 3, and we took every one of these kinds of forms that the parties gave us on the second request and we tracked it for every one of these forms. And we have that all in the book so that Your Honor can verify it. And the pattern is remarkably consistent. Where Office Depot is in the market, the prices are lower; and where they are not, the prices are higher.

We tracked it over time. We tracked it over a variety of different samples that the companies use to trace their pricing.

We also, Your Honor, took the same charts and we plotted the charts to show not only the markets where Depot is in and the markets where Depot is not in, but also to show the presence of the third office superstore, OfficeMax, and to show those zones where there are no competitors at all, no office superstore competitors, that is. There were numerous other type of retailers, but no other office superstores. And again in PX 3, for each and every one of the documents of that type that we received from the companies, we have tracked the stores and we have created again a colored version of that bar graph. This time we have rearranged it to clump together stores with the same type of competition. So, in this graph, what we have is the three-player markets in blue at the end. Those are the markets where there is a Staples and Office Depot and OfficeMax. We then have in the yellow the Staples-Max markets. We then have the no-competition markets. Again their term, not mine. And then we have at the far right the Staples-Depot zones.

And again, the pattern is consistent. Where they compete with Depot, the blues and the greens the prices are low. Where they compete only with Max the prices are higher, but not nearly as high where they face no competition. That is where they really raise their prices.

During the course of investigation we had the opportunity to conduct a deposition of Mr. Stemberg, the CEO and founder of Staples. And Mr. Stemberg came into the deposition and brought a document with him. What Mr. Stemberg said, to paraphrase, is, You guys are looking at the wrong stuff. You guys are focusing on the wrong bundle of products. Let me give you the bundle of products that you ought to be focusing on. And we said, Okay, Mr. Stemberg, we will look at the bundle you would like us to look at.

Here is the bundle Mr. Stemberg suggested was the appropriate sample to look at for consumable office supplies. And what this sample shows is that where there are three-player markets with Office Depot, prices are lower. Where there are two-player markets with Office Depot and Staples, prices are lower. But where Staples compete only with Max, prices go up; and where Staples has no office superstore competition, prices go way up.

Again, Your Honor, throughout this proceeding, we have been told that we are cherry-picking and that we are picking out examples. We did our best to use every piece of information the parties gave us. We went back after hearing that statement the first time in this hearing, and we pulled together another group of documents that have the pricing information on them of a type that we have summarized in PX 3 originally. There was a chart, one summary chart that showed what it showed, but we decided to display that in the same format. And again it is the same picture.

It really doesn't matter what sample you choose, whether it be the price-sensitive items, or the complete sample or the non-price-sensitive items. And we have all of those in your book. The picture is the same.

The next thing we did, Your Honor, was to take this picture and simply do a numerical average; say, What is the average price that consumers pay when they have got three-player markets, where there are two-player markets of Staples and Depot, where there are Staples-Max markets, and where there are no-competition markets. There was a pure numerical average, simply taking the number of bars, taking the prices of each one, and dividing the total price by the number of bars. And the picture that comes out of that again reveals that on an average consumers pay more where there is no superstore competition. Where there is Depot in the market, they pay about 95 on this index. Where Staples and

Depot are together, they pay about 96 on this picture, roughly. Where Staples and Max competes, the prices go up to about 99, 100. And then where they have no competition, they go up to 107.

Again, we have provided backup for this in your book.

Finally, Your Honor, we have traced this picture over time. And we show that for over time, again for each of the time periods where they gave us information, the picture remains constant. Occasionally, the Depot-Staples markets are slightly lower than the three-firm markets. But they are generally of the same low range compared to what happens when Staples compete only with OfficeMax or where Staples has no competition whatsoever, for each and every time period where we track this.

And finally we did the same thing for Office Depot. And again, the pattern emerges. Now, Office Depot's pricing is much more variable than Staples' pricing. So if you look at the breakdown, the pricing is not as consistent as the Staples pricing is. But if you aggregate the data and look at their average prices, Depot -- just like Staples -- charges more where they can because they have no competition in the red zones. And they charge less where they are forced to compete, and they charge even less when they are forced to compete with Staples.

Now, let's go back to the breakdown Mr. Stemberg suggested to us.

Your Honor, after this merger, each of those blue zones that are currently three-player markets are going to become Staples-Max markets. They will all become yellow, and prices will go up and consumers will pay more. And each of those green zones that are now Staples-Depot markets where consumers benefit from competition will become no-competition zones, and prices will go up to the top of that red line and consumers will pay the price.

Your Honor, this answers the ultimate question, will prices be higher? Can prices go up where there is no competition? We have seen what has happened where there has been no competition, and prices have been higher than where there is competition. Now, when we came to this conclusion, we thought that that was the end of it. But the parties said, No, no, you have it all wrong. Prices are not higher where we don't compete. You don't understand. It is not true. It is not true.

This last weekend, after working night and day for about a month trying to get ready for this hearing, and responding to the multiple binders we get daily from the Respondents, we actually had an occasion to stop and look through some of those binders. We found a document in there. I have got one bar here covered, but I will reveal what is on the other side of that cover later on in my opening argument.

This is their DX 1999. And unless I am reading it wrong, what this document seems to show is that in three-player markets prices are at 100 on the index; but in Staples-only markets, prices are 110.5. And where they compete only with OfficeMax, prices are 105. And where they compete only with Office Depot, prices are 99.5. That is about 11 percent price difference in the Staples-only markets from the Depot competitive markets.

What do the parties say to all this? Obviously they can't deny the price difference. They have it in their DX's, so they have to say something.

Through this proceeding they have basically said -- as best as can I determine, they have said four things. First, well, I guess it is because the cost of doing business in the Staples-only zones must be higher. In all of those places that have no other similarity, presumably, that are Staples-only markets, and there are lots and lots of those places, it must be that the costs are higher. Okay, they said that to us during the investigation and we decided to check that out.

The second thing they said was, It must be the presence or absence of other types of retailers that accounts for these huge differences. It must be Wal-Mart. That is it; it must be Wal-Mart, they say. And then they say, Well, it also must be something about the demographics of the local area. After all, Bangor, Maine, is not the same as Los Angeles, California, they say. So it must be the demographics.

And finally, their final statement was, No, no, you don't understand. Prices are not really higher. We have a econometrician. We have a man that has a Ph.D and teaches at MIT and he has a computer, and you put this data in the computer and out the other end all of these price differences evaporate. They disappear.

Again, we followed up on each of these statements that they made, each of these explanations, to see whether it could withstand scrutiny. So, first let's go back to the first statement, costs. They say it is the costs.

Let's look at a market, a single market. Let's take Visalia, California. Visalia, California. That is a market where Staples was there as the only superstore in the marketplace. Visalia, California, was a red zone, a no-competition zone according to Staples' pricing policy. But in June of 1995, after Office Depot entered Visalia, California, all of a sudden prices in Visalia went down. Originally, Visalia was a red zone where prices were at an index of 1. -- I guess it is 112. Again, they are a high price, no-competition zone. Price Zone 20 is what they call that, their high price zone.

Then Office Depot enters the marketplace. They reclassify Visalia, California, into their Zone 26 price zone. This is one of their Staples-Depot competitive zones and prices plummet 9 percent. Your Honor, these Defendants will not be able to show that all of a sudden one day in 1995 the cost of living in Visalia precipitously declined. That is not what happened. What happened was that Depot entered the market and they were forced to lower their prices as a result of competition.

Let's look at Jackson, Michigan. Again, August 1995; January, 1996; May, 1996. Zone 20 pricing for the citizens of Jackson, Michigan. Staples-only pricing. No-competition pricing in Jackson, Michigan.

Then, OfficeMax enters the marketplace. Jackson, Michigan, is reclassified from a Zone 20 no-competition zone to a Staples-Max zone, and prices plummet 6 percent. Again, not as far as they went down in Visalia, because Depot has not entered in Jackson, Michigan. And if we have this merger, Depot never will enter in Jackson, Michigan. But the prices go down.

Now, Your Honor, previously in the opening statement you will recall that there was a reference in the Staples' document to the entry of Depot into New York, into the Long Island and New Jersey areas. And you saw a reference in that document to the effect on prices and profit margins that that entry had on Staples. Let's show you what happened on Long Island after Depot entered the marketplace.

Again, Staples was competing with OfficeMax on Long Island. It was one of their yellow zones, Staples/Max zones. Office Depot opens in certain locations in Nassau County. And I am sorry, Depot, Office Depot entered in certain locations on Nassau County in Long Island, and Staples responded. They lowered their prices, but they didn't lower their prices everywhere on Long Island. They lowered their prices around the Depot stores in order to compete with Office Depot. That is the reference in the earlier document that says this was our impact on our pricing when Office Depot entered. These Defendants will not be able to show one piece of evidence that the cost of doing business on Long Island changed during this time period, December of 1996. Cost of living didn't fall, their prices fell; their prices fell because Depot entered.

The second argument that the Defendants make is, It is not really the superstores. The superstores really don't matter. They are just another retailer. It is really all of the retailers in the markets. It's the Wal-Marts, it's the Kmarts, it's the club stores.

We went out again and tested that statement. And going back to the cities where we saw the newspaper ads previously, Charlottesville and Fredericksberg, we discovered in fact in Fredericksberg -- where prices are high because there is no superstore competition -- there are Wal-Marts, there are Circuit Cities, there is a BJ's Club store. There is a Kmart and there is a Target. In Charlottesville, where prices are lower, there is a Wal-Mart, there is a Sam's Warehouse club, there is a Circuit City, there is a Kmart. So, the number of retailers is the same. In fact, the identity of the retailers is virtually the same. The same types of retailers are there. But in Fredericksberg the prices are at the 106.1 level and in Charlottesville prices are at the 94.9 level. What is the difference between Fredericksberg and Charlottesville? The difference is that Office Depot competes in Charlottesville. It is not the other retailers.

