

1 A F T E R N O O N S E S S I O N

2 THE COURT: Good afternoon. We are ready to
3 continue with FTC v. Staples.

4 MR. KEMPF: I think it will be longer than --

5 THE COURT: We will go ahead with the next area.

6 MR. KEMPF: I will turn to their statistical case,
7 to their concentration charts, which are PX 59, and to their
8 so-called pricing charts, which is our old friend PX 3. As I
9 turn to PX 3, I would remind us all that they have said many
10 times that is the key to their case. In fact, Mr. Orlans at
11 one point said PX 3 is our case. Let's start with the
12 concentration statistics, Your Honor. They have a series of
13 these. These are all in PX 159. They are attached to one of
14 the five -- count them, five declarations their witness,
15 Mr. Steffen, prepared.

16 The last one, Mr. Cary talked a little bit about
17 late arriving stuff. We got his last one, the last day or so
18 after we had taken his deposition. And the first four didn't
19 look so robust, anymore, and we got a fifth declaration from
20 Mr. Steffen. He prepared a whole series of these colored
21 charts. And the green bars are existing concentration and
22 the red is what it will go to under their theory of the
23 merger. These are these, back to what I call the HHI's, the
24 Herfindahl index. The concentration. And what FTC standard
25 says, if concentration is high -- take the ultimate, was a

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1 monopoly, so concentration would be 10,000, prices should be
2 high. And where concentration is low, prices should be low.
3 That is, of course, assuming that you are measuring things
4 right. If you are measuring things right, their standard
5 tells you there's correlation between concentration and
6 prices. Highly concentrated markets, high prices. Low
7 concentrated markets, low prices.

8 So, we said, let's take a look at these five
9 declarations that their fellow who did this did, and see what
10 they tell us. And let's start off by seeing whether they
11 tell us that they have the measurement right. So we took,
12 and this is the very first chart -- they do it six ways. And
13 I don't think they ever get it right, but this is the way
14 they think is the best way. This is the way their A chart,
15 their HHI A chart. This is a blowup of 6076, but it's
16 attached to PX 159, the first of many Steffen declarations.
17 I said, Let's test this baby out. Let's kick the tires.
18 Let's look over the 35 markets they have and let's take the
19 lowest and the highest. And so I looked and they say -- and
20 Mr. Steffen's declaration expressly says it, and words also
21 confirm in the chart. The lowest concentration is in Grand
22 Rapids, the highest concentration is -- before the merger, is
23 in Washington, D.C. So, what this tells us is that -- and we
24 have taken and I have blown up -- from the whole myriad, I've
25 blown up what they say current concentration is. We have

1 studied this carefully. This is the right way to look at the
2 market. These are the concentration figures. Low
3 concentration, relatively, over here in Grand Rapids. Very
4 high concentration in Washington, D.C.; Washington, the Grand
5 Rapids is the lowest.

6 So I said, Let's take a look at their pricing
7 charges and see if the facts comport with their theory. We
8 went to one of these charts; and by the way, Mr. Cary said
9 these are consistent, and on this point they are consistent.
10 What they tell you is when you look at it, every time the
11 least concentrated market -- and this is just taking from
12 their chart. If you compare the least concentrated market's
13 pricing with the most concentrated pricing, it tells exactly
14 the opposite of what their theory predicts. Their theory
15 says where it is low concentration it should be high prices,
16 and vice-versa. When you look at prices, and take the ones
17 in the lowest concentrated market of all and compare it to
18 the prices in the highest concentrated market prices of
19 all, you get exactly the opposite of that their theory
20 predicts. You go to the lowest concentrated market and its
21 prices are higher, not lower, than the most concentrated
22 market. What that tells you is that whatever they may be
23 measuring, they are not measuring the degree of competition
24 in the sale of office supplies, because it does not comport
25 with their theory.

1 Another thing we found is we said, Let's take a
2 look at these markets -- let me see where I put this one.
3 And by the way, I just picked the lowest and the highest.
4 You can pick the second highest and the second lowest and so
5 on, and the same story repeats itself. I took the two
6 extremes. Now, we took another couple of comparisons. We
7 said, what do we get when we look at some of the
8 no-competitions, against some of the ones they are most
9 concerned about. Here is what we found.

10 We found out in Bellingham, Washington, one of the
11 red bars on their charts, where there is no competition,
12 prices are lower than the five markets that they were most
13 concerned about during this case. When entered into this
14 consent decree, they said we want you to divest 63 stores in
15 the places we are most concerned about. More than two-thirds
16 of them were in these stores, were in these cities with
17 the green bars here. Louisville, D.C., San Diego, Tampa
18 Bay/St. Pete area, and LA. What we find is that the prices
19 in the area where there is no competition is lower than the
20 prices in any of the cities that were the most concern to
21 them. So the pattern they say is so consistent and so
22 explanatory, when you poke and pressure-test it, Judge, you
23 find out something different.

24 Let me give you one more example of the kind of
25 things that you find when you look in there. This is from an

1 Office Depot chart. Mr. Cary, a couple of times kept saying,
2 you know, it is the more superstores, the more competitive it
3 is. If you take a look at this, what you find is there are
4 towns that have three superstores that have higher prices
5 than virtually the entire array of ones where there are only
6 two superstores. Out in Pittsburg and Nashville there are
7 three superstores, and this is the price level in those two
8 towns. And as you can see, it is higher than all but one of
9 the two places where Depot and Max face each other, and
10 higher than all of the places where Depot and Staples face
11 each other. The notion that more superstores automatically
12 leads to lower prices is false, as we will be shown in
13 further charts. And indeed, one of their own declarants says
14 adding a third superstore is no big deal, it doesn't drive
15 prices down.

16 Another thing Mr. Cary talked about, and they do it
17 in their paper, they used a different number this morning.
18 It fell from 23 to 3. This morning he said 21 to 3. So they
19 sort of say, "What a tragic thing. We have lost all of these
20 superstores chains. And now we are down to the last 3, as it
21 were." Well, Judge, they missed the whole productivity loop
22 benefit. They missed the benefit that you can get from
23 consolidation. The merger guidelines don't. The merger
24 guidelines say when direct competitors merge they can gain
25 efficiencies, and those efficiencies can translate into lower

1 costs that can then be passed on to consumers in the form of
2 lower prices. So, there is no elimination of competition in
3 an antitrust meaningful way simply from the mere fact that
4 two competitors merge. It may be that two competitors
5 merging makes things more competitive, not less competitive.

6 That of course is precisely what is happening in
7 this industry. If we were to take on a national scale and
8 make up one of these so-called HHI figures on some sort of
9 office superstore-only market, what you would see is the
10 classic X chart. As concentration has increased, prices have
11 fallen. The consolidation from many superstore firms to few
12 superstore firms has served consumers well. They have gained
13 efficiencies, lowered costs and passed those on to consumers
14 in the form of lower prices. In short, and stated otherwise,
15 Your Honor, the consolidation of this industry has been a
16 good thing, not a bad thing. As it has occurred, prices have
17 fallen. So, we don't need to worry about that, and bemoan
18 the loss of the 21 people. That has been a good thing, not a
19 bad thing.

20 What we have when they go through these statistics,
21 Your Honor, is exactly the kind of misleading use of
22 statistics that then-Judges Ginsburg and Thomas, joined by
23 Judge Sentelle were so critical of in the Bakers House case.

24 I want to go to the subject of cherry picking. I
25 have said it before, and I will turn to it again right now.

1 And I will do that with one of the charts Mr. Cary used this
2 morning. This was the one he put up on the screen a little
3 earlier. It said Comparison of Staples' prices in two
4 Virginia cities. And he has a February '97 ad, and it shows,
5 and he has them circled, higher prices in the two-superstores
6 city -- excuse me, lower prices in the two-superstores city
7 than in the one-superstore city. Your Honor, as you might
8 expect, this was not the only city pair where they did the
9 advertising campaign. Staples, when they did this, did it in
10 towns all across America. When they did it, they priced to
11 local conditions in different towns across America. And if
12 you want to find, if you are not a cherry picker -- change
13 that. If you are a cherry picker and you want to not show
14 this, but you want to show the opposite, it is not hard to
15 do. All you need to do is get in the car and drive south.
16 Pretty soon you will come to South Carolina.

17 By the way, the circular is eight pages long.

18 All we need to do is go down to South Carolina and
19 look at the circular there. And this is a couple of pages
20 from the very same eight-page circular stuffed in the
21 newspaper. And if you go down and look in the circular, the
22 same circular in these two towns in South Carolina instead of
23 Virginia, what it tells us is the exact opposite story. Down
24 in South Carolina, the prices in the two-superstore town
25 instead of being lower, are higher. When you look at address

1 labels, the one-superstore town, 8.89; the two-superstore
2 town, 9.99. Xerox copy paper, the two-store town, 21.99; at
3 the one-store town, 20.99. Go over and look at ink-jet
4 cartridges. \$29.99 in the two-store town, and \$27.99 in the
5 one-store town. If you want to cherry-pick, you can
6 cherry-pick to show one thing or you can drive south and show
7 just the opposite.

8 The important thing, of course, is if you take all
9 of the items in the eight pages of the ad and you add them
10 all together, what to do they show? And when you do that,
11 what you find is it is the same directionally as it is in two
12 ads, but when you cherry-pick you get these huge things.
13 When you get them and run them and say, Let's total
14 everything in the ad. We all have 115 items, and you take
15 and you add all of the costs in the two Virginia towns and
16 the two South Carolina towns and they are pretty much the
17 same. In Virginia, the one is about 1 percent higher, that
18 has the Staples-only store. You go down to South Carolina
19 and the Staples only store is less than 1 percent lower.
20 Both of them are close to the other store. You don't get the
21 dramatic swings that you get if you take one page, one town,
22 and cherry-pick certain items out. And the source, Your
23 Honor, of the comparison is DX 6073. And the two Virginia
24 city comparison is -- has a DX sign on it that I can't find.

25 There is one other thing before I leave this, Your

1 Honor. It is DX 6064.

2 One other thing on here, the higher prices in the
3 two Virginia cities, it is -- Mel Brooks always used to say
4 -- beauty is in the eye of William Holden. And there is a
5 lot to that. If you look at the fine print on these ads, you
6 will see that what they show is the old price, the list price
7 the people used to pay in these towns. Take Fredericksberg,
8 the one that they say, Oh, my gosh, that is the
9 one-superstore town. In the fine print on here, so consumers
10 will know, it lists what they used to pay in the towns here.
11 And if you take a look at that, what you see is that the
12 higher prices in Fredericksberg when Staples opened there and
13 became a, quote, monopoly according to them, are actually a
14 lot lower than they have ever been before. The prices are
15 coming tumbling down. They may not have gotten as low as
16 they are in Charlottesville, but don't think these are high
17 prices for a minute, Your Honor. These are low prices. They
18 are lower than people in Fredericksberg have ever had
19 before.

20 There is a lot of cherry picking in PX 3, Your
21 Honor. He said that he went back and couldn't find any. I
22 have just shown one, and I will only on do one more this
23 morning. In PX 3 behind Tab G 3, that is the tab where they
24 told the commissioners and they are telling you -- and let me
25 quote it, "Actual price comparisons between nearby

1 communities show that prices are lower where there are more
2 superstores."

3 And they have two charts I want to show you, Your
4 Honor. This is the first one. They said "average price
5 comparison of two Ohio cities."

6 And then they picked six items. I don't know
7 whether they picked them randomly, but I do have views on
8 that. And they said, let's compare the two Ohio cities. And
9 we will take Columbus, where there is a Staples and Max, and
10 compare that to Cincinnati where there is three firms. And
11 lo and behold, for all six items the prices in Cincinnati,
12 the three-firm market, are lower than they are in Columbus,
13 the two-firm market. Stated here they say, each of them --
14 Columbus is the yellow bar. Columbus is higher than
15 Cincinnati, true of all items by varying degree. That is all
16 shown on their graphics here. And then to drive home the
17 point, the point that Mr. Cary kept driving home this
18 morning, you know, Judge, these come from their own
19 documents. They did a backup to it. And I want to show you
20 that one. This is part of the same tab. I think there is
21 one between them. What they did was said actual prices in
22 two Ohio cities, manila folders. And they compare and show
23 in Columbus, the town where there is only two -- Staples, Max
24 -- the price is 4.99. And in Cincinnati, the three-firm
25 market, the prices are \$2.99. And on the sheet next to it

1 they have in yellow, highlighted, Columbus and Cincinnati, to
2 show they took those right out of the company's own
3 documents. And the way it works is they have the firms that
4 are the two-firm cities on the top of this page and the
5 three-firm cities are on the bottom. They pull both of those
6 across. Manila folders to show, manila folders, actual
7 prices in two Ohio cities.

8 Now, to show the degree of cherry picking here, you
9 don't have to rummage through the 80 volumes that we've
10 saddled you with, between us, back in your office. I don't
11 have to go through a lot of stuff. I can show it right on
12 this document, Your Honor. And if you take and pull -- put
13 that one up here. Same document, same page, all you need to
14 do is move over one State. Just drop over to Indiana and see
15 if you can find in any other state in the top and bottom and
16 see what they look like. If you look at that same document,
17 sure enough, Kokomo, Indiana, right here, the town on the
18 top. And there is Elkhart-South Bend on the bottom, just like
19 Columbus on the top and Cincinnati on the bottom. And what
20 you find is exactly the opposite. Here, the two-firm one
21 higher than the three-firm one. Here, the three-firm one
22 higher than the two-firm one. So if you want to show the
23 cherry picking when they come in and say nearby towns, actual
24 things shows what this is. If you want to show -- if you are
25 a cherry picker and you want to show just the opposite. If

1 you just moved from Ohio to Indiana, same document, same
2 page, shows just the opposite results.

3 Then, what I did to carry it to the next step, I
4 said, Okay, here is what I will do. I won't pick six items.
5 I will take their six, and let me see how I fare. So I had
6 the computer run that. We have gotten their computer
7 program, so I was able to do it in the same graphics. When
8 you do it that way, I didn't hit all six, but I did hit
9 half. When I did it that way and said, Let me just take the
10 six numbers, six items they cherry picked and let me say I go
11 from my manila folders, which is the top one there; where, by
12 the way, they say over here in Columbus they are 51 percent
13 higher. They do the same difference. They say in Kokomo
14 they are 30 percent lower. So if you cherry-pick towns, you
15 can get these different results, Your Honor. When you do it,
16 we got half of them exactly the opposite of what they showed
17 when we were not cherry picking. I took their six.

18 Let me turn to another misleading comparison, Your
19 Honor, except I want to shift now from the misleading
20 individual comparisons to the misleading aggregate
21 comparisons. And I want to start with -- this one is PX 3,
22 Tab B. The chart. I refer to this in one of pretrial --
23 Staples prices consistently, big red "consistently" to
24 emphasize it, have been higher with less office superstore
25 competition. And I took a look at this. And Mr. Cary said

1 occasionally you do find -- that is the words he used.
2 Occasionally you do find prices are lower when there is two,
3 than there are when there are three. If you look at this,
4 the occasions on which you find that, is every single one of
5 the four charts. If you look at these, the blue chart on the
6 far left is three-firm markets, the second one is two-firm
7 markets where Depot and Staples are present. If you look at
8 these, what you find is Staples prices consistently have been
9 lower when there is less superstore competition, when you
10 compare the three markets here and the two markets here. The
11 green chart in each one of these is lower than the blue
12 chart.

13 I said earlier that there was no particular magic
14 to having the third store, and said we would return to that
15 later. This is another time we are now returning, as you can
16 see it in all four of their charts. Prices are higher where
17 there are three than when there are two in certain two-market
18 cities where you have Staples and Depot competing.

