

RETURN TO ARBITRAGE
DEPT. FILES

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

2 THE COURT: All right. We are ready to resume at
3 this time, Mr. Gidley.

4 MR. GIDLEY: I have a couple of clean-up items I
5 would like to mark for identification purposes. Ashenfelter
6 transcript as Exhibit 9003, and the side-by-side comparison
7 we showed you of two Plaintiff's exhibits as DX 90004.

8 And to a large extent, Your Honor, we are examining
9 Dr. Ashenfelter on the fly. At the conclusion of the
10 testimony we would like a copy of the binder that the witness
11 is referring to in his testimony. We'll make a copy of it.

12 THE COURT: They should have that.

13 MR. CARY: They have the material in the binder,
14 yes.

15 MR. GIDLEY: That is not altogether clear to me,
16 Your Honor.

17 THE COURT: I will let you review it and see if you
18 have what has been relied upon.

19 (Professor Ashenfelter resumes the witness stand)

20 CROSS-EXAMINATION

21 BY MR. GIDLEY:

22 Q. Dr. Ashenfelter, a little clean-up for us. Your
23 testimony this morning was based on PX 400; correct?

24 A. I think that's -- that is this document that -- yes.

25 Q. Because we are dealing with a paper record do you do at

ASHENFELTER #2

- 1 the bottom of the left-hand corner the date, 5-20-97?
- 2 A. Yes, I do.
- 3 Q. And that is PX 400, I will represent to you. So that is
- 4 what we have been talking about, isn't it, Doctor?
- 5 A. Yes, I think it is.
- 6 Q. And PX 400 was created yesterday, May 20, wasn't it?
- 7 A. Yes.
- 8 Q. The previous draft of PX 400 was PX 157; isn't that
- 9 correct?
- 10 A. That is something that you gave me also, isn't it,
- 11 earlier?
- 12 Q. Yes. It was up on the screen.
- 13 A. Yes, I think that is right. Yes.
- 14 Q. And we didn't have that at the time of your deposition,
- 15 did we, Doctor?
- 16 A. No, you didn't have this exact piece of paper. You had
- 17 the underlying results, I think.
- 18 Q. All right. And the prior version of this chart was a
- 19 chart that I showed you earlier in your examination. And
- 20 that was marked as Ashenfelter Exhibit 2; is that correct?
- 21 Do you see that?
- 22 A. Yes, the exhibit at the deposition.
- 23 Q. All right. What I would like to do is compare
- 24 Ashenfelter 2 with PX 400.
- 25 A. I think I have that here. It will be a little easier.

1 Q. My questions will relate to the left-hand side. The
2 descriptions of the variables on the left-hand side of PX 400
3 in Defendants' Exhibit 2?

4 A. Okay. Yes.

5 Q. Defendants' Exhibit 2 lists competitive variables
6 Hausman and FTC. Isn't it the case, sir, that the FTC
7 competitive variable is what you now label as MSAY?

8 A. Yes, they are the same.

9 Q. And up at the top or in the middle of the page, excuse
10 me, where it says the sample is Hausman stores and FTC
11 stores, you have relabeled those as complete sample and
12 Hausman sample; isn't that correct?

13 A. Yes, it is.

14 Q. The FTC stores are the California, Pennsylvania and
15 other stores that you added in for your final column, Column
16 7 of PX 400. Isn't that the case?

17 A. No. The FTC stores are the original Hausman stores plus
18 those stores.

19 Q. All right.

20 A. So that -- it refers to -- the "complete sample" means
21 FTC sample, so that means the complete one.

22 Q. But the FTC stores are the additional stores, correct,
23 that get you to the complete sample. Isn't that correct?

24 A. No. The way it is listed here is there is only a yes in
25 one of those rows, so the row that says FTC stores is the

1 same as complete. So that refers to the total of the
2 stores.

3 Q. All right. I will have one more go at it, and I think I
4 know what our problem is. FTC stores include the California
5 and Pennsylvania stores, plus the Hausman stores. Isn't that
6 the case?

7 A. Yes.

8 Q. All right, Doctor. Earlier in your testimony in direct,
9 you talked about your various background. You don't today
10 represent to this Court that you are in any way an impartial
11 referee between the FTC economist and Dr. Hausman; isn't that
12 correct?

13 A. I would not say that I was a referee, no.

14 Q. And you are under contract to the FTC; isn't that
15 correct?

16 A. Yes.

17 Q. And you never have spoken to Dr. Hausman about this
18 matter; isn't that also correct?

19 A. Yes.

20 Q. Let's talk a little bit about your methodology, this
21 MSAY competitor variable. How do you treat Baltimore and
22 Washington for purposes of the MSAY'd variable? Are they in
23 the same MSA?

24 A. I don't know. I have to look at the numbers.

25 Q. Sitting here today, you don't know whether you treated

1 them as a single MSA or a CMSA or some other variant. Isn't
2 that the case?

3 A. Yes.

4 Q. Let me direct your attention in PX 400 to the line that
5 says "Hausman Price Index." And let me refer you
6 specifically to the pricing effect simulation there in that
7 row. I think it is labeled Hausman -- excuse me. I am
8 looking at the row "Hausman Sample."

9 Is it your understanding that all of the data
10 Dr. Hausman used in generating his 0.9 percent pricing effect
11 estimate, the data that was contained in the Hausman sample?
12 Was that your understanding?

13 A. Yes.

14 Q. All right, Doctor. I would like to reference now the
15 cost study that you put together. And as I was -- why don't
16 we take that off the screen so it is not distracting. And
17 why don't we put that slide up.