So, the parties say, well, it must be the cost of living, it must be the demographics, it must be the business climate locally. We will test that hypothesis as well. Let's take a bunch of cities which presumably the only thing they have in common is that they have the same prices for office supplies and Staples. Let's just take a variety of cities.

Let's take Santa Barbara, California. About 369,000 people, very high median income. 10,000 businesses. Seven retail firms, and by this I mean chains like Wal-Mart, Kmart, Best Buy, those kinds of chains. And they only have one superstore and that's Staples, and their price index 107.8.

Let's contrast that to Yuma, Arizona. Population, just over 100,000. Annual income, a third as high. Businesses, one-fifth as many. Number of retailers, a little over half as many. They do have one thing in common; that is they both have Staples superstores, the Staples face no other superstore competition. The prices in Yuma are the same as the prices in Santa Barbara, California.

The same comparison can be made with Pittsfield, Massachusetts; Lancaster, Pennsylvania. Two cities of widely different size demographics, etc. The prices are the same. And it is the same as in Yuma, Arizona. The reason is these are all in their red zone.

Again, this is not limited to Staples. We can see the same pattern with Office Depot. If you compare Redding, California, with New Orleans, Louisiana, those are two cities about as different as we could imagine. One is in the rural northern California area, with 147,000 people, with 4,000 businesses, with five retailers. New Orleans, a city of over a million, major metropolitan center, 30,000 businesses, 6 retail firms. Office Depot pricing is the same. The reason is in neither town do they face superstore competition. It is not the demographics, not the costs, it is the competition that drives the prices down.

Again, Your Honor, a recurring theme here is going to be what you hear made for litigation, and what you will hear in this courtroom has to be contrasted with what the parties say in their documents. Because if you go back to the documents of what they actually do in the business world as opposed to what they say they do, you find that they understand this dynamic. They know that it is superstore competition. They know it is not all of these other things.

Staples, for example, was assessing the impact of OfficeMax's entry into Miami, Florida. And they were assessing what happened to Depot's pricing when OfficeMax enters Miami, Florida. And what they say in their document is that the prices go down when OfficeMax enters Miami, Florida. And they don't say the prices went down in Miami because cost of living went down in Miami. They don't say prices went down in Miami because Wal-Mart opened in Miami. They say, "Pricing levels today versus prior to OfficeMax entry." That's what they describe as the reason for the price decrease.

Let's look at Office Depot's retail pricing memorandum. What Office Depot says in their retail pricing memorandum is that it is the extent of superstore competition with a lack of superstore competition that allows them to raise their prices: This is PX 139, Your Honor, and it also is in the PX 3 in the compilation of their documents. Our company is divided into price zones, says Office Depot. The price zones are not based off geography or along district or regional boundaries. It is based off of what competition we have in the market and the pricing structure that that competitor is using in their stores. We have one pricing zone in our company that is made up of stores that don't have any superstore competition. This zone contains the highest priced stores in our company, as these stores do not have any competition. They are the ones that make the link between the amount of competition and their pricing levels in their retail pricing memorandum.

When Staples looks at its own pricing strategy, Staples makes the same observation that we make, Your Honor. On the average, prices are highest in non-competitive markets and lowest in highly-competitive markets, paren, three competitors. The three-player markets. And again they make the same observation when they are analyzing their major competitors' pricing. This is Staples' interpretation of Office Depot's pricing strategy. On the average, prices are highest in non-competitive markets and lowest in highly-competitive markets, in all three superstores.

In this courtroom, Your Honor will hear from the Defendants that they are very concerned about Wal-Mart and they are very concerned about Kmart. These are very aggressive competitors, and no one need be concerned about a merger of the two leading superstores because Wal-Mart and Kmart and these other retailers are out there. But when you look at their documents, when you look at what they do in business, what you find is that they don't consider Wal-Mart and Kmart as the same kind of threat as another superstore. For example, when they go out and look for sites to place their superstores, the first question they ask is, What other superstores are in this town? What other superstores are in this region? What other superstores might be entering? And they plot where the competition is.

What you see when they plot where the competition is, they mark all of the retailers in the area and they note that Wal-Mart is there and they note that Kmart is in the area. When it comes down to describing the competition, what they say is there is no competition in this market. There is a Wal-Mart down the street, there is a Kmart down the street. There's a Sears, and J.C. Penney, and Phar-Mor, and a Florence Mall, and a Piggly-Wiggly, but no competition, they say. What they mean is, there is no superstore. That was an Office Depot document, Your Honor.

Again, these documents are cited as PX numbers on the bottom, but they are all to be found in your PX 3 book. So that's probably the easiest place to find these documents and the underlying records.

But Staples follows the same pattern. Staples goes out looking for locations, they find the location and call it a new small non-competitive zone. What they mean is, there is no superstore. In the very next paragraph, they say Staples' new store is located in a heavy retail area in the center of town with good visibility and no competition. That means no superstores. The next sentence, co-tenants include Best Buys and Sam's. Best Buy and Sam's are next door, but they have no competition. When they measure their own market shares, again, they measure their market share based on the number of other superstores in the market, as this market share analysis shows.

Again, Your Honor, these documents are very recent documents. They were all done in 1996, and they show what these companies think is their competitive constraint. These documents show that whether or not there are other vendors that sell some office supplies, whether or not there are mass merchandisers that sell pads of paper along with clothing and plastic goods, et cetera, whether there are club stores that sell a few office supply items, what these stores are concerned about is another competitor that offers the broad array, that offers the convenience of one-stop shopping; because they know know that business people and consumers with home offices are going to go and pay extra if they have to, to shop in an office supply superstore if there is no competition.

Now, finally, with respect to their final argument, that if you put all of this pricing data into a black box, out the other end will come a document that shows that there is no effect of superstore competition on pricing. We will bring before the Court a world-class econometrician that will tell Your Honor, that if you do it right, the econometics supports what all of their documents show, what all of their pricing data shows, what all of the market data shows; that competition does matter. And that it is not a situation where the Defendants will tell you, Don't believe your eyes, listen to me. It is a situation where the econometics confirms and corroborates the business records of the companies and the perceptions of the companies when they conduct their day-to-day business.

And again, Your Honor, we are not the only ones who understand what the effects of this merger are going to be on consumers. It is the received wisdom in antitrust enforcement, the cardinal rule; that if other competitors in the marketplace like the deal, it must be because it will lead to higher prices and will be bad for consumers. Here, the record is very clear. And in fact we got another DX binder, I think it was Friday, that made the record even clearer.

The third competitor, OfficeMax, loves this deal, and so do the analysts that follow its stock. One analyst value line, for example, has described the potential benefits to OfficeMax if this deal goes through. OfficeMax is on record as supporting this deal. And Value Line explains why. The company, in this case OfficeMax -- this is an advisory on OfficeMax -- would benefit from the proposed Staples-Depot merger. Indeed, gross would receive support from a more favorable pricing environment. That is analyst talk for higher prices. Both office Max and the new Staples/Office Depot will have considerable market power after the deal is completed. At the very least, the risk of a three-tier pricing structure in certain regions would be averted.

Same comment made by Morgan Stanley, another analyst. "The merger eliminates concern over three-player markets. The just-announced merger of Staples and Office Depot permanently eliminates the lingering fear of intensified competition in three-player markets. The fear is frequently raised in discussions of the office products superstore."

More rational pricing. The merger also suggests a more rational pricing environment going forward. That is what the analysts are saying, and that is why OfficeMax loves this deal. And that is why OfficeMax' price goes up when the prospects for this deal go up and OfficeMax' price goes down when the prospects of this deal look dim.

Now, Your Honor, Mr. Kempf and I have not seen everything in this case eye to eye, but we have agreed on one thing. And that is Mr. Kempf has repeatedly said this is an unusual case. I agree it is an unusual case, but not for the reasons Mr. Kempf cites. It is not because the theory of this case is unusual or novel. Antitrust law is, merger laws, always been about preventing the exercise of market power, preserving competition for the benefit of consumers. What is unusual about this case is the detailed and consistent pricing evidence that allows the Court to make the judgment directly that these firms will have the power, the ability to raise prices after this merger that they don't have where they compete. The Court need not rely on the structural analysis and predictions based on structure. Although we have that, clearly this is going to make a major change in the structure. But we can look at the direct evidence what they do, not what they say they do, but what they do when they don't compete.

The issue in all antitrust cases is who constrains pricing. Firms that constrain the other firms' pricing ought to be included in the market. Firms that don't constrain pricing ought to be excluded from the market. That is the definition in the case law requires. What does it mean to say a firm constrains? It means that competition keeps prices lower than they would be in the absence of competition. Very straightforward.

This chart answers that question. In the absence of competition, prices are higher; and where there is competition, prices are lower. The econometics confirms these results, as Dr. Ashenfelter from Princeton University will testify. The merger analysis requires analysis of just this question, and here we have the answer. The reason consumers will pay extra if they have a superstore than if they don't have a superstore is because the other alternatives don't constrain the pricing.

And let's start by going back to DX 1999, the Defendants' exhibit which shows that in fact superstores do raise prices where they can get away with it. I told you earlier I would remove the cover of the last bar and I have now done that. What the last bar shows is that independent stationers cannot constrain the pricing of superstores at the same level as other superstores. Where superstores compete, the prices are down. Where superstores don't compete, they raise their prices. And the reason is, if the only other alternative that a consumer has is Baker's Office Supply in Greenfield, Massachusetts, that consumer will pay even more.