19 Let me go to another chart, Your Honor. It is
20 another one that you saw this morning. It is from PX 3. It
21 is the very first chart in PX. It is their very first
22 chart. If PX 3 is their case, this chart is the heart of
23 their case. And it is not beating, Your Honor. This is the
24 one that Mr. Cary had up this morning. Staples prices are
25 higher with less superstore competition. And, he has four

1 markets rated across here. Three firm, Staples/Depot, Max
2 and Staples, and Staples only. And it has that stair step
3 that he was talking about. This chart, Your Honor, is the
4 classic example of a confusion between correlation and
5 causation. It is the classic example of the false
6 explanatory variable. We all know a million examples of
7 those, the economic literature calls these nonsense
8 correlations. Hospitals must be dangerous places because
9 people are always dying there. Air pollution promotes
10 longevity because, as air pollution is increased, so has life
11 expectancy. And my favorite is the one that the Wall Street
12 Journal runs every year, and that is that whether the stock
13 market will go up or down in the coming year is best measured
14 by the results of the Super Bowl. They have this article
15 every year and they always do the chart. And the correlation
16 there is much stronger than any correlation you will see in
17 this case. And what it shows is that when the NFC wins -- it
18 is a 4-part chart, when the market is going up it is on the
19 top and when the market is going down it is on the bottom.
20 The whole article is in DX 273, Your Honor. But in terms of
21 the stock market going up and the stock market going down, it
22 shows whenever -- and this is the -- when this is going this
23 way, the right side is the NFC winning and the left side is
24 AFC winning. So what happens is, when the NFC wins, the
25 stock market goes up; when the AFC wins, the stock market

1 goes down. And only one time has the market gone down when
2 the AFC has won, and only the history of the Super Bowl twice
3 has it gone the other way when the NFC has won. As I say
4 it's a much stronger correlation. This is the false
5 variable. This is utter nonsense, but if you are looking to
6 find relationships, you can find them all of the time. In
7 fact, what you can also do is you can say that -- if you are
8 an economist who is stuck on this kind of thing, you can come
9 back and say, Green Bay's trouncing of New England in the
10 Super Bowl played after this chart was made -- you see, it
11 ends in 1996. And now we have the 1997 Super Bowl. So next
12 year's we'll say Ah-ha, further proof this is valid. That is
13 what is known as a nonsense correlation.

14 Now, we have looked at the data here. And there is
15 lots of them you can come up with here. We took the FTC's
16 charts and we did another one. We did this the other night.
17 We took the same thing Mr. Cary said. We took the black and
18 white one. And we took our crayons out and Mr. Gidley over
19 there said, I am going to color in all of the towns that
20 ended with a vowel and all that ends with a consonant. And
21 when you do that, you get proof positive that Office Depot's
22 prices are higher when they have a store and city that ends
23 in a consonant than they are when they have a city that ends
24 in a vowel. And they are significantly higher. That is,
25 again, Your Honor, another example of a false correlation.

1 Finally, we did a study of our own and we did some
2 price checking on Wal-Mart, for a variety of reasons. One
3 was to see whether they, like we do, price differently for
4 different markets. And what you can come up with is that
5 Wal-Mart charges more for Coca-Cola in cities where there is
6 only one office superstore than they do in cities where there
7 are three office superstores. The number of office
8 superstores determines how much Wal-Mart charges for
9 Coca-Cola. Again, Your Honor, an example of a false
10 correlation. What that chart does tell you, of course, and
11 this is a three-city, two-city -- excuse me, a city with
12 three superstores, two superstores and one superstore. And I
13 used the same colors they did on this one, and but what it
14 does tell you is that these companies are not the Lone
15 Rangers when they charge different prices in different
16 cities. There is a reason that Wal-Mart charges more for
17 Coke in one-superstore cities like Bangor, Maine, than they
18 do in three-superstore cities like Los Angeles. And it has
19 to do with a whole host of factors, and it is those same
20 factors that explain why the superstores that are before you
21 selling office supplies similarly charge more for those
22 supplies in Bangor, Maine, than they do in Los Angeles,
23 California, just like other retailers of other products do.
24 Bangor, Maine, is not Los Angeles. And there are a
25 host of reasons for that. Mr. Cary said, you know,

1 everything is efficiencies. It is not efficiencies. There
2 are a lot of differences that explain this. It has to do
3 with some of the things he talked about this morning;
4 weather, commuting patterns, education, occupation, income.

5 And one very important variable that he didn't
6 mention that is important is the mix of what they sell in the
7 stores. If you take a look at what is sold in the various
8 stores, it is not the same in all of the markets. Their
9 price index is the same in all of the products, but the
10 products sold are not the same. You go to places like
11 Bangor, Maine, and compare them with places like Los Angeles,
12 and this is an aggregate of all of the one-cities and all of
13 the three-cities. And you take a look at those and what you
14 find is the mix is dramatically different, more than twice as
15 much sales are accounted for by computers in the small areas
16 than they are in the three-player areas. The reason for that
17 is, there are a lot more channels of distribution for
18 computers in a place like Los Angeles than there are in
19 places like Bangor, Maine.

20 In fact, let me digress for a minute. There are a
21 couple of charts we had done over the weekend that we put
22 color on, that are back in the corner there.

23 Let me put a little more meat on this particular
24 thing, Your Honor. It is much easier to understand all of
25 these concepts if you shift from calling them not blue bars

1 and red bars or three players and two players, but take a
2 look at what kind of markets they are. Again, I did this
3 over the weekend. I took this, this is a series of them. I
4 want to show you just a couple. Let me put one up here and
5 Teft will put the other one up here.

6 The records show where the various towns are, and
7 it starts with the largest MSAs, you know, New York, Los
8 Angeles, Chicago; and it carries down to Goshen, Indiana;
9 Fargo; Lima, Ohio; Tyler, Texas; Terre Haute, Indiana; Yuba
10 City, California, etc. And when you get away from the red
11 and the blue and one-superstore versus three-superstore firm
12 towns and put some names on them, it becomes much more
13 apparent to you why the pricing is different. Los Angeles,
14 Chicago, Washington, San Francisco, Detroit; cities like that
15 are different from Yuma, Arizona; Florence, Alabama; Altoona,
16 Pennsylvania. There are a lot of differences between those
17 cities and that explains why there are one superstore
18 locations there. And why there are two or three here and why
19 the pricing is different when you step back and compare those
20 kinds of differences from market to market.

21 You know, Mr. Cary referred to the pink book. The
22 pink book tracks not just the superstores, it tracks
23 wholesale clubs, CompUSA, Best Buy, Circuit City, and other
24 stores as well, Your Honor.

25 Now, late Thursday was when the FTC decided that if

1 PX 3 was their case, maybe it was in disrepair. And so at
2 the eleventh hour we received, unannounced, two new exhibits
3 from them, son of PX 3. Or children of PX 3, maybe; it is PX
4 3(a) and PX 3(b). Until then, they had not compared a single
5 document that was in PX 3 that sought to even account for any
6 of these differences from market to market. And they can
7 denigrate Professor Hausman at MIT all they want, but he did
8 that and he has been in this case from the very outset
9 working with us.

10 And early on he said, these cross-sectional
11 analyses ignore two things. They ignore the differences
12 among these cities and they ignore the impact of competition
13 over time. So, I am going to try to do two things. I will
14 try to take account of these differences from market to
15 market, through some econometric models, and try and see what
16 the impact of the presence or absence, for example, of
17 certain other competitors does in explaining the differences
18 from market to market. And then as I will talk about a
19 little later, he also took a look at the stuff over time.
20 And the reality of what he found is confirmed in the
21 company's internal documents as well.

22 Let me refer to two of them, and we have a bunch of
23 them in DX 3, Your Honor. In fact, this is kind of
24 interesting. Mr. Cary talked about how we kept coming back
25 and giving them more data. A lot of that was driven by

1 them. You can compare this, this is in DX 3 at 3-140, and
2 3-142. If you go back a few pages my recollection is like
3 135 and 137. It is within striking distance here. We had
4 given them some what are called "hits analysis," that the
5 real estate department over at Staples does.

6 In the ordinary course of business they say, what
7 happens when various competitors -- that we think are
8 competitors anyway -- open a store? Does that have a hit on
9 us? And they have found that they did. When we showed those
10 to the FTC and those are the ones that I referred to earlier,
11 the ones that precede these, they say, that is everything
12 that you sell. We would like you to go back and rerun it
13 just on office supplies. Cut out furniture, cut out business
14 machines, cut out computers. So we went back and reran the
15 data. You will find this and the earlier one there, and it
16 will tell the same story. Whether it is the whole store or
17 office supplies, Staples loses sales when a Best Buy, a BJ's
18 or a Price/Costco comes to town. People do comparison shop.
19 They do have alternatives and they take advantage of them.

20 Same thing is also shown in what are called various
21 surveys the company does. They have what is called a
22 top-of-mind survey; where they interview people as they are
23 leaving the store, for example, and say to them, Where else
24 do you think you would go for the stuff that you get in our
25 store? And this is done in Greenville, North Carolina, from

1 the same thing, DX 3, page 125, and this is one of a series
2 of them that you can see in there, Your Honor. You can see,
3 Wal-Mart, Office Depot, Staples, Taft Office Supply. And
4 40 percent among the others. Viking is one of the mail-order
5 companies; it comes up at six percent. So the consumer, when
6 you catch them for a top-of-the-mind impression about where
7 they think they can turn, that is what they identified.

8 One other thing, let's go back to the PX 3 version
9 of this one. If this was the real world, this is PX 3, tab
10 B, first color graphic, the one Mr. Cary had. If that were
11 the real world and the only competition were where they faced
12 the other firms, what they would have for pricing zones is
13 four pricing zones. Staples, for example, would have one
14 pricing zone where it faced the other two, one where it faced
15 Depot, one where it faced Max, and one where it didn't face
16 anybody. But Staples doesn't have four pricing zones because
17 there are a lot of competitive factors. It is much more
18 robust than that. And the reality is this. Those other
19 factors lead Staples -- counting their sub zones and stuff --
20 they have about 40 pricing zones. Office Depot has about 55
21 pricing zones. And OfficeMax has 70 pricing zones. So the
22 notion that it is limited to these four is refuted by their
23 own conduct.

24 Mr. Cary said their own actions speak loud. They
25 speak quite loud. If the only thing you faced was these

1 four, you would have four pricing zones. You would not have
2 70 pricing zones. The reason you have 10 to 20 times as many
3 as their theory predicts is that there are lots of factors
4 that play out in the marketplace.

5 Now, I want to focus next, Your Honor, on an
6 especially misleading aspect of the exhibit that I just had
7 up there, the four charts. And that is that it ignores the
8 zero firm markets. Mr. Cary had the one we had up there on
9 them. And he said, Oh, my goodness, their own exhibit shows
10 this impact; it is DX 6070. It is a fancier version than the
11 one we had up there. Remember, we said we would send stuff
12 in draft form. I sent them in draft form. What I did is I
13 just, for the first four bars, I took PX 3 tab 3. And I
14 said, He is missing -- remember, he had Baker's Office
15 Supplies up there? I said, Let's add Baker's Office
16 Supplies. I think there is another one from California there
17 as well. I did it for two different towns, and the way I
18 picked the towns is these are two places that Staples is
19 considering opening stores in this year. And so I said, you
20 know, What can you tell me on prices in these towns where
21 there is no office superstore? And the thing that it tells
22 you is that prices are higher in those towns. And that -- we
23 don't want the medal he said he would give us for opening in
24 those towns. But it is true, when we go there, what happens
25 is, the people in those towns are not doing a lot of hand

1 wringing and signing petitions and complaining that the
2 prices are higher than they are in Chicago and Los Angeles
3 and Philadelphia. They are sending us telegrams welcoming us
4 to town. They are celebrating the fact that we are coming to
5 town because prices are coming tumbling down. They may not
6 have gotten this low yet, but they headed in the way that
7 people want them to head.

8 And let me just show you what they do this is a
9 photograph of what they do. They line up around the block to
10 come in and visit the store. This is the store opening and
11 it is repeated in city after city across this country. When
12 we come into town they aren't bemoaning the fact that prices
13 are lower in Los Angeles, they are celebrating because their
14 prices are 50 percent lower than they used to be. They would
15 line up in droves.

16 They talk about the one-firm-only cities. Well,
17 one of the good things about this transaction, and they talk
18 about potential competition. One of the good things about
19 this transaction is that the combined company is going to be
20 opening more stores in these kind of cities than the
21 combination of the two of them separately would. One of the
22 advantages they get from their increased size is that they
23 are going to accelerate the opening of stores. It will
24 translate potential competition. It will increase potential
25 competition and quickly translate it into actual competition

1 as they go out and implement that plan and do open in a town
2 like this and towns like this across the country and drive
3 prices down. And they are not the only ones either, Your
4 Honor. There has been a competitive response out in the
5 marketplace that is the same story.

6 And let me just read to you a portion from the
7 annual report of OfficeMax, which just came out a few weeks
8 ago. This is an example of the increase in potential
9 competition and the translation of coming year and beyond,
10 into increased actual competition. This is from the
11 OfficeMax annual report which is in the exhibits as DX 1673.

12 It says in a letter to the shareholders from the
13 chairman, Within 13 days of the announced proposal merger of
14 our competitors, Staples and Office Depot, and only four
15 months remaining in the year the company launched a major
16 preemptive acceleration store expansion program. That
17 strategy increased store openings by 20 percent during the
18 past year and will by well over 50 percent in fiscal 1997.
19 So, potential competition will increase.

20 Let's take two doses of reality here, Your Honor.
21 As I did on those charts I colored in over the weekend, to
22 show the two-firm and three-firm markets, as you would
23 expect, are in the country's major metropolitan areas. The
24 one-firm markets, as you would expect and as the charts show,
25 are in smaller communities.

1 Of the country's largest markets -- let's get the
2 first page there. Do you have the first page? The one I
3 have of the color charts with the bars? If you take a look
4 at that, Judge, there are not many one-firm towns left. And
5 on this chart there are three. This was done as of April.
6 And May -- there are two items in my information. On this
7 one, two of the three red bars have now changed or will
8 shortly.

9 In Buffalo-Niagara, which currently at this time is
10 an OfficeMax-only store, a Depot has now opened. So that is
11 now a two-firm market.

12 Similarly, New Orleans, one of the things that
13 OfficeMax says in its annual report is, during the coming
14 year we will open a New Orleans. So, this is part of their
15 accelerated program. And if you look at the next page, the
16 first red bar is Jacksonville, Florida. And my memory, if it
17 is right, is that is another town they are going to open in
18 very promptly. So, most of the large cities are already
19 slated to become two-firm towns. And the two firms is what
20 drives the competition.

21 Secondly, the -- most of the two-to-one cities we
22 are talking about in this case are in four metropolitan
23 areas, Washington-Baltimore, Tampa-St. Pete, San Diego and
24 Louisville. 46 of the 63 stores are in those towns. And the
25 reality, Your Honor, is that in those towns competition is

1 robust and intense because of a host of factors. And the
2 merger is not going to lead these companies when they are
3 combined to start charging prices in San Diego and
4 Washington, the same as they do in Yuma, Arizona, or Bangor,
5 Maine. That is not realistic, Your Honor. Common sense
6 tells you that.

7 You know, they talked about all of these charts. I
8 did not see a single chart up there where they said, you
9 know, here is where they go back and reverse prices and take
10 them the other way. It doesn't happen. Prices go down, they
11 don't go up. And not only does common sense tell you that,
12 Your Honor, so do the industry witnesses. Declarant after
13 declarant that we talked to confirmed that prices will go
14 down, not up. And they will do that in every market in
15 America, not just in the small towns that we have not opened
16 in yet.