Now, these Defendants want to end the inquiry with the first two bars. They want to say, look what we have done for the American public. We have lowered the prices of consumable office supplies. We agree that they are to be commended for having done that. We agree that 12 years ago when these companies started this industry, they provided a real service to the public by bringing under one roof all of the consumable supplies that a customer would need and lowering prices for that bundle of goods. And we are the first to recommend them for a medal for having brought those prices down to the 110 level. But that is not what this case is about, Your Honor. What this case is about is whether consumers are entitled to the difference between 110 and 100, the difference between superstore competition and no superstore competition.

While these Defendants would like to get a free pass and to say, "We have earned the right not to compete any longer because we have brought prices down to here," the antitrust laws don't buy such a free pass. The antitrust laws provide for competition, as much competition as we can get, because that brings prices even lower. And in the words of Mr. Stemberg, that competition forces him to get more efficient, forces him to look for lower costs and forces him to lower his prices. That is what the merger laws are designed to preserve.

The same situation applies to the mail-order firms. Sure, you can get your office supplies from a mail-order firm. But as the company documents indicate and as the evidence of the Third Parties indicates and as Mr. Fuentes, the CEO of Office Depot, has testified, mail-order does not constrain the pricing. It doesn't keep prices down to the same level. The best proof of that is the fact that many mail-order firms have national pricing. If a mail-order firm with a single price throughout the United States was a price restraint, why is it that we see superstores with higher prices in some stores where they have no competition and lower prices in others? The mail-order folks don't force them to lower prices as much, as much as they have to do where they compete with other superstores.

The Defendants over the last month have done an incredible job of seeking out witnesses, of working night and day and night and day to get witness declarations, of cross-examining our witnesses in the form of what they call their counter-declarations, bringing out all of the facts; all of which was designed to prove, from my reading of them, that Wal-Mart competes with the superstores or that Kmart competes with the superstores or the mail-order firms compete with the superstores. Well, it may be a little late for this, but I think we could have saved them all of that trouble.

Your Honor, we concede; if you mean by competition, do these people sell some office supplies, absolutely. If you mean by competition, would they like to have Staples' business for themselves rather than leaving it for Staples? Absolutely. No doubt about that. Yes, they do compete, if that is your definition of competition. But that is not the definition of competition in an antitrust case. That is not the definition of competition that the merger laws impose. The definition of competition for purposes of the merger laws is, "Do they constrain pricing? "

So as much as we will hear over the next few weeks -- or next week, I guess, about how much these other firms compete, again, we stipulate they compete. They would love to have that business. What they don't do is constrain the pricing. And this chart is the proof of that. And for all of the counter-declarations they have gone out and sought and obtained, they have not been able to break the fundamental fact of this case. If you get down to the facts and stay away from the self-serving conclusions, the bottom line is that superstores offer a broader variety of items. They offer it under one roof. They offer it in 12, 15, 20,000 square feet of selling space.

Any visit to these stores will demonstrate better than all of the affidavits in the world what the differences are between the superstore and the Wal-Mart, what the differences are between a club store and a superstore. There are differences and those differences apparently are important to consumers. And if they were not important to consumers, Mr. Stemberg would not be the success that he is today. That would not have been such a great idea he came up with. It is a great idea and consumers love it and consumers will continue to shop there whether these two firms merge or not. The difference will be whether consumers will get the benefit of the competition.

And the declarations they have obtained do not shake this fundamental fact. They don't shake the fact that the superstores are a destination shopping place for people that want this full service of office supplies. They don't shake the fact that the pricing of superstores is higher [sic] where they are forced to compete against each other. And they don't shake the fact that others who have tried to expand their office product line, such as Best Buy, were not successful in doing it because they could not become a destination for those shoppers.

Your Honor, from the first day we have suggested that the Respondents will try to run away from these documents, and the reason they will try to run away from these documents is because they are trying to paint a picture that is not reflected in their own business records. They are trying to paint a picture for litigation that is not corroborated by what they do in the real world, in the real business world.

We have made an effort in our exhibits to organize the exhibits for the Court. We have provided one document, PX 2, which is an annotated index of our exhibits. It lays out in quotes from the documents what the document is designed to show. And we divide their exhibits into categories. We have a category for strategic plans. We have a category for industry background. We have a category for pricing. We have a category for competitive tracking. We have laid it out in an organized and methodical way so the Court can look up the evidence in a systematic way. It can review PX 2 and figure out what is relevant and go to the document and find the underlying evidence.

We have also put together PX 3 and 3(a). PX 3 and 3(a) is a compilation of the documents of these companies. And we have attached the company document behind a demonstrative exhibit such as you have seen here today; oftentimes the photograph of the document and a section pulled out for easy reference what the relevance of the document is. The complete documents are then backed, and each one of these slides is marked with a PX number so you can find the underlying document, review it, make sure that what we represented is exactly what the document says.

In contrast, we have received binder after binder after binder after binder. We have received them when we were supposed to get them, when the opposition was filed, and we received them every day since from the Defendants. And when we go through those binders, what we find is not underlying business records. Out of those thousands and thousands of exhibits -- if you put aside the two we got last night that I have not had a chance to look at, there are 119 business records out of those thousands of exhibits. The rest of them are made-for-litigation documents. The rest of them are things like this; demonstrative exhibits, if you will. I'm not even sure they qualify for that name. There are newspaper articles.

You will hear a lot about the productivity loop in this case, Your Honor. The real productivity loop we have is the following. An Office Depot or Staples employee will say something to a reporter. The reporter will write it down in the newspaper. The editorial writer will take the quote and put it in the editorial page, and they will cite the editorial in their brief for evidence for the underlying statement. We have DX's that refer to other DX's and that refer to other DX's, and we find at the end of the day there is no evidence underneath it. It is either a self-serving statement, a letter, a company statement not verified, or a conclusion by a company officer not supported by underlying document. We will show as we go into the briefing stage here, Your Honor, that their case is not based on evidence. Their case is based on made-for-litigation documents, made-for-litigation opinions, and made-for-litigation conclusions that belie everything that you read in their documents. Let me give you just one example. Let's talk about their made-for-litigation efficiencies report.

Originally, when this deal was proposed, and as in all deals, the investment bankers were brought in. And the investment bankers are there to give an opinion as to the ratio, the price that is being paid for the company. Staples is paying a price for Office Depot, and the board of directors is analyzing is this a reasonable price to pay for this company. And Goldman Sachs comes in and they are given estimates from management what the cost savings will be as a result of the transaction. And Goldman Sachs dutifully reports what management's estimates are. And the Board of Directors relies on that report and say the ratio will be whatever the ratio is. They pick a price for the company, that they are willing to spend for their shareholders' money for this company, based on that report.

After the board decides to approve the terms of the transaction and the price, the FTC sends out an investigative letter. And the parties are now on notice that this transaction is going to be scrutinized. When they get on notice that the transaction will be scrutinized, they move into high gear. Their lawyers tell them, you know, efficiencies are really important. It will make a difference. It could possibly make a difference what your cost savings are, what the size of these cost savings are. So they go to work and they come up with a binder this thick of numbers, numbers and numbers and numbers. The binder full of numbers, though, doesn't tie into any of their business records. The one thing it does do, though, it comes up with this huge number as a bottom line. The huge number is based on an assumption piled on an assumption, piled on an estimate, piled on a guess. And they come in with this huge number at the bottom line.

But a week after they come up with that number -- actually that number is five times the number on the Goldman Sachs report. A week or two after they come up with this number, the companies are required to file with the Securities and Exchange Commission. And of course they are required to tell the truth to the Securities and Exchange Commission, because there is serious liability if you don't. And when they go to the Securities and Exchange Commission they don't rely on the binder full of numbers. They go back to the Goldman Sachs report. And they tell the FTC and they tell the investment community that the management's best estimate of the efficiencies is the number one-fifth smaller that appeared in the original Goldman Sachs report.

Here is a copy of the filing with the Securities and Exchange Commission. And here is the statement that says that the Goldman Sachs -- that the management estimate reflected in the Goldman Sachs report reflects the best currently available estimates of management as to what the cost savings are likely to be from this deal. So what they are saying in this litigation is the cost savings are going to be 3 billion dollars for what they told the Securities and Exchange Commission is 688 million, about one-fifth the amount.

This is the kind of made-for-litigation document that the parties are going to request that the Court will rely on. And the parties are going to say the Court, on behalf of consumers, ought to accept the risk that the big number is never realized. The consumers ought to pay the price if they fail to realize that goal of 3 billion dollars in savings. Because if they fail to realize that goal of 3 billion dollars, consumers will end up paying higher and higher prices. If they do meet it, we will show that number is not big enough to counteract the anti-competitive effect of this transaction. They will ask the Court to rely on that number, even though they themselves are not able to be put at risk by telling the investment community to rely on it with the consequences that flow from that kind of a representation.

Your Honor, the Federal Trade Commission has one overwhelming advantage in this case, and that advantage is we have the evidence out of these companies' files. We have their documents. We have their pricing data, which establish beyond debate the ultimate question in every merger case; can these firms raise prices where they don't face competition? And because we have that advantage, all of the charts and all of the fancy video presentations that we are going to see are likely not going to address that point. But that is the central question and that is why we are here today.

Your Honor, I would be happy to answer any questions that you might have at this time.

THE COURT: Now, not in opening statement. I think that I will wait as we go along in the case and when we get to closing arguments and I have heard all of the evidence for both sides.