17 Beyond that, Your Honor, another reality is this.
18 There will be a second office superstore in each of these
19 cities that the Government is doing a hand wringing around.

20 For example, as OfficeMax implements its strategy
21 of rolling out as a nationwide competitor. He mentioned two
22 towns, Visalia, California, and Jackson, Michigan, during his
23 presentation this morning. And my expectation is in those
24 towns and others the prices will come -- there will be a
25 second superstore town there. And it won't take very long

1 either, Your Honor.

2 If you want proof of that, you don't have to look
3 any further than our old friend PX 3. Here is one that I
4 didn't have a chart for. I was looking at it last night, but
5 it is Tab H is my recollection. Let me put it on the Elmo.
6 This is from PX 3 and it is a chart they have on San Diego.
7 And one of the things it says is OfficeMax is committed to
8 opening this MSA in 1997, with four stores. It's from
9 PX 88. It is also my recollection it is Tab H in PX 3.

10 And not only that, there is deposition testimony
11 from another executive that told him -- who testified that
12 the OfficeMax people told him they are opening in Washington
13 as well.

14 So, if you are concerned, if someone is concerned
15 about having two office superstores, the expansion that these
16 companies are undertaking is spectacular. Office Max, as I
17 read a minute ago, is increasing to opening up 150 stores in
18 1997 alone across the company. And the combined company's
19 plan is to open 200 stores across the country, which will
20 change a lot of those red bars to blue bars in places where
21 there is only one office superstore now. And that is another
22 good thing about the transaction. The increase in store
23 openings will take a number of what are currently
24 OfficeMax-only markets and will convert them into two-player
25 markets. And if that is something that the Government thinks

1 is a good thing to do, a good thing about this transaction is
2 it will accelerate that.

3 One last point on PX 3, Your Honor. They used it
4 in their papers and again this morning to argue that Office
5 Depot has the lowest prices. If we look at the various
6 charts, you see Office Depot has the lowest prices. Again,
7 Your Honor, that is good news for us, not bad news.

8 In short, there are reasons why Office Depot's
9 prices are lowest, lower than Staples, and I alluded to it
10 earlier. Office Depot is half again the size of Staples.
11 Staples is at 4 billion dollars in annual revenues, and
12 Office Depot is the 6 billion in annual revenues. And as the
13 evidence shows, at every turn of the productivity loop as you
14 increase your sales, you get lower cost to drive lower
15 prices. So, that's the reason why Office Depot is a
16 low-priced company. They are not some oddball monopoly
17 maverick, as the Government would have. They are simply
18 following the productivity loop and lowering prices as they
19 lower costs.

20 Your Honor, far from eliminating Office Depot as
21 the low-price supplier, this transaction will replace Office
22 Depot with a new, larger company that, because it will have
23 lower costs, it will be an even lower-priced competitor. It
24 will be, in short, the new lower-priced leader. We don't
25 lose that; we intensify it. And again, that is because the

1 10 billion dollars in revenues, the nationwide spread out,
2 lower procurement, distribution, marketing, costs, et cetera,
3 et cetera. And they will do other things. They will be able
4 to do global sourcing. They will have new products, less
5 expensive products; and that is all a good thing for
6 competition. All of that is realized and passed onto the
7 consumer in terms of higher-quality products, better
8 services, lower prices, and the like.

9 In short, Your Honor, what this transaction will
10 do, it will turbocharge the productivity loop on yet another
11 turnaround. And that is good, not only for shareholders, it
12 is good for consumers as well.

13 Now, one of the things that helps to ensure they
14 will do a good job in doing that, is that as part of the
15 transaction and another one of the personnel synergies is a
16 fellow named Dick Bennington, who has been in charge of
17 Office Depot's retail stores, has already been assigned the
18 responsibility upon limitation of the merger to take charge
19 of the new lower-priced strategy for the new company. You
20 will get a chance to see Mr. Bennington and he is the one of
21 the witnesses we will be calling in the case.

22 Your Honor, PX 3 takes no account at all of the
23 efficiencies that will be generated from this transaction.
24 It is what the economists call a cross-sectional analysis.
25 It is frozen in time like a snapshot, rather than a moving

1 picture. Because of that, it doesn't capture the dynamics
2 going on in the industry. And the dynamic -- this is another
3 thing we asked Professor Hausman to look at -- the dynamic
4 reality is this. Over time there has been a continuous and
5 substantial decline in the price of office supplies in all
6 markets, including those markets where there is only one
7 superstore firm.

8 That proves two things, Your Honor. First, it
9 proves that there is intense competition out in the
10 marketplace, including where there is only one office supply
11 superstore firm. And it also proves that there is something
12 to this productivity loop. If they really don't face any
13 competition, if the Herfindahl-Hirschman is really 10,000,
14 why is it that they keep lowering prices? Are they dumb
15 monopolists? We don't think so. We don't think that they're
16 monopolists at all. We think it tells you two things. We
17 think it tells you, one, they face vigorous competition quite
18 apart from the superstores; and two, it teaches you that
19 there is something to this productivity loop. And what the
20 low prices result from is that they grow, gain efficiencies,
21 drive down costs and they do pass those on to consumers.

22 We have some charts that we had prepared that are
23 based on, obviously, numbers. And let me walk you through
24 those. First, is the decline in Staples' prices looking at
25 all markets from 1993 to 1997. And over that short period,

1 Your Honor, the prices that Staples charges have fallen more
2 than 20 percent, using an index that goes from 100 down to
3 79.5. We asked them to break that down between one- and two-
4 and three-firm markets. It is the same story. It goes down.

5 In fact, when I first got this back from the
6 economist, I said these charts have what I would call the
7 Lake Wobegon effect. I don't know if you know Garrison
8 Keillor, who is on public radio and he has this fictional
9 town, Lake Wobegon, the little town that time forgot. And he
10 says, That is the news from Lake Wobegon, where all of the
11 men are strong; all of the women are good looking; and all of
12 the children are above average. And I called him, and I
13 said, how can I have them break down and say all of them are
14 85? This is the Lake Wobegon effect.

15 And they came back and said, what happens is, as
16 you break it down, some of the SKUs fall out over time
17 because they are not carried in all of the stores, so you
18 can't get a common comparison. And some of the stores open
19 at different dates. So when you break it down that way, the
20 numbers end up higher than the average, but the directional
21 conduct is exactly the same.

22 And I also did it in a chart going that way. Again
23 using the blue for three, two firm yellow; and one firm red.
24 If this is an index, Your Honor, the prices were not
25 identical in the first year. But I used the base of 100 for

1 all three and I said, What happens?

2 Now, in this case, the three firms are down, the
3 two firms are down and the one firms are down. And they are
4 down more in three than in two, than in one. So, Mr. Cary
5 said, it is all efficiency. It is not all efficiencies. Do
6 their presence or absence, and the distance apart, and
7 everything of other superstores impact it? Certainly. When
8 we open a second superstore ourselves, it impacts it. But it
9 is nothing like they suggested it is when you account for
10 other factors, and the efficiencies are overwhelming.

11 In these towns over here, the so-called one-firm
12 towns, there is a reason that prices have dropped as
13 dramatically as they have, and it has to do with competition
14 and efficiencies driving lower costs, driving lower prices.
15 If these were really isolated from everything, and really
16 didn't have these efficiencies, like they would have you
17 believe on both scores, you just would not see this. This is
18 explained by something and what it is explained by is two
19 things, strong competition and the reality that there is
20 something to this efficiency story.

21 If the merger goes forward, Your Honor, prices will
22 continue to go down in the future just as they have in the
23 past, and just as Chairman Pitofsky told us when we were over
24 at his office two weeks before this case was filed. And that
25 is detailed at length in DX 1251 and 1226, the declarations

1 of Mr. Stenberg and Mr. Fuentes filed with respect to the
2 last meetings we had with the chairman before they voted to
3 bring this case. When he interrupted Mr. Fuentes and said,
4 Stop talking about prices going up, nobody thinks his prices
5 are going up. The only issue is how fast they will go down.
6 Your Honor, what this merger will do is accelerate their
7 decline. And that is going to happen because of the merger,
8 because of the efficiencies we have talked about.

9 Now, their answer on efficiency is twofold and you
10 will hear it again this morning. They speak with a forked
11 tongue. They say they are speculative and inevitable. There
12 is a little bit of tension there, obviously, Your Honor.
13 Let's start with speculation. The only thing that is
14 speculative is which of the suppliers is going to provide the
15 new lower costs. And what is also speculative is precisely
16 how much deeper those discounts will be. But, there is no
17 speculation at all that the new company will get those
18 increased discounts and lower costs or that they will be
19 huge. And the fact that you don't know how huge, does not
20 make them speculative, Your Honor.

21 Those efficiencies are broken down. We have
22 this -- we have two cases, the base case and the aggressive
23 case. The base case is 5 billion dollars or a little under,
24 and the aggressive case is 6 and a half billion. Some of
25 that will go to shareholders and the balance to customers in

1 the form of lower prices we are talking about.

2 In our charts we have breakdowns that show where
3 those come from and Ms. Shira Goodman, who we've been talking
4 about from day one, I guess, will be one of the witnesses to
5 address that. But the cost savings are huge and they are
6 real. Now, that is confirmed not only by our exhibits, but
7 it is confirmed in one of the things we got right before last
8 or two nights ago, in son of PX 3. PX 3(b) is my
9 recollection. In fact, there are two of them. Do we have
10 them both here? These are from their PX 3.

11 It is when they shift from speculative to
12 inevitable, what they say is, Look at what Staples have done
13 so far. This is what Staples has done so far, when they went
14 from 1994, to 1995, to 1996. These are both from their PX
15 3(b). And as I say, this tension -- on the one hand they say
16 this is all speculation. On the other hand they say, it is
17 inevitable. When they are proving the inevitability, they
18 submit these that show the increases in Staples' discounts
19 from year to year as they have grown in size.

20 If you take 1994, the discounts are at this level
21 from 3M. At '95 they jump up. At '96 they jump up again. And
22 what we are saying is that their own exhibits and a little
23 common sense, they show you this stair-step all of the time.
24 And what will happen is when you change from a company that
25 is going from 2 billion to 3 billion to 4 billion, and make

1 it into a 10-billion-dollar company, you will get a quantum
2 leap in the jump, Your Honor. And their own charts suggest
3 that.

4 In short, there is nothing new about the
5 efficiencies story. It is just more of the same as what you
6 would expect. The thing they have used is they refer to the
7 investment banker and the Goldman Sachs and the prospective
8 study. Your Honor, that is a false comparison. It is
9 comparing two fundamentally different exercises. The first
10 is so-called investment banker or prospectus analysis. That
11 is done to make sure there are sufficient efficiencies from
12 what is called a financial-fairness-opinion standpoint so
13 that the shareholders' interest won't be harmed by the
14 transaction; to show that it is an accretive, rather than
15 dilutive.

16 Before the Board is going to agree to the
17 transaction, they will want to make sure those are covered;
18 so you immediately set about saying, Are there enough
19 efficiencies here that it makes sense to proceed? And that
20 is the nature of that exercise.

21 The second one is a far different one, and it
22 really begins after the first one. And that is once you have
23 made the decision that it makes sense for the transaction to
24 proceed, you then assemble a team of inside people and
25 outside people, and you say, Let's push those things as high

1 as we can get them, not for litigation purposes, but so we
2 can generate costs that are real low and drive those prices
3 down and pass them on to our consumers and increase the
4 volume. They don't do it for the courtroom, they do it for
5 the marketplace.

6 This is a list of -- this is the list of who some
7 of the people were on this task force, Your Honor. There
8 were a lot of people from the outside on the far right-hand
9 column, very highly respected people from the consulting
10 business. Some broad, some narrow, Bain, BCG, a lot of other
11 people, all participated in this exercise and they don't do
12 this for litigation. They did it to get real efficiencies to
13 drive their costs and prices down. So those efficiencies are
14 real, Your Honor.

15 As their own charts show, we have been able to
16 accomplish them every year. They will continue. I remember
17 the first day we were in here, Mr. Orlans used the old
18 Groucho Marx line, Who are you going to believe, me or your
19 eyes? On this, Your Honor, when it comes to the efficiencies
20 front, there is a long history. It all tells the same
21 story. There are eight boxes over there that the FTC put
22 together, and they all tell the same story. The only thing
23 that is different about this transaction is it makes a
24 quantum leap up in every box, and that is a good thing. Not
25 a bad thing.

1 Now, Your Honor, one other thing. They, when it
2 comes to -- let me go up to one other thing before I do
3 that. Let me put these two up. There is another thing we
4 have a history on, Your Honor, and that is what has happened
5 in the past in these companies that made acquisitions. That
6 was something else in the investigative stage the Government
7 asked for, and we gave them the data.

8 As it turns out back in 1990 there were a couple of
9 acquisitions. One was in Dallas, Texas, where Office Depot
10 acquired a company called Office Club, so we took a look at
11 what happened on prices. And after the acquisition, prices
12 didn't go up, price went down. Dallas is a big city and
13 there were efficiencies generated. And what happened to
14 prices after the acquisition is they went down, not up. So
15 we took a look and said, Do we have a Staples' acquisition
16 that shows the same thing? And sure enough, out in Los
17 Angeles was the same story, a company called HQ Office
18 Supplies that Staples acquired. And when they did, again the
19 market went from a three-person market to a two-person
20 market. When they did that, the prices didn't go up, the
21 prices went down. You can believe your eyes. We have a
22 track record of what we do when we make acquisitions.

23 Let me turn to their inevitability argument. This
24 goes like this, these companies are growing fast. They don't
25 need to merge to get to be 10 billion dollars. If we keep

1 them apart, they will get in there in five or six years on
2 their own, then we will have two 10-billion-dollar
3 companies. The answer, of course, is the combined company
4 will get there now and it won't stand still after that. It
5 will grow and in five or six years. It will be at least a
6 20-billion-dollar company, and likely more.

7 The good thing about the merger is that it enables
8 them to get there immediately, and they get on a new
9 lower-cost track by the new larger volume. And the other
10 companies don't catch up, they fall further behind.

11 What happens is, if they were to combine using
12 today's revenues, it would be a 12-billion-dollar company,
13 that would reflect since year-end. They have grown already.
14 Standing apart, sure, over time they will both hit 10 billion
15 dollars, but together they go up higher and they will be at
16 20 billion dollars or more. And the new cost structure they
17 will be on is not something that the other two companies
18 catch up to. They never catch up.

19 By the way, one of the things the merger guidelines
20 expressly provides -- these are the brand-new ones they just
21 issued -- is that timing can be a merger specifically
22 efficiency that the Court should recognize.

23 Let me turn to another factor, Your Honor, that
24 assures competitiveness. It's ease of entry. They make the
25 remarkable argument here that no one can enter an industry

1 that everyone who is in the industry has entered in the last
2 10 years. Retailing is the classic area of ease of entry.
3 Entry into retailing in all of the textbooks, they all
4 highlight that as the classic area; retailing, of ease of
5 entry. And there are eight companies in the United States
6 that have achieved 3 billion dollars in sales or more in less
7 than 10 years. Six of the eight sell office products.

8 I talked earlier about Mr. Ledecy's company and he
9 will be a witness who has gone over 3 billion dollars since
10 1994. Not only that, Your Honor, but there is a powerful,
11 powerful new entry on the horizon. And I would like, at this
12 point, to hand up a very brief typed portion of my opening
13 statement that contains confidential information from Third
14 Parties that they have asked be kept under seal. I would
15 hand that up to the Court if I could.