Are you finished, Mr. Cary?

MR. CARY: Yes.

THE COURT: Thank you very much for the efficient and comprehensive opening statement. What I will do, and I don't want to disrupt the audience here, but I will give my reporter about a two-minute break to make sure she is on-line. And we will come back and start up with the opening statement of the Office Depot and Staples group. So, I will take a short recess.

The rule is, on the public audience, if you would leave your seat you lose it. So we will not be gone long. The press can leave and come back. We will take a break for, we will say, five minutes and be right back. All right.

(Brief recess)

THE COURT: All right. Everybody get back in place. We will be ready to go with the opening statements on behalf of Office Depot and Staples by Mr. Kempf.

MR. KEMPF: Your Honor, I have a set of the documents we will be referring to. I think they will also be on your screen up there. It gives you the option of looking at it that way or this way. If they are hard to read you can always read this. I have a set for the Government as well. And my colleague, Mr. Smith -- assisted by Mr. Prentice, the fellow wandering around behind over there -- will be the fellow helping with the charts. I made a number of them on cards. For all of our whiz-bang stuff, I am a low-tech kind of guy. In fact, I have an easel with a black felt-tip. We have some stuff made up and some other things and they will be helping me to walk through, since there is quite a bit.

THE COURT: All right, fine.

MR. KEMPF: Okay. Let there be no doubt that Staples/Office Depot merger will bring about increased competition, not lessened competition. It will bring about lower prices, not higher prices. And the increased competition and the lower prices will not be limited to the FTC's 42 cities or to just consumable office supplies; they will extend to every city in America and to every product the new company sells. All office supplies, business machines, office furniture, computers, you name it.

Good morning, Your Honor, and may it please the Court. Let me put some meat on those bones.

Staples and Office Depot, and more importantly the combined company, have as their first commandment the proposition that their success depends upon continuously seeking to increase volume, to get constantly higher and higher volume by decreasing the prices they charge the customers. That is bedrock, Your Honor. Now, in a landmark speech that was given in 1990 a fellow by the name of Stephen Mandel -- and you will be seeing him; he will be one of our witnesses, Your Honor. 1990, not a litigation-driven document, a speech that he gave in 1990, he talked about something that he coined the phrase for, the productivity loop. This is a page out of his exhibit. You can see it over here. This is actually from the 1990 speech he gave in London.

And he talked about -- this was the time when the Wal-Marts of the world and the Toys "R" Us were also exploding onto the scene, the category killers, that would take some specialty or group of specialties and drive prices. And consumers were starting to flock to their stores. He gave what is really the seminal analysis of what was going on, and he coined the phrase for the productivity loop. Mr. Cary referred to it and it is in a lot of declarations. You will hear witnesses refer to it. It is standard terminology in retail today.

What it talks about is superior execution driving it. What it talks about is getting a lower cost structure that enables you to charge lower prices. That will drive higher sales. The higher sales will enable you to go back to your suppliers and get still lower costs, and that will enable you to drive lower prices; and so the cycle keeps repeating itself. That productivity loop and the fundamental reality of it is why the last decade these two fine companies, Staples and Office Depot have been able to deliver lower prices. It didn't all fall down in the bar that Mr. Cary had up there, one day. They came in and they lowered prices and they lowered it again and lowered it again. And they did it in every single market in America, Your Honor, whether it was one competing firm, two, three, or zero.

Let's go back to the beginning. For Staples it all began and the whole office superstore concept began in Hartford, Connecticut, in 1985. Tom Stemberg, the fellow in the corner with the blue shirt on, he had just been fired. Ironically, he was fired because he was a little too aggressive, and the company he was with said, Maybe we can do without him. A little too innovative. He came up with some ideas that they said, Well, maybe their time has not come yet. He was sitting around and unemployed, and he maps out on his kitchen table an idea where he is going to go next.

And he, with a fellow that ended up being his financial backer, on Friday afternoons, they would drive around looking for things that might work. And what he finally fixed on was the idea of a store that would focus on the sale of office products. And at his kitchen table he maps out the business plan for that company. It is in the evidence, that DX 1909. And let me read one passage from it. This was at time when there was zero firm markets everywhere in America. There was not an office superstore anywhere. This is an imaginary office superstore he was talking about when he writes these words, "Staples, the office superstore, will be a chain of deep discount office products stores employing mass merchandising techniques. The Staples concept uses the buying leverage of the relatively new wholesale clubs to produce a retailing vehicle able to maintain attractive margins while selling office products to small white-collar businesses at prices 37 to 50 percent below the alternative channels."

Your Honor, that has been the guiding philosophy both for Staples and for Office Depot; which, like Staples, opened its first store in 1986, ever since. This high volume, low price, core productivity loop business strategy continues straight through to the day of the merger, Your Honor. That message that was sent out on the day of the merger was loud and clear. It was printed on a banner on the podium when they announced it. It is in this photograph right here. This is Mr. Stemberg up in corporate headquarters in Massachusetts announcing the merger to the people who were all gathered there. And the banner behind him said it all, "Save even more." We actually have that banner from the first day in the courtroom.

Do you guys have it over there?

When they announced the merger, before they met any of the lawyers who are here at this courtroom, they knew what they were about. The purpose of the merger is to save even more. That banner and that message reflect the reality that this merger will indeed lower prices. And how is it going to do that? It is going to do it through huge merger-specific efficiencies from the merger that will allow the company, the combined company, to move to a whole new plateau of dramatic cost savings that will be passed on, passed on under the productivity loop we talked about before.

As they get the higher volume -- we are combining here two companies, one of which has 6 billion in sales. The other has 4 billion in sales. Combined, they move to the higher sales level of 10 billion dollars. That in turn enables them to back and get lower costs and provide lower prices. That is how it is done. It is not something -- it is not generosity or a promise or anything like that. It is the way that the business works, and it is required to work that way under the fundamental business principles of the productivity loop.

Now, to make sure that that message got out, the two companies also launched a joint advertising campaign, expressly committing to their customers from coast to coast that they would receive lower prices. They wanted everybody out there to know that that is what this transaction is about. And so they launched an advertising campaign, as I say, from coast to coast in a series of ads. We had one printed on our brief. This is a different one, and that is DX 24, Your Honor. But the message is the same for all. The message to all of them is the same. The new lower costs derived from the new greater efficiencies will translate for you, our customers, into lower prices.

These Defendants, Your Honor, will not disappoint. They will deliver those lower prices to the American consumer. And as I say, they will do so not because, as the FTC likes to say we are claiming, because we have good intentions, because we are generous, because we are beneficent, they will do it because the productivity loop mandates that they do it. It is what they have always done, it is what they do now, it is what they always do. It is, in short, what they must do. Now, that business reality is confirmed out there every day in the real world that this is what drives them.

If you go home tonight, Judge, and turn on the television set, this is the kind of thing you are apt to see there.

(Tape played. Reporting waived by counsel.)

Your Honor, if you were inspired by that TV commercial to go out and look for lower prices, and you say, you know, "I think I will check over at Depot and see what they can do on one of those items I saw in the ad," and you call over there and the guy says, "Sure, I will check on that for you." And he puts you on hold when he goes to check the low prices, this is what you hear on their hold message.

(Tape played. Reporting waived by counsel.)

Your Honor, this is not litigation rhetoric, this is the way they operate in the real world every day, day in and day out. The notion that, after merging, Staples and Office Depot as a combined company would suddenly reverse field, do a complete about-face and pursue a strategy of higher prices and a lower volume is not only wrong, it is unthinkable. And make no mistake about it, Your Honor, you cannot charge higher prices without having your volume shrink.

As the Nobel laureate and economist George Steigler once put it, consumers invariably obey one law as universal as any in social life, they buy less of a thing when its price rises. So a strategy that says, Let's raise our prices -- to look to some of Mr. Cary's charts -- 10, 15 percent, what that will do is it will drive away customers in droves. It will reverse the flow of customers from coming into the store to going out of the store.

Now, during his remarks this morning, Mr. Cary talked about how the past is a good indicator of the future. Well, Your Honor, these companies have a 10-year track record. It's a uniform history, a past as it were of consuming ever higher volume through ever-lower prices. That is the formula to enable them to achieve spectacular success for themselves and for the consumers.

Before I turn to the facts, Your Honor, I want to spend a little bit of time reviewing some of the principles of law. Let me start with product market definition. In its brief the FTC says that they agree with us that market definition is not an end to itself. But that is really where we part company, because they are wrong when they go on to suggest that therefore it makes no difference if they have it wrong. And quite the contrary, market definition is very important. And the reason it is important is that it helps you to assess the merger's likely competitive effects.

Their own merger guidelines expressly provide that the very first step in merger analysis is -- and let me quote it -- "to define the relevant product market." That is where they fall off the track, Your Honor, right at the first turn. The reason, of course, is that their product market definition is a contrivance.

A wise non-lawyer friend of mine, when I was discussing the case with him, said something that rang true. He said -- you know, I was telling him what their product market definition is. He said that that product market definition, "the sale of consumable office supplies through office supply superstores," he said it has too many words in it to be a real market. The purpose of their tortured market definition, Your Honor, is to generate high HHI numbers. Those are concentration numbers, the so-called Hirschman-Herfindahl index.

Herfindahl-Hirschman, a couple of economists. They had not been heard of until the early '80s. They had a different test and someone said, Hey, this is a different whiz-bang test. We will calculate HHI numbers. We will square market shares and do some equations to see how they fit in. And the reason they have defined the market the way they have, the way they have done it, it is the old game. Let's generate high numbers and then it will show that the market is concentrated and the merger is troublesome.