16 THE COURT: All right.

17 (Under seal Document handed to the Court).

18 MR. KEMPF: Your Honor, I won't respond to all of
19 the distortions of our documents. We will do that in the
20 course of the trial and our post-trial papers. I do want to
21 mention, too, Mr. Cary referred to a study that was done last
22 summer by Betsy Pete, who works -- who is working on some
23 long-range strategic planning. And her study shows the
24 margins have been increasing over time. And then he said --
25 I don't want to quote him -- he said this is something that

1 the top people were, quote, worrying about.

2 Well, when you look back at Ms. Pete's deposition,
3 that is not her testimony at all. What she said was, and its
4 at page 149 of her transcript, far from being resisted, her
5 recommendations with respect to what they should do were very
6 positively received by Staples' top management. The "very
7 positively received" was a quote from her deposition.

8 And they keep referring to -- this morning, to
9 these charts where we talk about the other office superstores
10 as our competition. And they have used a few of them. I
11 will tell you there are tons of those documents in the
12 record. Those don't even begin to suggest, let alone prove
13 that the companies think they are immune from competition and
14 only compete amongst themselves.

15 In the American league race this year, I would
16 think the Orioles would think the Yankees are their
17 competition, but there are a lot of other teams they have to
18 beat before they get to the World Series. The story goes on
19 all over. Macy's v. Gimbel's; Coke v. Pepsi; McDonald's v.
20 Burger King. Those, and a hundred more, illustrate that when
21 you are talking about the competition you focus on the people
22 who are generally most like you, and the ones that you think
23 you go the strongest head-to-head against.

24 Let me turn next, Your Honor, to the subject of the
25 equities. Section 13(b) is a two-part test, not a one-part

1 test. And the question before the Court goes beyond the
2 question of the Commission's likelihood of success.

3 Under 13(b) the issue is whether, one, weighing the
4 likelihood of success; and two, weighing the equities, a
5 preliminary injunction would be in the public interest. The
6 Government didn't talk at all about the equities, but there
7 are powerful equities favoring the confirmation of this
8 transaction.

9 First and foremost among those, Your Honor, is the
10 3 to 5 billion that the Defendants have pledged to pass onto
11 consumers in the form of lower prices as a result of this
12 merger. A preliminary injunction will kill the transaction.
13 And if the Defendants are right on that score and the FTC is
14 wrong, the preliminary injunction will have visited an
15 unfortunate but very real three-to-five-billion-dollar
16 penalty on the American consumer.

17 Let's contrast the concrete cost savings and
18 dynamic efficiencies that will benefit consumers with what
19 the FTC theorizes may happen here. Let me walk through a
20 series of charts here.

21 This is something we talked about before, Your
22 Honor. Total sales of these companies at year-end last year
23 was 10 billion dollars. The 10 billion dollars includes a
24 lot of things that the Government does not have at issue
25 here. They say, for example, eliminate furniture, eliminate

1 computers and business machines. And eliminate the stuff
2 that is not sold at retail. We have a mail-order operation
3 and they say mail-order is not part of it; let's cut that
4 out. When you do all that to measure it on the 10K, you see
5 what we are talking about is 2.27 billion dollars. That is
6 when you start with the two companies and use their
7 percentages and their 10Ks and the breakdowns in the various
8 categories, and pull it into a combined company. This
9 actually overstates it because it is all office supplies, not
10 what they just call consumable office supplies. It is a
11 little harder to get your arms around that. And we don't
12 break that out, so we have all office supplies. But still,
13 that is 2.27 billion dollars.

14 And then let me go back to something that I had
15 said earlier on the small scale when I was talking about
16 Mr. Lapinski. And let me do it now on the large scale.

17 The notion they would go in not only gouge
18 Mr. Lapinski, but gouge all of the people that they sell more
19 than 60 percent of their business to, in order -- excuse me,
20 they would gouge them on office supplies when it is the same
21 people that are buying 60 percent of the store's offerings in
22 furniture, computers, business machines and the like; it
23 makes no sense. They are not going to place their business
24 at risk through the whole store to take some perceived
25 marginal benefit on office supplies, Your Honor.

1 Now, against the efficiencies, the FTC posits; and
2 this is from their -- this is what Mr. Cary referred to in
3 his opening, he said, they have an economist. We hired a top
4 economist and we had him work the calculations through his
5 black box, and it confirms our story. That economist is
6 Dr. Ashenfelter, and we took his deposition. Actually, the
7 number we have here is different from the one he had in his
8 deposition. Because you talk about the efficiencies growing,
9 you should see the growth in their price effects numbers.

10 Professor Hausman's old number was less than 1
11 percent. The first time one of their economists said, I made
12 some corrections, and I ran it, I got 1.7 percent. And they
13 said, Gee, that is no good; and they kept doing it and doing
14 it. And when we took Dr. Ashenfelter's deposition it was
15 like 8.0-something. And then over the transom the other
16 night, and I think this is son of PX 3, or maybe it is an
17 accompanying one, that we have the new number. It is
18 higher. It went -- my recollection is 72 million to 89
19 million. But if you take and ask him about it, this is
20 something that he said, day one -- and let me back up to the
21 left side of the chart. When you pick up on the 2.27
22 billion, the point I made earlier is they say there is 46
23 percent overlap. If you go to the markets where the stores
24 compete now, it is not 2.27. I just do simple math on that
25 and it is a little over one billion dollars if you go to the

1 markets they compete in. The other 54 percent is sold in
2 markets where the two stores don't have any competitive
3 stores.

4 So, then Dr. Ashenfelter says, On my black box, I
5 come up with a theoretical price increase of 89 million
6 dollars, 8.6 percent they would do in the overlap markets on
7 day one, after the merger.

8 Now, the notion that these companies would place
9 their business at risk by raising prices 8 percent not only
10 belies common sense, it is totally out of line with all of
11 the numbers Mr. Cary showed you this morning. And I don't
12 have the PX list with me, but I remember one showed, you
13 know, on PSI items down so much, non-PSI so much, total
14 impact was 2 percent. There was another one less than 2
15 percent. But there is nothing like the black box man that
16 they used came up with here.

17 And then the next question we asked them is, Well,
18 what happens long-term? Is this sustainable? Can they
19 really get away with this, or will there be entry in other
20 things that will occur that will drive the price right back
21 down again? His answer, I'm not sure; I don't know. So
22 there is a real question whether it is sustainable.

23 Finally, Your Honor, to run the three together, is
24 if you take a look at it, you have this questionable whether
25 sustainable price increase of maybe 89 million dollars using

1 a whopping number they have here; looking at cost savings on
2 the base case analysis of five billion dollars, at least a
3 billion to be passed onto consumers. The balance somewhere
4 in the middle to customers. And they say, Oh, they are way
5 off on these. We could be spectacularly off and it swamps
6 this number, it absolutely swamps it. They can nitpick
7 around the edges all they want. We will show them these cost
8 savings and efficiencies are real. But even if their
9 nitpicking was solid, it would not change the story. They
10 just overwhelm the analysis that their black box man did.

11 And this doesn't give full credit to the
12 efficiencies we talked about, the dynamic efficiencies that
13 will result to other people in the industry as our suppliers
14 become more efficient and Kmart and OfficeMax and others
15 demand those lower prices too. We will not be the only ones
16 charging lower prices, others will as well.

17 There are other equities and I will skip those and
18 discuss them during the course of the trial on the public
19 equity side, but I want to mention briefly there are
20 important private equities that are at stake as well. The
21 largest, of course, involves the plight of the shareholders
22 of Office Depot. Not just Matt Scanlan's \$600, but all of
23 the shareholders. And I've got a couple of charts that show
24 this.

25 Before this merger transaction was entered into,

1 for the year preceding it, Office Depot was perceived by the
2 financial markets as a company that was experiencing serious
3 difficulty. The result of that is that from September of
4 1995 to August of 1996, when this transaction was announced,
5 their stock fell from 32 plus a share to 16 dollars a share.
6 That is a loss in market capitalization of more than 2.6
7 billion dollars. The stock market looked at Office Depot and
8 said, that is a company in trouble; and their stock took a
9 big hit as it went down. And, the reality -- and after the
10 merger, the stock has tracked the Staples stock. The two
11 have moved together because it is an exchange of Staples'
12 stock for Depot stock, so the market will trade the two
13 together.

14 But on two occasions -- and let me just show you
15 one of them, Your Honor. On two occasions, one when the FTC
16 voted to bring suit and the other when the consent decree was
17 rejected, in a single day the market tipped the company with
18 a billion-dollar loss in value.

19 On the day that the suit was filed to the day that
20 the announcement of the suit, the 7th was a Friday, and the
21 3rd was -- excuse me. The 10th of March was a Monday, and
22 the stock fell from 22 plus to 17. A loss in market
23 capitalization of 970 million dollars. Same story. And it
24 goes over a billion on the day they decided to file suit,
25 which I think was April 4th.

1 In any event, that is DX 761 and it is a companion
2 exhibit to this, Your Honor. So, a preliminary injunction
3 here, Your Honor, would convert that into a permanent loss.

4 Now, the Office Depot management team are skilled
5 and proud, and will they fight like crazy in the marketplace
6 to reestablish themselves? You bet they would, Your Honor.
7 But the shareholder' loss upon financial preliminary
8 injunction would be both immediate and immense, and we have
9 direct measures from two actual market occurrences.

10 Now, instructive in the equities area, Your Honor,
11 is the D.C. Circuit's opinion in the Weyerhaeuser case.
12 Unusual case. There, Judge Pratt, Judge John Pratt denied
13 the FTC's motion for a preliminary injunction in a 13(b) case
14 because of powerful equitable considerations. And he did so,
15 notwithstanding his conclusion that the FTC had prevailed on
16 the other half of the test. They had convinced him that they
17 were likely to succeed on the merits. And his balancing, I
18 think it is the only case I know that goes that way. The
19 other two say the two factors go this way or the two factors
20 go that way. This was an unusual case where he says, The two
21 factors go in opposite directions, and when I balance them, I
22 find that the equities dominate; and therefore I am denying
23 the FTC's Motion for Preliminary Injunction and letting the
24 case proceed.

25 Judge Ginsburg, then-Judge Ginsburg wrote the

1 opinion for the D.C. Circuit. And she said, no, that it is
2 the right thing to do. And the reason it is the right thing
3 to do is that the determination of likelihood of success at
4 the preliminary injunction stage must be made under time
5 pressure. And we have heard them complain about seven
6 weeks. It be under time pressure and on incomplete
7 evidence. Therefore, the risk of an erroneous assessment is
8 higher than it is after a full-evidentiary hearing. And so,
9 the D.C. Circuit affirmed the denial of a preliminary
10 injunction there, even though it was solely on the equitable
11 considerations.

12 Now, one thing that is very worth noting, Your
13 Honor, with respect to the wisdom of that decision is the
14 subsequent history of the Weyerhaeuser case itself. And in
15 that case, unlike this one where it basically came out on a
16 3-to-2 vote, the commissioners voted 5/0 to challenge the
17 transaction. Thanks to Judge Pratt's ruling, we had a chance
18 to get a full trial on the merits. When we did, the
19 Commission, again on a 5/0 vote, said, We got it wrong the
20 first time. This merger doesn't violate Section 7 after
21 all. And they voted 5/0 to dismiss the Complaint. They were
22 wrong, and Judge Pratt was wrong. And at the end of the day,
23 when they got to a full trial on the merits, Weyerhaeuser
24 prevailed on that case, thus indicating the wisdom of a good
25 healthy consideration of the equitable considerations.

1 One other reason why a PI would not be appropriate
2 here, Your Honor, this is not a scrambling of the eggs
3 situation. An office store at Fourth and Main in San
4 Francisco cannot be scrambled with one at Seventh and Central
5 in Pittsburg. It is not like a factory where the two are
6 going to be integrated or something like that. These office
7 superstores are freestanding locations.

8 The Government's only answer to that is they say
9 some of them will be closed. What that ignores is that there
10 will be massive new openings. And for every one that is
11 closed, there will be five or more that are opened. So here,
12 Your Honor, is the classic case where if they want to take
13 the case through an administrative hearing, there is more
14 than adequate relief at the end of that hearing in an ability
15 to order an effective divestiture.

16 In fact, with all of the store openings that will
17 occur, the divested company would likely be stronger, not
18 weaker than Office Depot is today.

19 Your Honor, it wasn't the FTC that brought a dose
20 of new competition for the sale of office supplies and
21 brought office supplies across this country tumbling down, it
22 was the business executives sitting in this courtroom.
23 Staples and Office Depot have been two of the best friends
24 that the small businessman in the home office has ever had.
25 The combined company will be able to and will do an even

1 better job of serving that constituency. It is not a
2 question here of promises. These people and these companies
3 have an unblemished track record of 10 years of constantly
4 striving to get those efficiencies.

5 Remember when Mr. Cary handed up the stuff that
6 talked in terms of basis points. Let me give you a little
7 meat on that bone. A basis point is 1/100th of 1 percent.
8 These people are looking for ways to save money that is as
9 small as 1/100th of one percent. That is a basis point.
10 They strive to do that. They do it every day. It is the
11 productivity loop. They know it is the formula for their
12 past success. They know it is the formula for their future
13 success.

14 And they know that they can persuade any trier of
15 fact to that reality, but that is not our burden here, Your
16 Honor. Indeed, preliminary injunction states the burden is
17 not on us at all, it is on the FTC. And they have the burden
18 of showing that both their likely success and the equities on
19 injunction would be in the public's interest. They can't
20 meet that burden, Your Honor. The PSI should be denied and
21 the merger should be permitted to be consummated and the
22 company to get about the business of serving consumers well
23 into the future in the same way as they have in the past.

24 If they want to proceed with their administrative
25 Complaint, they can still do that. It is not the end of the

1 road. The Defendants are not, in short, Your Honor, asking
2 for any final approval of this transaction. They are just
3 being asked to be sent over to get their full trial on the
4 merits if the Government wants to do that route.

5 There are not many cases like this that go to trial
6 anymore, Your Honor. Usually they crater. It is a very
7 expensive proposition. I am sure that Your Honor from its
8 observation can tell that. The risks of disruption are too
9 great. The costs of it are too high. The taking of
10 productive resources and diverting them to litigation are all
11 of the kinds of things that most companies -- they cave when
12 they get sued. But these companies are fighters. They know
13 what this transaction is about. They know what they were
14 formed a decade ago to do. They know what they will do if
15 this goes forward. That is not higher prices, it is lower
16 prices, Your Honor. They have they have served consumers
17 well. They have delivered in the real world what antitrust
18 policy says you are supposed to deliver, theoretically. They
19 have done it and they have done it on all three touchstones
20 of competition. Lower prices, better quality, more service.
21 And by combining, they only seek to continue that, Your
22 Honor, through a merger that they know because they have been
23 there is the best way other to do it. Thank you.

24 THE COURT: All right. Thank you, Mr. Kempf. The
25 Court will take its afternoon recess. We will be back, and I

1 think we will be ready to begin with the first witness on
2 behalf of the Plaintiff. We will take a 15-minute recess
3 until 3:15, please.

4 THE DEPUTY CLERK: All rise.

5 (Brief recess)

6 MR. KEMPF: Your Honor, a quick thing. We have
7 noted on both sides that a lot of young people have done a
8 lot of good work in this case, and some of them are going to
9 get their moment in the spotlight, Your Honor, because they
10 have earned it. And I want to introduce you to the fellow
11 who will be doing the cross-examination of the Government's
12 first witness. You have not met him before. Jim Basile, the
13 second fellow right there, Your Honor.