Well, it is well to bear in mind, when looking at that exercise, the Supreme Court's admonition in its landmark decision in the General Dynamics case. That was a case cited in 1974. It is really the last major horizontal merger case that the Supreme Court decided. There the Supreme Court cautioned -- their word, not mine. Cautioned that, and let me quote it for you. It says: Statistical data, quote, are not conclusive indicators of anti-competitive effects. Only a further examination of the particular market, its structure -- remember, Mr. Cary earlier said you can skip the structure. We have that, you can skip it.

Supreme Court didn't say that. They said: Only a further examination of the particular market, its structure, history, and probable future can provide the appropriate setting for judging the likely competitive effects of a merger.

That is the merger law, Your Honor. Not the guidelines, not what he says, not what I said. That is the Supreme Court.

Your Honor, the decisive and determinative facts here are not going to change one iota whether the label for the product market is consumable office supplies, office supplies or chicken soup. Let me illustrate the point, Your Honor, by again referring to the General Dynamics case itself. That case concerned a merger of two coal companies. The product market debate went like this: Do these two companies have over 23 percent of the coal market or do they have less than 2 percent of the energy market? One sounds high. The other sounds low. One sounds troublesome, the other sounds comforting. What we said to the Court there, we say to the Court here. More important than the labels for the particular market are its structure, history and probable future. When you look at those, we said there and we say here, then it will be clear that the merger poses no threat to competition.

The Defendants in General Dynamics pointed out that coal is not sold in wheelbarrows anymore. It is sold by dedicated mines that ship it to a power plant. And the competition when that power plant is being built is intense. Will it be a coal-fired plant, a nuclear plant? Will air pollution concerns cause it to be gas-powered or oil-fueled?

So we said there as we say here, the broader context is the most appropriate way to look at it. But the underlying facts of the intense competitive rivalry at issue there and here is not going to change depending upon the particular label you give to the market.

Now, Judge Robeson, in deciding that case at the District Court level, recognized that. He found the appropriate product market encompassed a variety of fuels and not just coal. But went beyond that. And he emphasized, as I have argued here today, that the facts are the facts and those facts don't change because of some label applied to them. He went on to find also that even though he defined the product market definition in the broader context, even were he to define it in the narrower context of coal only, the merger transaction before him in that case would not run afoul of Section 7, because of the same underlying facts that would not change regardless of the label.

When it got up to the Supreme Court, they affirmed. And in affirming they stated as follows, confirming that Judge Robeson's approach served him and consumers as well. "By concluding that divestiture would not benefit competition, even were the Court to accept the Government's, the unrealistic product, the District Court rendered superfluous its further determinations that the Government also erred in its choice of relevant markets."

In other words, he said, "The Government has it wrong. I see it this way, but I will look at it both ways." When it got to the Supreme Court, the Government said, "Oh, he made a mistake." The Supreme Court said, "So what? He looked at it both ways. The underlying facts didn't change, and he was comfortable whichever way he looked at it."

To sum up on this issue, Your Honor, we believe that the sensible way to assess the transaction before you is in the context of the broad marketplace for the sale of office products. But in the end, the facts are what they are, Your Honor, and the labels won't change them. And it is those inescapable facts, not labels, that prove that this proposed transaction poses no threat to competition in the sale of office products, in the sale of office products -- in the sale of consumable office supplies sold through office supply superstores, or in any product market under the sun.

Now, against that legal background, let me turn to the facts regarding product market definition and regarding the whole issue of the sale of office supplies and how competitive it is.

The reality is this, Your Honor. There is a multitude of competitors out there in the marketplace every day competing like crazy for the consumers' dollar that he allocates to the buying of office supplies. And I have some of them on his chart over here. It shows they face a multitude of different kinds. They have -- some people buy manufacturer direct, like Dell and Gateway; mail-order. And I'm going to talk more about these, as you'll recall Mr. Cary did as well. Quill, Viking, Reliable and a whole bunch of others -- including Defendants here, who have all now gone into selling mail-order themselves.

Remember when we heard Mr. Lapinski last week, we took his two receipts. And he was one of their consumers that said, "You can't look to those people." He only gave us two receipts. Both of them, he did it the way they said you can't do it. Mr. Cary said that is not a realistic way, but the only two receipts we got from him show he did it the unrealistic way. In any event, those people are over here.

The Internet, explosive. That is the newest and latest and it's another highly aggressive marketplace. Retailers, ourselves, OfficeMax -- and then we do have a bunch of other ones that he talked about this morning, that I want to talk about these at some length this morning. And many of these people have turned in declarations and some of them will be witnesses, Your Honor, as well as people over here in this column. And there is dealers and contract stationers who business can turn to as well.

The consumer is in the middle, and he can look to all of these places. And there is no restraint on him that says, no, no, no, you can't do that. As we will see this morning, not only can they do that, they do do it. What the Government says, and Mr. Cary said it again this morning, is that all of the competitors other than OfficeMax and the two superstores, Staples and Office Depot, they all compete in a different way. They are different from the others, so you can just ignore all of them and concentrate on those three.

But, Your Honor, the fact that these people all are trying to get the consumers' dollars in different ways; one offering delivery; another one saying, you know, we will do your tax records for you; another one saying, we will do inventory control; all of the different ways they go about competing is the very essence of competition, Your Honor. That is not an absence of competition. That is what competition is all about. It is the essence, not the absence of it.

Let's go through them a little bit. They say for the mass merchandisers like Wal-Mart, the consumer electronic stores like Best Buy, the computer stores like CompUSA. They all sell fewer SKUs. SKUs is a Stock Keeping Unit. Here are two SKUs, a red felt-tip pen and a blue felt-tip pen. Each one a little different. They give it a different so-called SKU number, Stock Keeping Unit number. And they say, these folks, they sell less SKUs than the office superstores do, so you can forget about them.

There is a long standing rule of thumb in retailing, Your Honor. When I cross-examined their expert, he knew it without me even asking him. And one of our witnesses, our expert witness from retailing, Mr. Siegel, will tell you about it. It is called the 80/20 ruling. What that says is 80 percent of your revenues come from 20 percent of your products. Now, when he was deposed, the witness from Sam's Club, said, Gee, when it comes to office supplies, I would say it is more like a 95/5 rule. And you will see that deposition, Your Honor, because we took it on videotape and we will have some excerpts we will be showing you.

And what he meant by that, and as he testified, is the SKUs we carry, you're right, there is a lot less of them. But guess what, it is the heart of their business. It is the 95/5 rule. Do we compete with them? You bet we do. We picked out the key items they sell the most of. And remember when Mr. Cary was up here and he said, Let me tell you what consumer office supplies are. They are things like pens and pads and Post-its. And he is right. If he gave you a list of 10 or 15 more, as they do in their interrogatories to us, when they say, "Here is generally what we mean," that is generally what all of these people have.

They don't -- what one -- the way we try to get them into the store is we offer a bigger number of SKUs. And we say, we hope that that gets them there, and while they are there, they buy what is the 95 percent. Other people offer different kind of things. They try to compete in different ways.

Wal-Mart -- Mr. Cary talked about one-stop shopping and the convenience that provides. Wal-Mart has a bigger store. You can one-stop shop there for a lot more than you can one-stop shop in our place. And so they, they say we are more convenient for your one-stop.

The mail-order people, what they say is, Guess what we have got for you? We have got zero-stop shopping. You can take a look at our catalog at home, and you can call it and we will deliver it to your front doors.

Now, some people like to kick the tires. Some people want to go in and pick it out for themselves. Other people say no. My time, or time value for me is much better to not get in my car and drive over somewhere. I would rather stay at home and spend less time looking at a catalog and order it that way.

Wal-Mart. Wal-Mart in his article under productivity loop -- which as I say was early on. Another phrase that Mr. Mandel coined was he referred to Wal-Mart as the silent killer. And what he said was, you know, Wal-Mart sneaks up on everybody. They don't -- people don't view them as their traditional competition. They view them as -- to go to the charts there. They are non-competitive. And so what Wal-Mart does is, while everybody is sleeping, they sneak up on you and they steal away your sales. And their sales now are 100 billion dollars. I noticed a month or so ago the new Fortune 500 came out, and they are the fourth-largest company in America now. They have over -- 100 billion dollars in sales. And of course, with that, they have huge buying power and they have been able rather dramatically to increase their participation in the competitive arena for the sale of office supplies. And not only that, but they are accelerating it. They are adding to it all the time.

In a sort of superstore of superstores, the way that you can do that pretty easily, you just change the allocation of your shelf space. If something is moving well and you are making good money on it and somebody else raises their prices and you want to take their business away, you just add a few more shelves and put some signs and advertisements out and tell people to come into the store. And if anyone who suggests that Wal-Mart is not a factor, whether it it's George Cary here or Tom Stemberg a month or two before the merger, is wrong. They are just wrong. And you will be hearing testimony from a number of witnesses that will tell you that, including the witnesses from Wal-Mart. We, as I said, have some videotapes of them.

Now, you will be hearing declarations and live testimony from a variety of other competitors, Your Honor, recognizing not only the power of Wal-Mart in the office supply competitive arena, but who see themselves -- unlike the way the FTC sees them -- as very effective competitors to these companies and for everyone else in the sale of office supplies.

The FTC says that you can also ignore the traditional retailer. They are ancient history according to the FTC. Well, many have fallen by the wayside, Your Honor, but others are competing today harder than ever. Collectively, they still account for more sales of office supplies than any other channel of distribution in the country. And they are trying to compete, as I say, even harder today than they have in the past.

They are doing that for a variety of ways. One way, they form buying groups. And they say, Let's get together, all join a buying group so we can get some of the efficiencies that that productivity loop is talking about. Maybe we can take a ride on that as well. What we will do, we will band together. We will form a buying group. Instead of 100, 200, 300 stores on their own, suddenly we will have three or 400 of us buying together and we can get some of these same efficiencies.

They have a hard time on this side of the room seeing those efficiencies. People that do this for a living don't.

Another thing they have done, and this is another witness that you will be hearing, they have formed together in a different way. One of our witnesses is a fellow named Jonathan Ledecky. He is the fellow who is -- we have a chart of this one -- yes, U.S. Office Products, Mr. Ledecky's company. About a month ago I was reading an article in the Washington Post that said his company, U.S. Office Products Company, is the fastest growing company in the Washington, D.C., area. They were founded in 1994, and right now this year they will have sales of over 3 billion dollars.

Can't enter? Nobody apparently told him that.

Can't compete in the sale of office supplies against these other people? Nobody told him that. What he did, he went out and competed like crazy. And what he did, he came up with a good concept. He said I will go around to these individual stores and we will acquire them in exchange for the company stock. And we will get a company that is comprised of these people that are ancient history and we will go out and grow our sales, and when we do that we will get some buying power and we will be able to kick some butt in the marketplace, as it were.

Now, there are some other people that have not gotten the word yet, either, Your Honor. And if you take a trip up to Boston, you rent a car at the airport and you turn on the radio, here's the kind of thing you will hear in Boston.

(Tape played. Reporting waived by counsel.)

Let me show you a couple of others, Your Honor, because the story repeats itself over and over again, these people that can't compete with us.

If you take a trip to New Orleans, this is the kind of truck that passes you on the street. It is a local area and they have a big sign on the side of it, the name of the company, Warehouse Express down in New Orleans, Louisiana. And what they have on the side of their truck is a big sign, "We beat Office Depot prices, guaranteed."

And let me show you another one, Your Honor. A friend of mine sent this to me last weekend. Did I submit it late? You bet I did. He took a trip up -- he is a lawyer in New York City. He lives up in Greenwich. He knows I am involved in the case. He went out over the weekend to a place he shops for office supplies, the Marks Brothers stationers, a local place, in Greenwich, Connecticut. And this is what he picked up. Compare our prices. They have a list of products, a list of our price, and the list of Staples prices something that they can't compete against. And at the bottom it says you can save 17.58 if you buy at Marks Brothers Stationers.

Your Honor, none of these people have gotten the word that they can't compete against Staples and Office Depot. So in their ignorance, what they do, if they go out and compete like gangbusters every single day.

There is another group, a big group that has not gotten the word that none of these other channels of distribution are competitive against the office superstores. It is the people who work over at the FTC; not the bigwigs, the people down in the administration trenches, the people that buy the office supplies for the FTC.

One of the things we did in the burdensome discovery we served on them, is we said, "Tell us where you folks buy your office supplies." And this is the list we got back from them. There is 100 names, plus, on here. What is the total we came up to? 105 different suppliers. These are the people to who they need to send a message. Not from the chairman. I think the people that work in the supply room need to send a message to the chairman that says, you know, I think you may have a little something wrong here. We buy our office supplies at 105 different places.

And let me tell you one other thing, Your Honor. When we did this chart, we put a label on here, where the FTC buys consumable office supplies. I said to the young people who were working on this, let's not include anything except consumable office supplies. Let's use their definition. The rest of it, forget about it. What that meant, Your Honor, if you look here under the K's, Kmart is not on this list. The reason it is not on this list is because Mr. Broyles -- he's the fellow in the second chair there -- last August 21st, said, "I think I need a lamp for my office. Where can I get to get that office supply?" He took a trip to Kmart and bought it there. Because it is not a consumable one, we left it off the list. It is a conservative list.

Your Honor, the air of unreality that drives the FTC's product market definition is pervasive throughout its papers. In their reply brief they have a passage. Let me quote it to Your Honor. It says: When a consumer wants to shop for a wide variety of office supplies and wants to compare alternatives, a mass merchandiser with limited merchandise is not an effective substitute for an office superstore.

It may or may not be true, but it is meaningless. And the reason it's meaningless is that the customer they are describing is a one-in-10,000 or one-in-50,000 customer. The typical customer doesn't pull up in a van and take away 500 SKUs. The typical customer, and we have evidence of this already in the record from both companies, buys between three to five items and he spends between 25 and $50.

Now, maybe the rarer person who pulls up in a van, the superstores could charge higher prices to. This person that says, Gee, if I go to Wal-Mart I can't get everything. If I retire tomorrow and I want to open up an office in my home, I could go to the superstore and get everything for it. Although, what I would probably do, so I wouldn't have to lug it around, instead I would go over to Viking and Quill and make a phone call and have it delivered to the house. If I wanted to I could rent a van and go to Staples or Depot or Max and I could get more than I could get at Best Buy or CompUSA or a lot of other places. But that is the rare customer.

The typical customer is a different customer. He buys three to five items and spends under $50. People don't walk through the front door with a bar code on their forehead or a computer chip there that tells us, hey, here is a customer who wants a whole bunch of stuff. You can charge him more because he can't get all that stuff at Wal-Mart. And neither do they come in with a bar code that tells us whether they are the kind of person that says, you know, I am always going to shop at OfficeMax. I will always shop at a superstore and I won't go to Wal-Mart. We don't know as they come in and greet us, because we can't bar code read their forehead, what kind of shopper they are.

And so what these companies do, is what every retailer in America does. They price to the marginal shopper. They have to figure that the person who is coming in the front door, since they don't know who he is, may be a person who comparison shops. He may be a person who is not to fill up their whole office, but the more typical customer who is a person who is just looking for a few items. They don't have an ability to say, We will divide the store in half. And the people who are in a van or don't comparison shop, we will send them to the left side of the store where we have the high prices. And for people who want just a few items or who are comparison shoppers, we will send them over to the right side of the store where we have the lower prices. It doesn't work that way, Your Honor.

And let me comment on one other thing on this subject. It is the price, price, price conversation.

Consumers seek value. Value is the catchall they seek. And that is comprised not of one item, like price; it is comprised of a bundle of items. Value includes delivery. It includes convenience, it includes the breadth of selection. And different customers value that bundle differently and they also individually value it different over time. And every form of distribution and competition as they strive to capture that consumers' office supply dollar is always increasing the level of competition.

They do it -- we talked about adding delivery. Let's go backwards in time. 10 years ago, if you wanted delivery, it would take you a week, maybe. Now it is overnight. And in the Washington area here, they have a rule that if you get the order in by 11:00 they will get it to you at 5:00. Same-day delivery now. They are not only competing in different ways, each of them is improving all the time. And when our clients, Staples and Office Depot, set out about dramatically lowering prices, guess what, these other people follow. They don't stand still; they would lose business. They know they're in a competitive horse race. There is action and reaction, and it is all going to value in a variety of ways. Now, while they may not get it, the consumers do and so do competitors.

One of the things that I did when I took their expert's deposition last week, I asked their expert, "What about the views of consumers?" And this is what he said: Consumer opinion, I think that any merger investigation, the position of informed customers and the views of informed customers are something one should look at.

Well, Your Honor, here is there is an abundance of informed consumer evidence. Thanks to the Internet site, we have the benefit of going through a lot of thoughtful emails from individual competitors. I am sure Your Honor remembers that discussion we had with you early on in the case. Those people are not a bunch of yahoos, Your Honor, and they took the time and the trouble to sit down and send the FTC their views when the FTC said, We want to open up an Internet. We already counted them up, and overwhelmingly they support the transaction. We went through and I would like to read a portion of one of those emails to you. It is from an individual consumer who took the time to let the FTC know what his views are. He thought this was a good transaction. I will read it to you. It is from the DX 1072, a long one. I will read the highlighted part, Your Honor.

"My name is George Scalla. I am the retired CEO of Leach Maring, a Boston-based low margin hard-lined superstore retail chain which, when I retired, was doing about a billion dollars worth of business in New England from 30-plus superstores. With all due respect and humility, I would like to give you a dose of retail reality. The net effect of this merger will result in lower prices for our nation's consumers of products. Why? The retailer who ultimately wins is the low-cost operator. The low-cost operator gets to that position not only by managing expenses effectively but also through purchasing efficiency, which is almost always brought about by economies of scale. In this case, Staples will be able to get better merchandise costs as a result of their consolidated buying power. These lower costs will enable them to lower their margins so that their retails will indeed be among the best in the marketplace for the products which they sell. The American consuming public will benefit from this merger."

Now, that is the kind of thoughtful response the website elicited. The other consumers took time to write letters to our executives, encouraging them not to knuckle under and to fight the FTC on behalf of this transaction. I want to take a moment to read just one of them. It is addressed to Tom Stemberg, Staples' CEO. That comes from a 13-year-old boy in Florida. And there is more practical wisdom in this young man's letter than anything we have seen out of the FTC. Let me read portions of this to Your Honor.

"Dear Mr. Stemberg" -- this is from a 13-year-old kid.

"I saw you on TV Friday and it seemed to me that you were the only person more angry than me. I am 13 years old and my grandfather lends me money to buy stocks. I thought Office Depot was a cool store. Also, my aunt worked there and she was always working very hard and late. This is what the whole business was like and so I thought this would be a great buy. I thought it was going to be even better when I found out that Staples and Office Depot were going to merge. But after I saw the closing Friday, and heard how the Government stopped the deal, I couldn't believe it. I am now $600 in debt."