14 THE COURT: Thank you. If we are ready to go.

15 MR. DOYLE: Your Honor, my name is Robert Doyle. I
16 represent the Federal Trade Commission, and we call Walter
17 Edwards on behalf of the Federal Trade Commission.

18 WALTER EDWARDS, GOVERNMENT'S WITNESS, SWORN

19 BY MR. DOYLE: Your Honor, I would like to introduce
20 counsel representing Mr. Edwards. It's Deborah Miela,
21 in-house counsel for Kmart Corporation, and Jeffrey Petrash,
22 of the Washington office of Dickenson Wright, a Detroit law
23 firm.

24 THE COURT: All right, Mr. Petrash.

25

1 DIRECT EXAMINATION

2 BY MR. DOYLE:

3 Q. Mr. Edwards, would you state your name for the record,
4 sir.

5 A. Yes. Walter Edwards.

6 Q. By whom are you employed, sir?

7 A. Kmart Corporation.

8 Q. How long have you been employed by Kmart?

9 A. 25 years.

10 Q. Can you tell us a little bit about Kmart? How many
11 stores does Kmart have?

12 A. Approximately 2150 stores located throughout the United
13 States, Puerto Rico, Virgin Islands.

14 Q. Is there many areas in the United States where Kmart
15 does not have a store?

16 A. I don't believe there are.

17 Q. Can you briefly describe for the Court, sir, the various
18 positions you have held at Kmart?

19 A. Yes. I began my career in the management training
20 program, progressed through assistant manager, store
21 manager. I went into district or regional manager, as they
22 classify them today; and then area marketing and merchandise
23 coordinator; and then the buying position that I currently
24 hold.

25 Q. How many years have you been employed by Kmart?

- 1 A. 25.
- 2 Q. And your present position is what, sir?
- 3 A. I am one of the buyers for stationery.
- 4 Q. How long have you been a buyer for stationery?
- 5 A. Approximately two and a half years.
- 6 Q. You said that you are one of the buyers. Is there
7 another buyer of stationery products?
- 8 A. Yes, there is.
- 9 Q. Who is that, sir?
- 10 A. That is Jim Cary.
- 11 Q. Now, what responsibilities do you have, sir, as a buyer
12 of stationery products?
- 13 A. I buy the section that we consider the home and office
14 products.
- 15 Q. And how many home and office products do you have direct
16 responsibility for, sir?
- 17 A. Approximately 450 to 500 SKUs.
- 18 Q. Can you give the Court a rough idea as to what kind of
19 products you have responsibility for?
- 20 A. Okay. I have responsibilities for the filing, filing
21 supplies; the fire chests; what we call coin; the planning
22 and organization section; the home office supplies, which
23 would be the small items like the paper clips, Post-its,
24 staples, et cetera; envelopes; social stationery; tape and
25 mailing.

- 1 Q. Sir, you mentioned Jim Cary that has responsibilities
2 for other stationery products. What products does he have
3 responsibility for?
- 4 A. He has what we classify as our school supplies.
- 5 Q. Did he have any responsibility for home and office
6 products?
- 7 A. Not what we classify as home and office, no.
- 8 Q. Now, sir, would you tell us, does he have responsibility
9 for back-to-school items?
- 10 A. Yes, that is his primary responsibility.
- 11 Q. Now, what kind of products would fall within the
12 back-to-school category he has responsibility for?
- 13 A. He would have art, crayons, message boards, writing
14 utensils, pads, and notebooks.
- 15 Q. Are you familiar, sir, with the term "consumable office
16 supplies"?
- 17 A. I believe I am, yes.
- 18 Q. What does that term mean to you?
- 19 A. That is basically an item that the customer comes back
20 on repeated buys.
- 21 Q. Now, with respect to the items that you have
22 responsibility for, the 450 to 500 items that you mentioned,
23 what percent of those items would be consumable office
24 supplies?
- 25 A. I would say, approximately, 50 percent.

- 1 Q. Does Mr. Cary, the other buyer, have any responsibility
2 for any consumable office supplies?
- 3 A. Not what we classify as office supplies, no.
- 4 Q. Now, sir, in your position as a buyer of office
5 supplies, do you also have responsibility for the pricing of
6 Kmart's consumable office supplies?
- 7 A. Yes, I do.
- 8 Q. Before we get into the specifics of your pricing
9 responsibilities, let's talk for a moment, sir, a little bit
10 about the competition that you face. Do you track other
11 retailers of office supplies?
- 12 A. Yes, we do.
- 13 Q. What other retailers do you track, sir?
- 14 A. Our primary competitors that we focus on are Wal-Mart
15 and Target.
- 16 Q. Now, based on your experiences at the company for 25-odd
17 years, do you have -- do you consider any other retailers
18 your primary competitors of office supplies?
- 19 A. Yes. There are regional chains such as the Ventures,
20 Meyers, Bradleys of the world. We consider them
21 competition.
- 22 Q. Now, are they comparable to Kmarts on a regional basis?
- 23 A. I am sorry.
- 24 Q. The Hills, Venture, and other regional retailers that
25 you --

1 A. They are mass retailers, discounters. They target the
2 same customers we do.

3 Q. Now, are you familiar, sir, with the office supply
4 superstores?

5 A. Yes, I am.

6 Q. Do you consider the office supply superstores your
7 primary competitors for the sale of office supplies?

8 A. We do not consider them as primary competitors, no.

9 Q. But you do sell some of the same items that the
10 superstores sell?

11 A. Yes, we do.

12 Q. To that extent, you have some overlapping product?

13 A. Yes, we do.

14 Q. Now, can you tell us, sir, what are some of the
15 differences between your primary competitors, Wal-Mart and
16 Target, and the office supply superstores, with respect to
17 office supplies?

18 A. Well, the difference would be in the mass market. The
19 discounters, they do not offer the breadth of assortment that
20 the office superstores do; where Kmart, we more or less gear
21 our assessment as a convenience stop, not a destination.

22 Q. And what do you mean when you say you are a convenience
23 stop?

24 A. That the customer is in our store shopping for their
25 general needs. And, you know, happens through -- we feed off

1 the traffic drawn by that customer and we hope to have the
2 best or the most likely purchased items included in our
3 assortment in home and office.

4 Q. Sir, you mentioned a destination stop. What do you mean
5 by the term "destination stop"?

6 A. That would be where, when the customer comes into the
7 store, they are coming through that location for a
8 predetermined purchase. And in our case we target the busy
9 budget-conscious mom for her general purchases overall.

10 Q. Do you consider Kmart a destination stop for office
11 supplies?

12 A. No, we do not.

13 Q. Do Kmart's office supply products draw traffic to Kmart
14 stores?

15 A. No. I believe as I have stated there, we live off of
16 the traffic drawn in by the balance of the store.

17 Q. Does Kmart advertise itself as an office supplies
18 destination stop?

19 A. We do not.

20 Q. Does Kmart actively advertise and promote itself as a
21 full-line supplier of office supplies?

22 A. No, we do not.

23 Q. Do you consider the office supply superstores, sir,
24 destination stops for office supplies?

25 A. Yes.

1 MR. BASILE: Objection, leading, Your Honor.

2 THE COURT: Leading question. I sustained it.

3 BY MR. DOYLE:

4 Q. Are office supply superstores --

5 MR. BASILE: Leading.

6 THE COURT: You can answer whether or not in his
7 opinion, are they?

8 BY MR. DOYLE:

9 Q. Sir, in your opinion are office supply superstores
10 destination stores?

11 A. In my opinion, they are.

12 Q. And can you tell us why, sir?

13 A. I believe they target a customer's total home and office
14 needs with their vast assortment.

15 Q. And when you say they target a particular customer, what
16 do you mean by that?

17 A. The small office, home office, and even larger office
18 customers. Anybody needing supplies and/or furnishings for
19 the office.

20 Q. Sir, in your opinion, do office supply superstores
21 advertise and promote themselves as destination stops?

22 A. I believe they do, yes.

23 Q. Let's talk for a minute, sir, about some of the price
24 checking activities of the company. Does Wal-Mart generally
25 price-check its competitors?

1 A. Does Wal-Mart generally price check? I believe they do.

2 THE COURT: Are you talking about Wal-Mart or
3 Kmart?

4 BY MR. DOYLE:

5 Q. I am sorry. Does Kmart regularly check your
6 competitors?

7 A. Yes, we do.

8 Q. Do you check your competitors with respect to office
9 supplies?

10 A. Yes, we do.

11 Q. What companies do you price check?

12 A. Again, our primary targets. Our primary competitors, we
13 feel, are Wal-Marts and Targets.

14 Q. Do you individually price check any of your competitors?

15 A. Yes, I do.

16 Q. Who do you check? Who do you price-check?

17 A. Wal-Mart and Target are my primary targets. Again,
18 however, I don't exclude anyone else. If I am in the market
19 where there is other retailers, I will go into those stores
20 also.

21 Q. How often is Wal-Mart and Target price-checked by Kmart?

22 A. By myself or by -- by Kmart? By the pricing
23 department?

24 Q. Let's break it down by both. How about by the pricing
25 department?

1 A. By the pricing department, you have an annual line
2 review which there will be a more comprehensive check done
3 every year. And then any time a buyer requests checks on
4 individual categories, lines, et cetera, they can be done.

5 Myself, I am in competition at least a handful of
6 times a month, and sometimes on a weekly basis.

7 Q. Now, are the office supply superstores price-checked at
8 all, sir?

9 A. I am sorry.

10 Q. Are they price-checked at all?

11 A. Yes, they are.

12 Q. And how often would they be price-checked?

13 A. If I am in a market where there is an office superstore
14 near where I am visiting at, I will go into it.

15 Q. How often is that?

16 A. It is, right now, very occasional. I would say maybe
17 every other month.

18 Q. Does the pricing department of Kmart price-check the
19 office supply superstores for office supply products?

20 A. Not as a primary target. We do have checks that come
21 back, but they are few and far between. They are focused
22 mainly on Wal-Mart and Target.

23 Q. Mr. Edwards, let me ask you to provide the Court with a
24 general description, if you can, of the pricing process at
25 Kmart with respect to office supplies.

1 A. Okay. Are you talking with our pricing department, or
2 my process?

3 Q. I am talking about the zone pricing system in place at
4 Kmart. Could you describe that for the Court?

5 A. Okay. Requests are sent out nationally to do pricing
6 surveys. They are brought back into the building and they
7 are classified into three zones. They are classified into a
8 Wal-Mart market, a Wal-Mart market with Target influence, and
9 a non-competitive market.

10 Q. Now, when you say that you have a Wal-Mart price zone,
11 can you elaborate a little bit on why that kind of a price
12 zone exists occasionally?

13 A. The reason it exists is because they are our primary
14 competition. Our primary focus is aimed at Wal-Mart.

15 Q. Now, with respect to the second zone that you mentioned,
16 Wal-Mart zone with a Target influence, can you elaborate
17 somewhat on that?

18 A. That would be where both competitors are in the same
19 market. And again, our pricing guidelines are based
20 predominately off of the Wal-Mart pricing, but consideration
21 is given to the Target pricing.

22 Q. And the non-competition zone that you mentioned, can you
23 describe that?

24 A. That is what we would call our higher tier of pricing.
25 Without the Wal-Mart and Target principals in the area, we

1 are able to take a slightly higher markup in that area.

2 Q. Now, sir, within the various price zones, are there
3 uniform office supply prices?

4 A. Yes. That is a national pricing scale for us.

5 Q. Within the Wal-Mart price zone, are the Wal-Mart office
6 supply prices uniform, regardless of the number of
7 superstores within those zones?

8 A. Yes. We target Wal-Mart's price.

9 Q. So let me see if I understand this. Let's say you have
10 a Kmart?

11 MR. BASILE: Objection, leading.

12 THE COURT: He can ask him to explain his answer.

13 Go ahead.

14 BY MR. DOYLE:

15 Q. Assume on the west coast you have a Wal-Mart zone where
16 Kmart is doing business and there are three superstores in
17 that zone. Let's say on the east coast you have a Wal-Mart
18 zone with a Kmart doing business and one superstore. Would
19 the office supply prices be the same in both of those
20 superstore zones?

21 A. Yes. They should be.

22 Q. Is there ever any deviation from this zone pricing?

23 A. No. The the only deviation is if items are designated
24 as image items.

25 Q. What is an image item?

1 A. An image item is a highly-recognizable item within the
2 department that the company will give the stores flexibility
3 of pricing to local competition. They can adjust downward,
4 but not above our list book pricing.

5 Q. Mr. Edwards, how many products that you have
6 responsibility for, office supply products, are image items?

7 A. Currently we have none.

8 Q. How often is an office supply product an image item,
9 based on your experience?

10 A. We have not had any of them fall into the image category
11 now for approximately two years.

12 Q. So Mr. Edwards, is it fair to say that you set prices
13 for office supplies based on the presence or absence of
14 Wal-Mart and Target?

15 MR. BASILE: Objection, leading.

16 THE COURT: Why don't you rephrase the question.

17 BY MR. DOYLE:

18 Q. Sir, do you set prices under the zone system just on the
19 basis of Wal-Mart and Target?

20 MR. BASILE: Object, that is leading.

21 THE COURT: This is a non-jury trial. He can ask
22 him how he sets his prices. That is what he is doing, based
23 on the factors. Go ahead.

24 THE WITNESS: Yes. It is primarily focused off of
25 a Wal-Mart competition.

1 BY MR. DOYLE:

2 Q. And therefore, sir, am I accurate when I say, then, the
3 office supply superstores, the number of office supply
4 superstores in a zone does not affect Kmart's pricing?

5 A. It does not, no.

6 Q. Mr. Edwards, let me talk for a moment about shelf space
7 expansion and store layout. Do you have any flexibility,
8 sir, with respect to ordering the expansion of office
9 supplies sold by Kmart?

10 A. For me to be able to expand the selection, I would have
11 to -- I would have to prove my point financially with my
12 people that the product I was displacing would in fact belong
13 in that space, versus, you know, what was there at the time.

14 Q. Now, when you say "product displacing," what do you mean
15 by that?

16 A. The product from another department or another area of
17 our department that I would suggest to replace with home and
18 office products. I would have to not only show comparable
19 growth, but naturally appreciable growth over and above
20 growth, as well as productivity.

21 Q. So, are you suggesting that the amount of shelf space
22 within a Kmart retail store is fixed?

23 A. It is fixed, yes. We have limitations as to how much
24 space we can allocate to the different departments, because
25 of the range, the variety we offer the customer.

1 Q. Now, sir, have you considered making a recommendation to
2 your superiors to expand the shelf space for office supplies?

3 A. I have not, no.

4 Q. Is it something that you will likely recommend in the
5 future?

6 A. Not right now, no.

7 Q. If you did make that recommendation, what factors would
8 you look at?

9 A. I would have to look at the overall growth of the area,
10 the marketing information, which way the market was headed.
11 There would be an array of different considerations, and
12 again I would have to be able to financially prove that that
13 merchandise should occupy that space.

14 Q. If you did recommend it, sir, do you think your
15 superiors would be inclined to accept your recommendation?

16 MR. BASILE: Objection, leading.

17 THE COURT: I think that is speculation unless you
18 can lay a better foundation on what your superiors will do.

19 BY MR. DOYLE:

20 Q. Based on your experience with the company, if you made a
21 recommendation with respect to changing the layout of a store
22 and expanding a particular product group, do you think your
23 superiors would be inclined to accept that?

24 MR. BASILE: Same objection, Your Honor,
25 speculation.

1 BY MR. DOYLE:

2 Q. I will try again. Sir, is it difficult to change shelf
3 space and store layout at Kmart?

4 A. Yes, extremely difficult.

5 Q. Why is that, sir?

6 A. Again, the area of the store -- the store area has been
7 sectioned-off based off of financials, potential, what the
8 company feels is potential market growth in the mass trade,
9 and what blends into the mix and the target customer they are
10 going after. And again, our -- we have space limitations.

11 Our maximum department length is 120 foot, and then we
12 digress from there.

13 Q. Sir, could you make a recommendation to expand the shelf
14 space on a local level?

15 A. No, not to expand the shelf space. We could not.

16 Q. Could you make a recommendation to expand shelf space
17 for office supplies? Again I am referring to on a larger
18 regional area?

19 A. No, not to expand shelf space, no.

20 Q. Could it only be done on a national scale?

21 A. Yes.

22 Q. And again, why is that?

23 A. Again, we have targeted an assortment we feel that is
24 best for the company nationally, and we work from there as
25 far as space goes. That space is allocated. The only thing,

1 that there is an exception made for additional items, but not
2 additional space. The store has to fit that within the
3 allocated space.

4 Q. Now, sir, if after the merger Staples and Office Depot
5 raised prices on office supplies by 5 to 10 percent, would
6 Kmart expand its products offerings of office supplies?

7 MR. BASILE: Objection, speculation.

8 THE COURT: Let me just look at this.

9 MR. DOYLE: I am sorry, Your Honor?

10 THE COURT: You are asking his opinion that after
11 the merger, if it occurred, and there was a raise in office
12 supplies of 5 to 10 percent, would Kmart expand its product
13 offerings of office supplies?

14 I will sustain the objection. I don't know how he
15 can answer that to know how Kmart, whether they are in a
16 position to or not.

17 BY MR. DOYLE:

18 Q. Sir, let me rephrase the question. After the merger, if
19 Staples and Office Depot raise the prices of office supplies
20 by 5 to 10 percent, would you make a recommendation to your
21 superiors to expand the product offering of consumable office
22 supplies?

23 A. No, I would not.

24 Q. Why not, sir?

25 A. What we are up against, more so in the case of going

1 against an office-supply store, is in the -- more of a
2 competitive battle on assortment. We cannot compete with a
3 vast assortment they have versus our limited area. And the
4 pricing I do not feel would affect our sales to a point that
5 would be able to recommend expansion.

6 BY MR. DOYLE:

7 Q. Now, if prices rose after the acquisition, would you
8 expect to see -- assume the acquisition takes place and
9 prices rise. Would you expect to see an increase in the
10 sales of your department?

11 A. From price increasing?

12 Q. If after the acquisition Staples and Depot raise the
13 price by 5 and 10 percent, would you see an increase in the
14 total volume of sales of your department?

15 MR. BASILE: Objection. Calls for speculation.

16 THE COURT: I'm not sure of the basis you are
17 asking this question. If after the acquisition Staples and
18 Depot raise the price by 5 and 10 percent, would you expect
19 see an increase in the total volume of sales of your
20 department?

21 Are you offering this as an expert, I guess, in
22 the area of office supplies being sold by the discount
23 chain? You are asking his opinions based on some
24 hypotheticals here.

25 MR. DOYLE: I am asking about his experience based

1 on 25 years in the business, and having direct responsibility
2 for buying office supplies and pricing them. If prices rose
3 as a result of the acquisition, would he expect to see the
4 volume in his department increase?

5 THE COURT: I will allow it -- go ahead, over
6 objection.

7 BY MR. DOYLE:

8 Q. Could you answer that, Mr. Edwards?

9 A. I would not expect to see sales increase from that.

10 Again, I go back to -- I don't believe the assortment
11 comparison that -- that that amount of pricing increase would
12 necessarily take that office customer and shift them over to
13 a discounter.

14 Q. Now, sir, when you deal with vendors do you try to get
15 the best deal possible for Kmart --

16 A. Yes, we do.

17 Q. -- and if you know that Staples or Depot is getting a
18 good deal, would you try to match that deal with respect to
19 the vendors you are dealing with?

20 A. I certainly would.

21 Q. Is there any way for you to verify whether you are
22 getting the same deal with respect to vendors that Staples
23 and Depot is getting?

24 A. No, there is not.

25 Q. Have you ever asked a vendor to give you cost

1 information for Staples and Depot?

2 A. Not so much cost information as equality in the
3 pricing. I have, yes.

4 Q. Is there any way for you to verify whether the
5 information you are getting from the vendor is accurate?

6 A. No, there is not.

7 Q. Do you have access to Staples' and Depot's cost data to
8 determine whether you are being treated equally from the
9 vendors you are dealing with?

10 A. I do not.

11 MR. DOYLE: Thank you, Mr. Edwards. No further
12 questions.

13 THE COURT: Thank you, Mr. Doyle.

14 MR. BASILE: James Basile.

15 THE WITNESS: Hello, Mr. Basile.

16 CROSS-EXAMINATION

17 BY MR. BASILE:

18 Q. The fact is, Mr. Edwards, you consider your stationery
19 department in Kmart to compete with the office supply market?

20 A. Yes, I do.

21 Q. And success in that market is based partially on product
22 mix; is that right?

23 A. Yes, that is correct.

24 Q. And success in that market is also based partially on
25 convenience; isn't that correct?

1 A. That is correct.

2 Q. Now, if a home office shopper wanted to do one-stop
3 shopping for note pads and clothes, Kmart would be a more
4 convenient place to shop than a superstore; correct?

5 A. Yes, it would be.

6 Q. And if a home office shopper wanted to buy envelopes and
7 aspirin, Kmart would be more convenient than a superstore as
8 a one-stop shopping place; right?

9 MR. DOYLE: Objection, calls for speculation.

10 THE COURT: All right. I will allow him to testify
11 as a result of his experience. He has testified earlier what
12 he thought would happen if the merger took place. Go ahead.

13 THE WITNESS: I believe it would be.

14 BY MR. BASILE:

15 Q. If a home office consumer wanted to buy paper pads or
16 paper clips and automotive supplies, Kmart would be a more
17 convenient one-stop shop than an office superstore; wouldn't
18 it?

19 A. I believe it would be.

20 Q. So you agree, don't you, that for home office consumers
21 that want to pick up a variety of products, including office
22 supplies, Kmart would be a good place to one-stop shop?

23 A. I would say yes, but it would depend on their office
24 needs.

25 BY MR. BASILE: Counsel, deposition page 26, line 14:

1 Mr. Edwards, when you were deposed in this matter,
2 did I ask you this question and did you give this answer:

3 "Q: Now, if a home office consumer, a consumer
4 that has an an office at home wanted to pick up a variety of
5 products, including office supplies, would Kmart be a good
6 place to one-stop shop?

7 "A: Yes."

8 Did I ask that question and did you give that
9 answer?

10 A. Yes, you did; and yes, I did.

11 Q. Now, as a matter of fact, Kmart would be disappointed if
12 home office shoppers thought they could not come to Kmart and
13 get basic office supplies, as well as other things; correct?

14 A. That is correct.

15 Q. Now, you talked about Kmart as a destination for persons
16 shopping for office supplies. I want to ask you a few
17 questions about that.

18 Kmart sells business supplies to businesses,
19 doesn't it?

20 A. I imagine it does, yes.

21 Q. It does, doesn't it?

22 A. Yes. We don't limit who we sell to.

23 Q. And Kmart sells office supplies to people with home
24 offices, doesn't it?

25 A. Yes.

1 Q. And you have not done any demographic research to
2 determine how many persons come to Kmart for home office
3 supplies, have you?

4 A. No, I have not.

5 Q. And you have no demographic data to support your claim
6 that people don't come to Kmart as a destination for their
7 home office supplies, do you?

8 A. No, I do not.

9 Q. And you don't know how many people a year come to Kmart
10 for home office supplies, do you?

11 A. No, I do not.

12 Q. And you have never even looked for such a figure, have
13 you?

14 A. I don't know that there is such a figure available.

15 Q. You have never looked for such a figure, have you?

16 A. I don't believe I have.

17 Q. And you would not even know where to look for such a
18 figure, would you?

19 A. No, I would not.

20 Q. And you don't know how many people with small businesses
21 of under 20 employees come to Kmart as a destination for
22 office supplies each year, do you?

23 A. No, I do not.

24 Q. Now, we talked about these 450 to 500 SKUs of office
25 supplies. Now, that 450 to 500 SKUs referred to in your

- 1 testimony, that doesn't include computer disks, does it?
- 2 A. No, it does not.
- 3 Q. And Kmart sells computer disks, doesn't it?
- 4 A. Yes, they do.
- 5 Q. And that 450 to 500 SKUs that you referred to, that
- 6 doesn't include batteries, does it?
- 7 A. No, it does not.
- 8 Q. And Kmart sells batteries, don't they?
- 9 A. Yes.
- 10 Q. And in fact, Kmart has a whole department that sells
- 11 batteries, don't they?
- 12 A. Yes.
- 13 Q. And nothing sold in that department is included in your
- 14 450 to 500 SKUs, is there?
- 15 A. No, there isn't.
- 16 Q. The computer disks we talked about that Kmart sells,
- 17 those are sold in the home electronics department; right?
- 18 A. That is correct.
- 19 Q. And the computer software sold by Kmart, that is in the
- 20 home electronics department; correct?
- 21 A. That is correct.
- 22 Q. But computer software is not included in the 450 to 500
- 23 SKUs you talked about; is that correct?
- 24 A. No, that is not included.
- 25 Q. And you didn't include in your 450 to 500 SKUs any

1 products sold in the home electronics department at Kmart,
2 did you?

3 A. No. They are all SKUs under my responsibility.

4 Q. So your definition of "consumable office supply" is
5 limited just to the things you sell in your part of the
6 stationery department; correct?

7 A. Yes, that would be correct.

8 Q. And the listing of 450 to 500 SKUs in your declaration
9 which are only things that were in your planigram or things
10 that would be included in your seasonal purchases or
11 subdepartment; correct?

12 A. That is correct.

13 Q. You think that offices like to have computer disks on
14 hand, don't you?

15 A. Yes, I do.

16 Q. And in fact, there are a variety of things that are
17 office supplies that are not carried in your department;
18 right?

19 A. Yes.

20 Q. And as a result, there are a variety of things that are
21 office supplies that are not counted in your 450 to 500 SKUs
22 mentioned today; correct?

23 A. Yes. That would be correct.

24 Q. If we want to know anything about those other office
25 supplies we would have to talk to somebody else at Kmart;

- 1 correct?
- 2 A. That would be correct.
- 3 Q. Now, Kmart believes it provides value for the home
4 office consumer to buy office products at Kmart; right?
- 5 A. Yes, we do.
- 6 Q. And Kmart believes it provides value to the businesses
7 that buy business supplies at Kmart; isn't that correct?
- 8 A. Yes, we would. Yes, we do.
- 9 Q. In fact, you believe yourself that the prices Kmart
10 charges for office supplies are competitive; correct?
- 11 A. Yes, I do.
- 12 Q. And your policy is to remain price competitive with
13 Wal-Mart; right?
- 14 A. This is correct.
- 15 Q. And you try to prevent any significant disparity with
16 prices with Wal-Mart; correct?
- 17 A. As much as possible, yes, we do.
- 18 Q. That is one of your responsibilities; correct?
- 19 A. That is correct.
- 20 Q. You price-check Wal-Mart on a pretty frequent basis; is
21 that correct?
- 22 A. Yes, I do.
- 23 Q. Would it be fair to say you price-check Wal-Mart
24 vigorously?
- 25 A. I would say yes.

- 1 Q. And you don't know whether Wal-Mart price-checks all of
2 the office superstores, do you?
- 3 A. No, I do not.
- 4 Q. And you would be surprised to know that Wal-Mart checks
5 office supply items at Staples and Office Depot and OfficeMax
6 on a weekly basis; right?
- 7 A. On a weekly basis, yes.
- 8 Q. You would be surprised to learn that?
- 9 A. Yes.
- 10 Q. And you are not aware that Wal-Mart price-checks the
11 superstores in order to make sure that Wal-Mart's prices
12 remain competitive with them; right?
- 13 A. No, I am not aware.
- 14 Q. But nonetheless, you try to prevent any significant
15 disparity with your prices with Wal-Mart; is that correct?
- 16 A. That is correct.
- 17 Q. Now, Wal-Mart is a primary competitor of Kmart's;
18 correct?
- 19 A. Yes, they are the primary competitor.
- 20 Q. You don't know how many office SKUs of office supplies
21 they carry; is that correct?
- 22 A. No, I don't know.
- 23 Q. You don't think they carry 2,000 SKUs, do you?
- 24 A. No.
- 25 Q. Now, haven't you recently prepared a report in which you

1 indicated that Wal-Mart sells \$151,000 a year per store in
2 office supplies?

3 A. Yes. That was in a -- that was an approximate figure
4 based off of corporate financials reported via the Internet,
5 and a percentage application developed by -- I believe it was
6 Discount News.

7 Q. But the report that you prepared said that Wal-Mart
8 sells \$151,000 a year per store in office supplies; is that
9 correct?

10 A. That is correct.

11 Q. And would you be surprised to learn that Wal-Mart
12 actually sells \$800,000 a year in office supplies; is that
13 correct?

14 A. That is correct.

15 Q. Now, you said that you probably would not increase the
16 number of SKUs if prices increased by five to ten percent at
17 the superstores. I want to ask you some questions about
18 that.

19 Before making business decisions regarding
20 stationery sales at Kmart, you like to review the facts,
21 don't you?

22 A. Yes, we do.

23 Q. And when you are sitting here today saying that you
24 would probably increase the number -- would not increase the
25 number of SKUs in the face of a price hike, you are doing so

- 1 without looking at how many people come to Kmart a year for
2 home office supplies right now; correct?
- 3 A. That is correct.
- 4 Q. And making that statement here today, you are doing so
5 without knowing how many people come to Kmart as a
6 destination for home office supplies; correct?
- 7 A. That would be correct.
- 8 Q. In making that statement here today, you are doing so
9 without any demographic research to indicate whether office
10 supplies -- if office supply superstores raise their prices
11 more, whether more people would buy office supplies at Kmart;
12 is that correct?
- 13 A. Yes.
- 14 Q. Now, when you say that you would not increase the number
15 of SKUs at Kmart, you are referring to 450 to 500 SKUs at
16 Kmart; is that correct?
- 17 A. That is correct.
- 18 Q. If Staples and Office Depot raised their prices 5 and 10
19 percent after the merger, you can't say what the people in
20 the home electronics department would do, could you?
- 21 A. No, I can't.
- 22 Q. And you have no personal knowledge what anybody else
23 controlling all of the other office supplies throughout Kmart
24 would do in that situation; is that correct?
- 25 A. That is correct.

- 1 Q. And you have no knowledge what Wal-Mart would do in that
2 situation, do you?
- 3 A. That is correct.
- 4 Q. You have no knowledge what Sam's Club would do?
- 5 A. Correct.
- 6 Q. Or PriceCostco?
- 7 A. Correct.
- 8 Q. Or BJ's?
- 9 A. Correct.
- 10 Q. Or any other competitor; right?
- 11 A. That is correct.
- 12 Q. In fact, you don't have any knowledge what anyone would
13 do, except your subdepartment of the stationery department at
14 Kmart; correct?
- 15 A. Yes.
- 16 Q. Now, Kmart does have the ability to increase the number
17 of SKUs of office supplies it carries; is that correct?
- 18 A. Yes, they do.
- 19 Q. And in fact, you do increase the number of SKUs that you
20 carry at Kmart when a competitive opportunity presents
21 itself, don't you?
- 22 A. The number of SKUs?
- 23 Q. Yes.
- 24 A. What I stated before, if there is a local area where
25 going back to school they require X merchandise, yes, we will

1 allow the store to buy it.