We are going to come back when we talk about the equities and talk about that, not in terms of this young man, but in terms of all of the shareholders. Who do these FTC people think they are? They talk about how prices are lower for office supplies in cities who have more competition. They say that as if there is no other place to buy these products. You can buy the same office supplies, though maybe not with purple and yellow polka dots, at Wal-Mart, Publix, Costco, Kmart, Winn-Dixie, Egghead, Toys "R" Us, K-Bee toys, et cetera. This is his closing line.

"I hope you don't give up and battle this all the way. Good luck. Sincerely, Matt Scanlan."

Let me contrast that evidence, Your Honor -- that real world evidence, with the FTC's case. If they can make a movie about this case, they would call it The Incredible Shrinking Witness List. The plot goes like this. They start off on April 10th and they give you about 40 declarations from consumers, suppliers and competitors. The next thing we get from them, and we had to goad them into getting this, is their tentative witness list. This is their all-star line up, the best supposed of the best. And on it we find 30 -- excuse me, 20 -- more than 20. I think it is 21 of these Third-Party witnesses. Next up was their revised witness list, and that cut it down to just under 15 of the Third Parties. A week ago today, we got their final witness list. Now, they were down to six. Then, over the weekend, we got their revised final witness list, which shows that the FTC will call at most only three Third Parties.

We know those witnesses, Your Honor. We deposed one of them and have declarations from two of the others. Mr. Edwards of Kmart will testify that he certainly has no basis to give any opinion that a combined Staples/Office Depot would raise prices after the merger. We know that because that is what he said in his deposition. Mr. Edwards will also tell us when he goes to office supply vendors he insists that Kmart get the same price for its supplies as Staples and Depot get. And if the two companies, the combined company were able to get lower cost from vendors as a result of the merger, he will insist on those same savings for Kmart. Savings he will tell you that Kmart can pass on to customers in the form of lower prices if it chose to do so.

Mr. Gellman of Computer City, the second one that remains on the list. He will provide even stronger testimony on this subject of efficiencies that Mr. Cary is, oh, so skeptical about. He will tell the Court from up there on the witness stand, if they call him, what he has already testified to and is in evidence by way of his declaration. Based on his experience, the merged company -- let me quote it to you -- should be able to negotiate greater discounts from their suppliers and they could pass those savings on to consumers. We know he will say that because he has already said it. Mr. Gellman will, I am sure, go on to tell us that when the FTC sent him the declaration they drafted for him, it stated that Computer City had no intention of expanding its line of office supplies, but that he wrote in by hand next to it the phrase "at this time." And that he did that to emphasize that in today's dynamically changing marketplace, business plans can and must change to meet the demands of the marketplace.

And he will testify in fact further, that after he executed the FTC's declaration he added a new line of office supplies that he picked up from Avery. And that even now his company is reviewing the possibility of expanding that line further in the future. And most importantly, he would not foreclose a decision to expand the selection of office supplies sold through his company to meet the needs of home and small office companies.

Finally, the only other witness list, the witness on their list that they say that they still might call live is Mr. Atkinson of BJ's Wholesale Club. And he will testify that he certainly considers the office supply superstore a competitor of BJ's in the sale of office supplies to home office and small office business customers. And that accordingly, BJ price-checks against the superstores. Mr. Atkinson will go on to testify that he would consider expanding BJ's office supply products if a combined Staples/Office Depot increased its prices, including through an expansion of shelf-space that I talked about a moment ago that BJ's presently allocates to office supplies. He would welcome the opportunity to take customers away from Staples and Office Depot.

There is, of course, Your Honor, a reason why the FTC shrunk the witness list. It is no mystery why these people vanished. After we were provided the long list, we went out and talked to the people on the long list, the 40 declarants. Mr. Cary says, Oh, they did so much. They went out and talked to people -- of course we did. We are the Defendants. In my country you get a chance to defend yourself when the Government sues you. And am I bashful or ashamed we went out and talked to all of these people? I am proud of it. When we did, like Paul Harvey says, we got the rest of the story. We did something else, Your Honor. We secured declarations from those people and those are now in evidence.

Now, in our interviews, one of the things that was most revealing to us when we talked with the declarants is what the FTC didn't ask them. Because the FTC didn't want to know about it. I will read to you from one declaration we secured. It is from the CEO of OfficeMax, whose name is Michael Feuer, he was on FTC's final witness list we got last week and he was just dropped over the weekend. The declaration he provided is 19 pages long. The good news is I won't read all 19 pages, but let me read a portion to you.

He says -- I am quoting from it throughout. "I understand that one of the issues that the FTC considers significant is whether substantial efficiencies will derive from the merger of Staples and Office Depot. I believe the efficiencies derived from the merger and the resulting price competitiveness of the combined entity will be substantial. OfficeMax's own history is a classic study in the efficiencies and price reductions that can occur through wise acquisitions and mergers. We have made four strategic acquisitions of other office products superstores since 1990, adding a total of 158 stores to our chain. The larger the chain OfficeMax acquired, the more efficiencies we derived and the more price competitive we became. That was the case because a superstore's productivity loop creates a direct correlation between size and price decreases. In my prior declaration" -- that is the one he gave the FTC.

"In my prior declaration provided to the FTC I was not asked specifically to address the question of what impact I thought the merger of Staples and Office Depot would have on prices. For the reasons outlined above, I believe that Staples/Office Depot is likely to lower prices as a result of the merger."

Now, when Mr. Cary was up here he was talking about an analysts report. He said, you know, competitors, if they like it, that is a tip off it is anti-competitive. He said OfficeMax loves this deal. There is a reason OfficeMax loves this deal, and it is not the sinister one Mr. Cary would have you believe. It is what Mr. Feuer states right in his affidavit, and you will hear the same story from countless declarations and from people up on that witness stand. It's called dynamic efficiencies. What happens is when our clients get these efficiencies, let's spell it out.

They go over to the producer and they say, we are not a couple of 5 or 6 billion dollar companies, we are a 10-billion-dollar company. And our companies overlap less than 50 percent right now. That's Mr. Cary's number, 46 percent. He said most of the companies don't overlap. They are in different areas. What they do is, they round out the country and it enables them to become for the first time a true nationwide competitor. They now have 10 billion dollars, and with 10 billion dollars and a true nationwide setup they can do national advertising for the first time. They can get improved distribution.

They can go to these people and say, Look, we can figure out a way with this huge amount we will be buying from you to make it a win/win situation. Not just a question of beating up on somebody and saying, I am buying more stuff, I demand lower prices. It is sitting down and working with them, saying, "We will be buying a lot more here. Maybe we can figure out a way to do this better. We can give you lower prices. Consumers can get lower prices and we can make out in the process as well."

What happens is the same productivity loop story, and you will hear that from a number of witnesses. Let me get back to what Mr. Feuer said in his declaration, because it is on that very subject. It explains why he and others like the deal and, most of all, consumers.

Along with the direct price impact caused by Staples and Office Depot cutting prices, there will be further efficiencies throughout the industry that will further decrease costs and price. Because Staples/Office Depot will have additional pricing leverage with suppliers, they will demand lower costs and, in my opinion, will get them. When they do so, I know that we will also demand the benefit of any such supplier price decreases, and I trust we will be treated equally. Others throughout the industry will expect likewise.

Let me pause for a minute. I just talked about Mr. Edwards from Kmart, and we already know that is what he will testify as well.

Back to Mr. Feuer. While I do not believe that Staples/Office Depot will engage in a round of pricing increase, if they did, OfficeMax would eat their lunch from coast to coast. Nothing would provide a greater competitive opportunity for OfficeMax than if Staples/Office Depot raised prices, especially by a margin like 5 or 10 percent. First, the entire corporate image and the ethos of Staples/Office Depot would be vulnerable. The two companies have spent 10 years advertising to the world that they are paragons of price cutting. Should the new entity start raising prices, the public would be rapidly and prominently informed of that fact, not just by OfficeMax, but by other competitors in the OfficeMax products arena. The tarnishing of the Staples/Office Depot image that that price boost would cause a major boon to other office products competitors. We would leverage it to the maximum advantage in every market.

Your Honor, Mr. Feuer's declaration is at DX 1788.

In the first brief that we filed with Your Honor back on April 11, we emphasized that the FTC staff, from the outset it sought to cook the books, is the word used on the evidentiary front. Let me emphasize in that regard that this is not just a simple situation where each side secures declarations that emphasize the evidence in the light most favorable to it. The FTC's principal declarations in the record here were not prepared after this case was filed. They were prepared earlier, during what has been referred to repeatedly on this side of the room as the impartial investigation that they did before deciding to file suit. We went out and talked to declarants, Your Honor, and what we found is the impartial investigation was neither impartial nor an investigation. Let's start with consumers.

The FTC staff got 15 or so consumers to execute boilerplate declarations drafted by the FTC lawyers that all told the same story on the surface. When we talked to the individual consumers, we heard a different story. In our brief and opposition we made a side-by-side comparison of the two declarations of consumer witness Cindy Callaway down in Tampa, Florida. A lot of our declarations come from their declarants. We have some we went out and got on our own. One of the things we did, we said, Let's take their "dec" and let's pressure-test it. One of the people we pressure-tested with was Cindy Callaway in Florida. This declaration they secured in their partial declaration, it echoed their party line.