2 Q. Page 103, line 16, Counsel, when you were deposed in
3 this case, Mr. Edwards, did I ask this question and did you
4 give this answer:

5 "Q: And you do increase the number of SKUs in the
6 stationery department at various times of the year; correct?

7 "A: Yes.

8 "Q: Whether you think a competitive opportunity
9 presents itself, you increase the number; is that correct?

10 "A: Yes. That could be, yes.

11 "Q: The answer is yes?

12 "A: Yes."

13 Did I ask those questions and did you give those
14 answers when you were deposed?

15 A. Yes.

16 Q. There is nothing in your declaration that you gave to
17 the FTC, that says that you think Staples and Office Depot
18 would raise prices after the merger; is that correct?

19 A. Yes, that's correct.

20 Q. And as a matter of fact, you don't have any basis as you
21 are sitting here today to offer an opinion as to whether
22 Staples and Office Depot would raise prices after the merger;
23 correct?

24 A. That is correct.

25 Q. Now, when you buy office supplies from vendors that also

1 sell to Staples, you insist that they sell you those office
2 supplies for the same prices they sell them to Staples;
3 correct?

4 A. Yes.

5 Q. And you insist that those vendors sell them for the same
6 price that they sell them to Office Depot; correct?

7 A. Yes.

8 Q. And you will continue to pursue that policy on behalf of
9 Kmart in the future, won't you?

10 A. I will.

11 Q. And if Staples and Office Depot merge, you will continue
12 to insist on equal treatment and pricing from your vendors,
13 won't you?

14 A. Yes, I would.

15 Q. If after the merger Staples and Office Depot were able
16 to get lower prices from vendors, you would insist on those
17 same lower prices for Kmart; correct?

18 A. That is correct.

19 Q. And Kmart could then pass those lower prices from
20 vendors onto its consumers if they chose; couldn't they?

21 A. That would be a possibility, yes.

22 Q. They could, couldn't they?

23 A. Yes.

24 MR. BASILE: Thank you.

25 THE COURT: Mr. Doyle, would you like to redirect?

1 MR. DOYLE: I just have a couple of things.

2 REDIRECT EXAMINATION

3 BY MR. DOYLE:

4 Q. Mr. Edwards, what is your understanding of the concept
5 of one-stop shopping?

6 A. One-stop shopping would be where consumers can get
7 everything that they felt they needed during their shopping
8 trip at one convenient location.

9 Q. Is Kmart a one-stop shopping location for office
10 supplies?

11 A. No, they are not.

12 Q. Now, counsel raised the issue of Wal-Mart on cross. You
13 have reviewed the Wal-Mart counter declaration in this
14 matter, haven't you, sir?

15 A. Yes, I have.

16 Q. And it is DX 2021. Let me ask you a few questions about
17 that.

18 MR. DOYLE: Your Honor, may I approach the
19 witness?

20 THE COURT: Yes, sir.

21 BY MR. DOYLE:

22 Q. Mr. Edwards, this is the declaration filed by Defendants
23 in this matter from Wal-Mart. It is labeled DX 2021. Let me
24 ask you a couple of questions about it since counsel brought
25 Wal-Mart up on cross.

1 He asked you if you would be surprised to know that
2 Wal-Mart price-checks office supplies on a weekly basis. Do
3 you recall that, Mr. Edwards?

4 A. Yes, I do.

5 Q. And you said that you would be surprised about that?

6 A. Yes, I did.

7 Q. Let me ask you a couple of other questions that he
8 didn't ask you. Let me ask you if you would be surprised by
9 the first sentence in paragraph 11 of DX 2021, wherein the
10 declarant says the following: Through our price checking, we
11 have noticed that the office supply superstores have
12 different prices in different areas of the country, period,
13 end quote. Does that surprise you, Mr. Edwards?

14 A. No, it doesn't.

15 Q. You know that as an employee of Kmart, don't you?

16 A. Yes.

17 Q. Let me see if you are surprised by some other statements
18 in DX 2021, and I will direct your attention to the second
19 sentence in paragraph 11, sir, wherein the declarant says the
20 following:

21 Quote, these price differences appear to be related
22 to the number of other office supply superstores in the same
23 area, and not the existence of Wal-Mart or other retailers,
24 period, end quote. That doesn't surprise you, does it, sir?

25 MR. BASILE: Objection, Your Honor, this is leading

1 and outside of the scope of direct.

2 THE COURT: Where are you going with this?

3 MR. DOYLE: Your Honor --

4 THE COURT: Are you having him review somebody
5 else's statement?

6 MR. DOYLE: I think the Defendant raises the issue
7 whether this witness is aware of certain aspects in the
8 declaration, and I think to be complete we should test the
9 witness' knowledge of other issues in the declaration.

10 THE COURT: I will sustain the objection. I think
11 he is commenting on somebody else's declaration. I don't
12 think that is substantive evidence. I think it is a
13 declaration from Wal-Mart, if that is what you wish to do at
14 the appropriate time. I will sustain the objection.

15 MR. DOYLE: No further questions.

16 THE COURT: You may step down. Do you have another
17 witness ready?

18 MR. KEMPF: While the next witness is coming up,
19 another one of my young partners, Mr. Eugene Assaf will
20 handle this next witness. Eugene Assaf, he should be on our
21 list. He ran the thing for Mr. Basile and now he is moving
22 over and taking over Mr. Basile's chair. Mr. Eugene Assaf.

23 THE COURT: It is not on the list that I have. It
24 may be on another list. I don't have the complete list.

25 MR. ASSAF: It's Assaf, A-s-s-a-f.

1 THE COURT: Good afternoon, sir. Phillip Broyles
2 for the Plaintiff Federal Trade Commission. We call Mr. Mike
3 Atkinson of BJ's.

4 THE COURT: Thank you.

5 MIKE ATKINSON, GOVERNMENT'S WITNESS, SWORN

6 MR. BROYLES: Your Honor, may I take a moment to
7 introduce Mr. Atkinson's counsel, Mr. Roy Wolf, of Sidley and
8 Austin, and Mr. Arthur Clark from BJ's.

9 THE COURT: Thank you, sir.

10 DIRECT EXAMINATION

11 BY MR. BROYLES:

12 Q. Good afternoon, Mr. Atkinson. And welcome to
13 Washington. Are you here voluntarily?

14 A. Yes.

15 Q. I take it, though, that there are places you would
16 rather be than right here?

17 A. Absolutely.

18 Q. Are you employed, Mr. Atkinson?

19 A. Yes, I am.

20 Q. By whom are you employed?

21 A. BJ's Wholesale Club.

22 Q. And in what capacity are you employed at BJ's?

23 A. I am a vice-president, division merchandise manager.

24 Q. How long have you held that position?

25 A. About six years.

1 Q. And what are your responsibilities in that position?

2 A. I oversee the merchandise acquisition for several
3 categories. Domestics, office supplies, all kinds of
4 different areas.

5 Q. Can you describe for us, for the Court, what BJ's
6 business actually is?

7 A. We are a membership warehouse club, offering a
8 self-service environment for consumers and small businesses
9 to be able to purchase their needs.

10 Q. And can you describe, for example, how BJ's would differ
11 from a retailer like Kmart in terms of the retail format?

12 A. Again, we are a membership-based business, so somebody
13 has to pay to be a member. They have to pay \$30 a year to be
14 a member. And for that they are going to get a limited
15 selection of merchandise. But what they do get, our goal is
16 to be able to offer a value better than what they can find in
17 the rest of the market.

18 Q. Is that why you offer the limited selection?

19 A. Right.

20 Q. How are you able to offer that value to your customers?

21 A. We work on low margins. We have a very low cost
22 structure, so we don't have a lot of labor. We don't -- we
23 have efficiencies to the way we ship and display products.
24 All of those help to keep our costs down and we can lower our
25 retails.

1 Q. Is it important to that value to sell products very
2 quickly?

3 A. Absolutely.

4 Q. Why is that?

5 A. If we don't turn over the product, then we will not be
6 able to justify our low margins in products.

7 Q. How many club stores does BJ's have in the United
8 States?

9 A. We have 80.

10 Q. Is the format for BJ's standard in the country?

11 A. Somewhat standard. We have nine smaller locations, but
12 it's a similar format. We have nine locations that are less
13 square footage.

14 THE COURT: How many stores do you have total?

15 THE WITNESS: 80.

16 THE COURT: Thank you.

17 BY MR. BROYLES:

18 Q. Can you tell the Court what a "draw" area is?

19 A. It is pretty much what market we draw from, and it may
20 be within a particular geographical area. It may be tied in
21 with road patterns. It may be tied in with just natural
22 access to a building.

23 Q. Can you tell the Court how a draw area for BJ's would
24 compare with a retailer like Kmart?

25 A. I can't speak specifically for Kmart. A lot of it

- 1 certainly varies for BJ's, depending if it is a suburban
2 location or urban. A suburban location tends to draw further
3 than an urban location.
- 4 Q. Does BJ's sell office supplies?
- 5 A. Yes, we do.
- 6 Q. How many SKUs of office supplies does BJ's carry?
- 7 A. It varies over the course of a year, but it averages
8 about 240.
- 9 Q. What kind of items are included within your office
10 supply selection?
- 11 A. Primarily consumable supplies. The items that are the
12 fastest movers in the industry; again, are copy paper, perf
13 pads, fax paper, pencils, pens, things along those lines.
- 14 Q. Can you define "consumable" for the Court?
- 15 A. We consider consumable things that people will use up,
16 whether it is being like in food, obviously something that is
17 consumed or something eaten; something consumable in office
18 supplies is something that gets used up.
- 19 Q. Are you familiar with office supplies superstores?
- 20 A. Yes.
- 21 Q. Are you familiar with the number of SKUs of office
22 supplies they carry?
- 23 A. No, I am not.
- 24 Q. Do you have any information as to how the number of
25 office supplies you carry compares with the number that are

- 1 carried in the superstore?
- 2 A. No, I am not clear on that.
- 3 Q. How much floor space does BJ's devote to office
4 supplies?
- 5 A. About 1300, 1400 square feet.
- 6 Q. First of all, how much floor space is there in a typical
7 BJ's store?
- 8 A. The larger boxes, the 71 larger boxes are 110,000 square
9 feet on an average, and the smaller ones are 61,000 square
10 feet.
- 11 Q. Have you ever been in an office supplies store?
- 12 A. Yes.
- 13 Q. Do you know how much floor space they devote to office
14 supplies?
- 15 A. I have not counted it.
- 16 Q. Is it more than than 1400 square feet you offer?
- 17 A. Yes.
- 18 Q. Is it significantly more?
- 19 A. Yes.
- 20 Q. Do you compete with office supply superstores in the
21 sale of office supplies?
- 22 A. Yes, we do.
- 23 Q. Do you price check office supply superstores?
- 24 A. Yes, we do.
- 25 Q. How long has BJ's price-checked office supply

- 1 superstores?
- 2 A. Our whole price-check procedure has been in place for
3 probably three years, maybe a little bit longer.
- 4 Q. How frequently do you check, price-check office supplies
5 superstores for office supplies?
- 6 A. The majority of the items are price-checked monthly. We
7 do some key items. Basically copy paper we do weekly.
- 8 Q. Are there any other items that you price-check weekly?
- 9 A. Within the company? Or within --
- 10 Q. For superstores, office supply superstores?
- 11 A. No. Really -- well, computer paper.
- 12 Q. How do prices at office supply superstores compare to
13 the prices at BJ's for office supplies?
- 14 A. Generally higher.
- 15 Q. And in your experience, have office supply superstores
16 been successful?
- 17 A. Yes.
- 18 Q. Have they in your experience -- have they been
19 successful in markets in which where BJ's is also present?
- 20 A. Yes.
- 21 Q. Why would anyone go to an office supply superstore such
22 as Staples, if they can get the products at BJ's for lower
23 prices?
- 24 A. Because of our limited mix that we have. We are not
25 going to offer everything to everybody, so somebody who wants

1 a broader selection, somebody that wants delivery. We don't
2 offer any delivery of the product. Somebody that wants to be
3 able to do the one-stop shopping will tend to gravitate
4 toward the superstore.

5 Q. Now, going back again to the price-checking that you do
6 of the superstores, do you price-check Staples in markets
7 where it is the only superstore?

8 A. Yes.

9 Q. Do you price-check Staples and markets where it is
10 competing with Office Depot?

11 A. Yes.

12 Q. Do you price-check Staples where it is competing with
13 Office Depot and OfficeMax?

14 A. I'm not sure off the top of my head if we have markets
15 with all three.

16 Q. In your experience, Mr. Atkinson, how do office supply
17 superstore prices compare in markets where both Office Depot
18 and Staples compete, in comparison with markets which Staples
19 is there by itself?

20 A. We only have less than 10 percent of our clubs actually
21 have a Staples in it, or actually have an Office Depot with
22 them. So it is not a large base, but those that do have it
23 generally we found that our price or the prices are lower
24 where there is both a Staples and an Office Depot.

25 Q. In your experience, Mr. Atkinson do BJ's prices for

1 office supplies affect office superstore prices?

2 A. I would say generally not.

3 Q. In your experience, Mr. Atkinson, have you seen markets
4 in which the office supply superstores have raised prices at
5 the same time that BJ's was lowering prices on office
6 supplies?

7 A. Yes, I have.

8 Q. Has BJ's ever tried to expand the number of office
9 supplies it carries?

10 A. We periodically will test expansion of categories. We
11 have done that a couple of times with office supplies. A lot
12 of times on a very limited basis. We have tried a couple of
13 times in the past with a little bit more broad based.

14 Q. Were those efforts successful?

15 A. No, they were not.

16 Q. Why not?

17 A. Because we look at sales productivity, that we are
18 expecting a certain amount of space per pallet. Our building
19 is not fixed to be just office supplies. We can shift in and
20 out of categories as businesses warrant, and if we don't see
21 the sales productivity, we will give that space to something
22 else. And those items were not productive.

23 MR. BROYLES: Nothing further, Your Honor.

24 THE COURT: Thank you. All right. For the
25 Defendant, cross by Mr. Assaf.

1 CROSS-EXAMINATION

2 BY MR. ASSAF:

3 Q. Mr. Atkinson, you sell office supplies at BJ's; correct?

4 A. Correct.

5 Q. You also sell office products?

6 A. I don't know what you mean by office products versus
7 office supplies.8 Q. Do you have a separate department for office products in
9 BJ's?

10 A. My understanding is the same.

11 Q. Same. Where do you sell batteries?

12 A. In the battery department.

13 Q. Where do you sell printer cartridges?

14 A. In the office electronics department.

15 Q. So you have an office electronics department at BJ's?

16 A. Right.

17 Q. And in that department is included printers?

18 A. Yes.

19 Q. Printer cartridges?

20 A. Correct.

21 Q. Toner?

22 A. Correct.

23 Q. Are printer cartridges and toner consumable under your
24 definition?

25 A. Right.

- 1 Q. Now, Mr. Broyles in his direct examination talked about
2 some of your competition in office supplies, and I would like
3 to follow up on that. Do you see Sam's as a competitor in
4 the sale of office supplies?
- 5 A. Yes.
- 6 Q. Do you view PriceCostco as a competitor in the sale of
7 office supplies?
- 8 A. Yes.
- 9 Q. What about in the sale of office products?
- 10 A. I don't know your definition of office products.
- 11 Q. What about on the sale of office electronics?
- 12 A. Yes.
- 13 Q. And do you view the office superstores as competitors in
14 the sale of office supplies?
- 15 A. Yes.
- 16 Q. And in fact, you believe that BJ's compete with Staples
17 and Office Depot and OfficeMax; correct?
- 18 A. Correct.
- 19 Q. And in the sale of office supplies, does BJ's also
20 compete with Wal-Mart?
- 21 A. On a more limited basis. They certainly carry office
22 supplies, but we are not generally in the same kind of pack
23 size.
- 24 Q. Do you compete with Wal-Mart?
- 25 A. Yes.

- 1 Q. And do you price-check Wal-Mart?
- 2 A. Selectively.
- 3 Q. Do you price-check the office superstores for office
4 supplies?
- 5 A. Yes.
- 6 Q. Now, regarding Wal-Mart -- withdraw.
- 7 Have you ever heard the phrase, "every day low
8 price guaranteed"?
- 9 A. Yes.
- 10 Q. What does that mean to you?
- 11 A. It means somebody is going to honor -- doesn't mean they
12 necessarily have the lowest price. It means that they will
13 assure that someone who checks it, they will give the lowest
14 price to.
- 15 Q. What is your understanding based on all of your
16 experience in the industry, regarding Wal-Mart's pricing
17 philosophy?
- 18 A. They generally have a low price. They don't necessarily
19 have the lowest price.
- 20 Q. Have you ever heard the term in your industry based on
21 all of your experience, Wal-Mart is a "silent killer"?
- 22 A. Yes.
- 23 Q. And would you explain for the Court what Wal-Mart as a
24 "silent killer" means?
- 25 A. Someone who doesn't have to use an exceptional amount of

1 prices in somebody's face, by means of advertising item of
2 price to be able to garner a lot of business. They don't
3 have to shout it out to get a lot of business.

4 Q. And is it fair to say, based upon your experience in the
5 industry, that when Wal-Mart attacks a market with aggression
6 it gains market share?

7 A. I have not studied Wal-Mart. It would be hard for me to
8 disagree with it, but also I have not studied it to that end.

9 Q. Sir, based on your experience and all of your years of
10 retailing, isn't it fair to say when Wal-Mart attacks a
11 category, Wal-Mart gains market share based upon your
12 experience with BJ's?

13 A. I don't know what category you are referring to.

14 MR. BROYLES: Objection. Asked and answered.

15 THE COURT: All right.

16 THE WITNESS: It is possible they can gain market
17 share.

18 BY MR. ASSAF:

19 Q. Has Wal-Mart gained the sale of market share against
20 BJ's in toys?

21 A. I am not familiar with toys.

22 Q. Do you have any understanding what Wal-Mart has gained
23 in market share for toys against BJ's?

24 A. No, I don't.

25 MR. BROYLES: Objection.

1 THE COURT: All right. He doesn't, so --

2 BY MR. ASSAF:

3 Q. Now, there is a time, February or March of 1997 when you
4 signed a declaration for the FTC; correct?

5 A. Right.

6 Q. And at that time you didn't believe that Wal-Mart was a
7 significant player in the sale of office supplies; correct?

8 A. Correct.

9 Q. And in February of 1997 you didn't believe that Wal-Mart
10 was a competitive threat to the office superstores in the
11 sale of office supplies; did you?

12 A. Correct.

13 Q. Since the time that you signed your declaration for the
14 FTC until today, have you changed your view whether Wal-Mart
15 is in fact a significant player in the sale of office
16 supplies?

17 A. I believe they have the potential to be a greater impact
18 on the sale of office supplies based on the statement.

19 Q. Now, before getting to that statement, sir, when you
20 signed the declaration for the FTC, what was your
21 understanding of how many SKUs Wal-Mart carried in terms of
22 office supplies?

23 A. I never counted it. I honestly have never judged it. I
24 know it's those two aisles of office supplies in stationery
25 supplies.

1 Q. Is it fair to say when you signed the declaration of the
2 FTC you believed that Wal-Mart didn't carry a broad
3 assortment of office supplies?
4 A. I know that they carried office supplies, but they
5 carried them in pack sizes smaller than a warehouse club
6 would typically carry.
7 Q. When you signed your statement for the FTC, isn't it
8 true that you believed Wal-Mart did not carry a broad
9 selection of office supplies?
10 A. Of specifically office-related supplies, correct.
11 Q. And then you read the declaration of vice-president of
12 Wal-Mart; correct?
13 A. Correct.
14 Q. In that declaration you learned that Wal-Mart will carry
15 over 2500 SKUs of office supplies; correct?
16 A. Correct.
17 Q. Now, you believe that Wal-Mart, in fact, is a
18 significant player in office supplies, don't you?
19 A. I stated in there that I would believe they would
20 become, if those are truly, it is based on their SKU
21 expansion that they announced in there, 180 SKUs. If truly
22 their expansion is in office supplies, Wal-Mart can become a
23 very dominant force in office supplies.
24 Q. And Mr. Broyles asked you a little bit about pricing in
25 the direct examination, and he asked you about superstore

1 pricing. Do you have any reliable data suggesting that
2 office superstores price differently in markets where there
3 are multiple office superstores?

4 A. Just our price shops that we have.

5 Q. And sir, as we sit here today, you don't believe that
6 the data from your price shops are reliable; correct?

7 A. I don't believe they are 100 percent accurate.

8 Q. In fact, you told the FTC you don't believe the price
9 shopping data that you had was reliable?

10 A. I said that it is lay people that do it. It is not the
11 professional price shopper. And there are errors from time
12 to time.

13 Q. When you collect your data regarding various competitors
14 in the marketplace, there are a whole host of competitors
15 that you don't check; correct?

16 A. Correct.

17 Q. For example, you don't check WB Mason for office
18 products, do you?

19 A. Correct.

20 Q. So BJ's doesn't have any data suggesting how WB Mason
21 affects the office superstore pricing, do you?

22 A. Correct.

23 Q. And you have no personal knowledge -- withdrawn.

24 BJ's has no data suggesting how the opening of a
25 Sam's Club affects the superstore pricing?

- 1 A. Not that I am aware of.
- 2 Q. Mr. Broyles also asked you about how superstore prices
3 affect BJ's prices. And I think that you mentioned that
4 there are several instances where superstores raised their
5 prices, even though you lowered yours; correct?
- 6 A. Correct.
- 7 Q. Let's take another example. Leave over Mr. Broyles
8 example. Aren't there situations where the superstores have
9 lowered prices on items when BJ's also lowered their prices?
- 10 A. Yes.
- 11 Q. There are examples to both sides, aren't there?
- 12 A. Sure.
- 13 Q. And in fact, sir, based on all of your experience with
14 BJ's and all of your experience in the industry, what would
15 BJ's do if Staples and Office Depot lowered their prices by
16 10 percent?
- 17 A. We would attempt to also lower our prices.
- 18 Q. And your consumers would see lower prices on the shelves
19 of BJ's; wouldn't they?
- 20 A. Yes.
- 21 Q. You mentioned that BJ's has 80 stores?
- 22 A. Um-hum.
- 23 Q. How long has it taken BJ's to grow to 80 stores?
- 24 A. About 12 years, 13 years.
- 25 Q. How many stores did BJ's start off with?

- 1 A. I believe one.
- 2 Q. From that one store, from that one little store to the
3 80 today, would you describe for us what has happened with
4 BJ's purchasing leverage with its vendors?
- 5 A. It has improved.
- 6 Q. Well, tell us how it has improved.
- 7 A. I have been involved with office supplies for six years,
8 so I have not been back to the beginning on office supplies.
9 Certainly when I joined the company there were about ten
10 locations. I can't give you a specific percentage, but we
11 have become more efficient as we have done things for our
12 business.
- 13 Q. You have gotten greater volume discounts as you have
14 grown; correct?
- 15 A. Correct.
- 16 Q. And BJ's has also become more efficient in its
17 distribution as it has grown; correct?
- 18 A. Correct.
- 19 Q. And those efficiencies from BJ's growth have allowed
20 BJ's to keep its prices low; correct?
- 21 A. Correct.
- 22 Q. And BJ's growth and its distributional efficiencies have
23 allowed BJ's to lower its prices to consumers; correct?
- 24 A. Correct.
- 25 Q. Talking a little about SKUs, have you ever heard the

- 1 phrase the 80/20 rule?
- 2 A. Um-hum. What does the 80/20 rule mean in the world of
3 warehouses and retailers?
- 4 A. For a general retailer it will mean that 80 percent of
5 the business comes off 20 percent of the SKUs. Yeah, that's
6 right. 80 percent of the business off 20 percent of the
7 SKUs. A warehouse club, just by the nature of offering a
8 limited assortment, it doesn't quite work to that same
9 extreme, but there are still the top items that will generate
10 more volume and than the lower-volume items.
- 11 Q. And BJ's offers the most popular and the fastest moving
12 SKUs; right?
- 13 A. Right.
- 14 Q. Why does it do that, sir?
- 15 A. So we can turn our inventory quickly. That is a major
16 part of our profit equation.
- 17 Q. The fact take BJ has a quick-turning inventory, does
18 that give you any competitive advantages?
- 19 A. It could. Sure.
- 20 Q. Well, in particular to the office superstores, isn't it
21 fair to say that by having a fast-moving inventory and
22 offering a limited amount of SKUs that BJs in your view has a
23 competitive advantage over the office superstores; correct?
- 24 A. Yes.
- 25 Q. And in fact, it is your view that the office

- 1 superstores, because they carry such a broad selection
2 actually have higher carrying cost for its stores; correct?
- 3 A. Correct.
- 4 Q. And it is more difficult for the office superstores to
5 keep their prices as low as BJ's on some items; correct, on
6 the faster-moving items?
- 7 A. On the faster-moving items, correct.
- 8 Q. Let's talk about BJ's expanding. Not from 1 one of the
9 80 stores, but from BJ's -- how big is BJ's square footage
10 wise?
- 11 A. It has about 110,000 square feet.
- 12 Q. Big steel box; correct?
- 13 A. Correct.
- 14 Q. Any walls from one end of the store to the other?
- 15 A. No.
- 16 Q. And fair to say that you simply move the shelves around
17 within the big steel box?
- 18 A. We have the potential to do that. It doesn't work that
19 easily, but we have the potential to do that.
- 20 Q. Over your time with BJ's you have moved shelf space
21 around within BJ's, haven't you?
- 22 A. Certainly.
- 23 Q. And what are the reasons that you change or you expand
24 shelf space within BJ's?
- 25 A. Based upon sales trends of any given category.

1 Q. Based upon the market, market demand?

2 A. Based upon our sales results that we see within
3 categories, plus market demand.

4 Q. So, for example, ten years ago BJ's had, I assume, a
5 whole host of typewriter ribbons; correct?

6 A. I don't think ten years ago we stocked typewriter
7 ribbons.

8 Q. You had a whole host of items. You didn't have a lot of
9 computer items ten years ago. You didn't have a lot of
10 printer toner cartridges?

11 A. Correct.

12 Q. And you expanded space or reorganized your shelf space
13 so you are now able to meet the demand of the consumers;
14 correct? And similarly, BJ's has the capacity to expand
15 shelf space for the sale of office supplies, doesn't it?

16 A. Correct.

17 Q. And one of the hallmarks of a warehouse club like BJ's
18 is its capacity to be able to modify its shelf space to meet
19 the needs of consumers that come to BJ's; correct?

20 A. Correct.

21 Q. And BJ's is committed to offering its warehouse members
22 low price office supplies, isn't it?

23 A. Right.

24 Q. And as we sit here today, as a representative of BJ's,
25 you believe that BJ's would respond appropriately to any

1 market demand in the sale of office supplies, don't you?

2 A. If the market, if the market demand shows on our
3 existing sales first, yes. On our existing item sales.

4 Q. Sir, do you believe that BJ's would respond
5 appropriately to any market demand in the sale of office
6 supplies, don't you?

7 A. I can't say I am comfortable saying any market demand.
8 If a market demand is for something that is labor intensive,
9 not necessarily.

10 MR. ASSAF: This is 21. Your Honor, may I approach
11 the witness?

12 THE COURT: All right.

13 BY MR. ASSAF:

14 Q. Mr. Atkinson, do you realize or do you recognize your
15 declaration?

16 A. Yes, I do.

17 Q. And this is the declaration that you signed on May 8,
18 1997; correct?

19 A. Correct.

20 Q. And I would like to turn your attention to paragraph 5.

21 A. Um-hum.

22 THE DEPUTY CLERK: What number?

23 MR. ASSAF: DX 1821.

24 BY MR. ASSAF:

25 Q. In paragraph 5, you state given BJ's philosophy with low

1 cost merchandise for the home and office and BJ's capacity to
2 expand selling space within given categories, I would respond
3 appropriately to any market demand in the sale of office
4 supplies. Do you see that, sir?

5 A. Yes, I do. And in fact, as we sit here today there is
6 nothing would you like better than to take away Staples and
7 Office Depot's customers if they raise their prices; correct?

8 A. Correct.

9 MR. ASSAF: No more questions.

10 MR. BROYLES: I have redirect, limited redirect.

11 THE COURT: That's fine.

12 REDIRECT EXAMINATION

13 BY MR. BROYLES:

14 Q. First of all, Mr. Atkinson, why do you price-check other
15 stores?

16 A. To make sure we are offering a value for our members,
17 for prices lower than what they can buy the products for
18 somewhere else.

19 Q. How do you use the information you get in the
20 price-check to do that?

21 A. Based on the information we will price our products
22 against that. If we have a question on the price, we may
23 call the club if it looks out of line.

24 Q. And would you characterize BJ's as a successful company?

25 A. Yes, I would.

1 Q. Now, Mr. Assaf asked you some questions about Wal-Mart
2 and your opinion about Wal-Mart. I would like to ask you
3 from the time that you signed the declaration for the FTC and
4 the time that you signed the declaration for the Defendants,
5 what information came to you that caused you to change your
6 opinion about Wal-Mart?

7 A. I was provided their statement that said they were going
8 to -- based on how many SKUs they had on office supplies, but
9 primarily it was their expansion of the SKUs we were looking
10 at.

11 Q. Did you notice anything in Wal-Mart's market response
12 that prompted you to change your opinion of Wal-Mart?

13 A. No, just really their expansion of SKUs.

14 Q. When Staples' counsel and the Defendants' counsel showed
15 you Mr. Orlans' affidavit did they tell you they recently
16 sent their own employees out to count the SKUs of Wal-Mart?

17 A. No, they didn't.

18 Q. Did they tell you the number that they found?

19 A. Just what I read in the statement .

20 Q. They didn't tell you they counted only a thousand?

21 A. No.

22 Q. I want to go back to the growth of BJ's and its impact
23 on your buying power and ask you a simple question. Did you
24 merge to get the improvement in your buying power?

25 A. No. So that came just as a result of your own internal

1 growth?

2 A. Right.

3 MR. BROYLES: Nothing further, Your Honor.

4 THE COURT: All right. Thank you. You are
5 excused. Thank you. Do you have another witness briefly or
6 where are you?

7 MR. CARY: Your Honor, we had one more witness who
8 was unable to make it today, because of a prior commitment
9 with a corporate board meeting, so at this point --

10 THE COURT: You have run out?

11 MR. CARY: We have run out.

12 THE COURT: All right. Well, it is 4:45, and we
13 started at 9:30, so we got a lot done today. We will take
14 our evening recess and be back tomorrow morning ready to go
15 at 9:30.

16 I cancelled all of my preliminary matters, so we
17 will start promptly at 9:30 in the morning with our next
18 witness.

19 THE MARSHAL: All rise.

20 (Which were all proceedings
21 had at this time.)

22

23

24

25