Let's make a side-by-side comparison of Declaration 1 and Declaration No. 2. Start with the FTC's. This is back in February, two months before they filed this lawsuit. This is during their impartial investigation. They wanted to go to the commissioners and say, "Look at the evidence we got out there in the world as to what people's reactions are." And this is what the commissioners, these commissioners who ultimately on a three-to-two vote decided that they would challenge this transaction, they did so on the basis of the stuff that you got with the filing of the Complaint. They did it specifically on the basis of things like the Cindy Callaway declarations and similar ones from other consumers.

"My name is Cindy Callaway. I am providing this statement voluntarily to the FTC. I am business manager at Green Acre Properties located in Tampa, Florida. One of my responsibilities is to purchase office supplies for our office. I purchase -- she made a little change on her own here. "I purchase our local walk in and shop office supplies at the Staples store located near the office. Office Depot and Staples are direct competitors and they are the only two office supply superstores that I am aware of in Tampa."

Sounds like she has limited options here. Next paragraph.

"Office Depot and Staples offer the best combination of convenience, price and selection." Sounds like something I heard Mr. Cary say earlier today.

"Unlike other retailers that sell office supplies, I can purchase all of my office supply needs at the office supply superstores without having to go from store to store. Superstores' prices are also usually lower than other sellers of office supplies. Other retailers such as warehouse club stores, Kmart or Wal-Mart or Circuit City or Best Buy do not carry all of the items that I need."

Just to confirm the boilerplate nature of these, it's all the same list and all of the same locations.

"5. If the proposed merger of Staples and Office Depot eliminated Office Depot as a competitor, prices may increase at the remaining office supply superstore. If this happens I would continue to shop there because there are no satisfactory alternatives that would allow me the convenience of buying all of my office supplies at one store at a reasonable price."

It is pretty powerful stuff. So we went out and we said, let's go down and meet Ms. Callaway and talk to her and find out what the facts are. When we did that, we found out a little bit more. The rest of the story, as I said, from an old Paul Harvey news show.

First she says, "I am the same Cindy Callaway. I am the business manager of Green Acres Properties. I am the same person that provided the declaration of the FTC. As set forth in Paragraph 3 of my declaration, I purchase, quote, local walk in and shop office supplies." That is the portion that she had in pencil over here. When you read this by itself, that will leap out at you what there is, what all of that means. She explains it here.

"However, only 10 to 20 percent of my purchases are made at these stores. 80 to 90 percent of our office supply needs are purchased from Viking Office Supply." Teft has that here. Let me take this down for a second. Viking Office Supply is right over here, Your Honor. They are a mail-order firm. Their CEO will be one of our witnesses. They don't compete in this business and they are not an option consumers can look for. As it turns out, this consumer, one that they picked, gets 80 to 90 percent of her office supplies there.

Continuing on. "Based on my experience, Viking Office Supply is more convenient and is competitive in pricing with Staples and Office Depot and sometimes cheaper.

"4.. Office Depot and Staples are the most useful for purchasing unusual office supply items that you can't find at Sam's Club, Wal-Mart and Circuit City and Best Buy. If the prices are higher at Staples and Office Depot, I would buy the item from Viking, which also has a broad selection.

"5. There are many places in the Tampa Bay area to shop for general office supplies." Most telling of all, "It is a hotbed of competition."

Finally, she says, "When I was interviewed by the FTC, I was not aware that Staples had taken out an advertisement which states they intend to lower prices."

That is an ad like the one that we saw a minute ago, like this one right here.

"If the merger is approved, if this is true, I would favor a merger of Office Depot, Staples and Office Depot." There is a little more to the story, Your Honor.

Now, Ms. Callaway was not the only one who flipped on the FTC. There are others, and we have those declarations as well. We even have good evidence from people that would not talk to us. You remember Mr. Lapinski. I referred to him earlier. He was too busy to back-up his and declaration, and the only thing he gave us was two receipts. And as I said earlier, the two receipts prove the opposite of what he said in his declaration. When we were left to our own, I went back and said, "What else can we find out about Mr. Lapinski?" And turned out he had an account at Staples. So, we said, "Let's pull together what he has." This is kind of revealing. This is his -- from our accounting records, Mr. Lapinski's office purchases for last year and this year so far.

One of the things it shows is, again, these customers don't walk in and say, I am a consumable-office-supplies-sold-through-superstores customer. They come in to buy stuff. Mr. Lapinski did just that. They buy a variety of things. Equipment, not part of their case. Their declarant buys more than twice as much equipment as he does supplies from us. That tells us a lot of things, Your Honor. It tells us among other things, do we really want to gouge this fellow on what is the one-third, or actually he buys his biggest use, is at our copy center, which is also not part of this case. You say to yourself, if he is buying a thousand dollars, and buys 20 percent of it as office supplies, do we really want to stick it to him? Do we want to gouge him so he doesn't buy all of these other things we are selling to him? And another thing it is telling you, it is a list like Mr. Cary talked about. When we talk about a list of office supplies, here are the kind of things he buys: Envelopes, file folders, audiotapes, appointment books. Appointment books -- let's pause on that. That is the Daytimers and stuff like that.

One of our exhibits -- I was not going to refer to it today, but I know it is in our DX 3. We go back five or six years ago, the number one supplier, the number one seller of those kind of things was Dave Fuente's Company, Office Depot, and second was Staples. Now they are fourth and fifth on the list. Who is number one? Wal-Mart is number one.

And you go through Mr. Lapinski's list; and if you do the shop around, the site visit thing we talked about, these kind of items are at virtually every single place that you go. These are the 95/5 rule. Mr. Lapinski might not be able to buy the oddball stuff we use as our competitive strategy to get him in the store, because we want him in the store to buy our 95 percent of our revenue. We just have a different hook to get him in there. He buys this stuff that you can buy at all of the other places. All of these things back on DX 6027, that lists all of these places that you can buy.

THE COURT: How are you doing timewise?

MR. KEMPF: I think I am at a point somewhere where I would take a break, Your Honor. Let me look at my notes here. I can finish up in about two or three minutes before a break.

THE COURT: Great. All right. I won't stop you.

MR. KEMPF: Let me turn to competitors, Your Honor, and when I finish that I will turn the statistics. And I will take a break before I turn to statistics.

THE COURT: All right.

MR. KEMPF: Same story, Your Honor. You know, when he was up here at the podium, Mr. Cary talked a lot about the declarations. What I want to do is just read them. And I have already covered several of them from competitors. Let me just do brief excerpts from two more declarations and one deposition.

Let me start off with the declaration Mr. Zenner at Office One. He says, "After I received a subpoena from the FTC, I agreed to a telephone interview by the FTC. During that interview I discussed the office supply market in their proposed Staples/Office Depot merger. I expected the merger to be approved, and much of what I said to the FTC was pro-merger. Indeed, from an analytical viewpoint I believe that the merger will result in increased purchase power and lower prices for consumers."

Next, let me turn to the declaration for Mr. London at Best Buy. And again I won't talk about it, I will read it.

"Contrary to the incorrect statements made in the draft declaration the FTC wanted me to sign, Best Buy actively price-checks our competitors, including price-checks of the office superstores. In my prior declaration I stated that Best Buy's experience suggested that a retailer may not be able to successfully complete against the superstores in the office supply business without offering similar size facilities, a similar range in size of SKUs and a similar level of service. In a draft prepared by the FTC it was stated that Best Buy's experience suggested that a retailer, quote, cannot, close quote, compete against the superstores and that, quote, to accomplish this feat would take years and I know of no retailer today that is willing to undertake such a risky venture, close quote. That is what the FTC wanted me to say. I refused to sign on the FTC's draft declaration of those statements because, as I stated to the FTC, I don't believe that they are true. It is my understanding that other retailers can and do offer a large variety of office supply SKUs and have a large share of office supply sales."

Finally, Your Honor, at deposition, Mr. Pratt of Sam's Club testified as follows:

"Q: Did you tell the FTC that Sam's Club does not view the office superstore -- the office supplies superstores as competitors?

"A: No, I did not tell him that.

"Q: In fact, didn't you tell Mr. Fishkin and the FTC you viewed the office supply superstores as competitors for office supplies?

"A: Yes, I did. Yes, I did."

And continuing on,

"Q: The sentence in the draft affidavit provided by the FTC says, quote, Staples/Office Depot and OfficeMax are not our primary competitors for office supplies, end of quote. Do you see that?

"A: Yes, I see that.

"It is not in the declaration you signed, is it?

"A: No, it is not.

"Q: The reason it is not in the declaration that you signed is because it is not true, is it?

"A: That's correct."

One more thing, Your Honor, when it was out seeking declarations, the FTC never asked the key question. Instead of just asking what would happen if there were a theoretical price increase following the merger, the FTC should have asked what would happen if there were an actual price decrease following the merger. If they had asked that question, they would have found out that such an occurrence would lead even more consumers to go to the combined company stores to buy their office supplies. It would enable the company, as it's seeking to expand its volume, to get a bigger and bigger share of the 90 percent of the marketplace it has not penetrated yet. That is one of the things -- Mr. Cary referred to grocery stores. A couple of times big, big difference. The superstores account for about 10 percent of the 180 or so billion dollars sales each year in office supplies. If they can do this, if it is two grocery stores competing, the only thing it can take it from is another grocery store, basically. Here, there are all kinds of channels of distribution, and there is a tremendous opportunity to increase your volume because you are not taking it from OfficeMax. You are taking it from a whole variety of other channels of distribution.

Your Honor, I am about to turn to the statistical case, and this is a good time to take a break.

THE COURT: I think it would be, if you are going to go to statistics. We better have lunch and we will be back. We will recess. Thank you, so far, for the opening statement. We will be back at 1:30 and we will begin at 1:30.

THE DEPUTY CLERK: All rise.

(Court Recessed For Lunch)