18 This is the cost regression slide for PX 400, and I
19 think we have to use the Elmo for that.

20 Doctor, while we are pulling that exhibit, let me
21 ask you a few questions generally about paper. As I was
22 listening to your direct testimony I understood that you knew
23 because of your involvement with the American Economic Review
24 that from time to time price -- the price of paper would
25 rise; isn't that correct?

- 1 A. Yes.
- 2 Q. And so in administering the journal you have some
3 knowledge of paper pricing; isn't that correct?
- 4 A. Very small. Not much.
- 5 Q. But from time to time you've developed an awareness when
6 the paper price shoots up; isn't that correct?
- 7 A. When it really goes up high, yes, I do learn about it.
- 8 Q. Do you also observe or conclude today, sitting here,
9 that there are also times when paper prices are not that
10 high?
- 11 A. They come down, yes.
- 12 Q. Would you say that the price of paper fluctuates with
13 respect to your work at the American Economic Review in
14 buying paper and publishing the journal?
- 15 A. It has fluctuated, yes.
- 16 Q. In your cost analysis, let me direct your attention to
17 the specifics of the cost analysis. Yes. And just for
18 reference purposes, this was the last page of PX 400, and
19 it's -- the easiest way I think of it, doctor, is the 30 SKU
20 study that you did.
- 21 A. I have it right here.
- 22 Q. As I understand it, Doctor, column 1, you were able to
23 demonstrate or your numbers work out so that Staples' costs
24 are related to the prices Staples charge; isn't that correct?
- 25 A. Yes.

1 Q. And the .57 figure, isn't it the case that that figure
2 indicates that Staples passes through some 57 percent of any
3 cost savings that it receives? Isn't that what that number
4 implies?

5 A. It implies that they -- it's -- because it is in the log
6 of the price and log of the cost it implies roughly that a
7 price increase or decrease of, let's say, 1 percent will be
8 passed through. The price change will be .57 of whatever the
9 proportionate cost change was.

10 Q. But the majority of the cost savings will be passed
11 through. Isn't that the plain way to put this?

12 A. That is a very straightforward way to put it, yes. I
13 wanted to make sure we understood this is based on
14 proportionate changes in cost and their effect on
15 proportionate changes of prices.

16 Q. So as I understand it, Column 4, we bucket the cost that
17 Staples faces between industry-specific cost or industry-wide
18 cost, I should say, and Staples-specific cost. Is that fair?

19 A. That is the goal of the analysis. It is not exactly
20 that, because the industry measure is to the extent that it
21 is captured by the Office Depot. But specifically, it's a
22 Staples and Office Depot separate cost, and the idea is to
23 try to get at what you are saying. That's right.

24 Q. Now, do you believe in the real world people worry
25 whether a cost reduction or cost increase is related to an

1 industry phenomenon or something that they faced?

2 A. Well, in what context?

3 Q. Well, for instance, let's take an example. At the
4 American Economics Review, have you ever asked the
5 administrative staff to bucket the cost savings they received
6 into an industry-wide cost savings bucket and an American
7 Economic Review cost savings bucket? Have you ever done
8 that, sir?

9 A. No.

10 Q. Have you seen any documents that Staples does that in
11 the ordinary course of business?

12 A. No.

13 Q. And have you seen any documents that Office Depot does
14 that in the ordinary course of their business?

15 A. No.

16 Q. Did you interview anyone from Staples or Office Depot in
17 connection with this regression?

18 A. No.

19 Q. And isn't it the case, sir, that you didn't sit in on
20 any of the depositions of the Staples or Office Depot
21 witnesses? Isn't that the case?

22 A. Yes.

23 Q. Let's talk about the cost regression itself. Your cost
24 model is based on a regression involving 30 SKUs; isn't that
25 correct?

1 A. Yes.

2 Q. And those 30 SKUs -- strike that. And isn't it the case
3 that in terms of a time period you were only looking at
4 product costs during the 1995, 1996 time period? Isn't that
5 the case?

6 A. Yes, it is.

7 Q. Now, those 30 SKUs, those were not a random sample, were
8 they?

9 A. No. No, they were not.

10 Q. And you didn't perform any test to determine whether the
11 30 SKUs were representative of all of the products sold at
12 Staples, did you?

13 A. No.

14 Q. Let me show you what we are going to mark for the record
15 as Defendants' Exhibit 9005.

16 MR. GIDLEY: I would like to approach the witness.

17 THE COURT: All right.

18 BY MR. GIDLEY:

19 Q. Directing your attention to Defendants' Exhibit 9005,
20 let me direct your attention to the handwriting at the bottom
21 of the page. And there is a little schedule at the bottom
22 that says category, quote, before drop. Quote, final FTC
23 sample after drop. Do you see that language?

24 A. Yes, I do.

25 Q. Doctor, is that your handwriting?

- 1 A. No.
- 2 Q. And who did the dropping from the 41 SKUs to 30 SKUs?
- 3 A. I believe that was done by David Ashmore and the FTC
4 staff.
- 5 Q. Let me -- directing your attention to the top of the
6 exhibit. Now, the first six SKUs are all Uniball pens; isn't
7 that the case?
- 8 A. Yes.
- 9 Q. In fact, if we look at the same three, they are all the
10 same size, just different colors. Blue, black and red; is
11 that right?
- 12 A. I think that is right.
- 13 Q. Would you expect their shelf price to differ?
- 14 A. I have not looked at these particular pens, but I don't
15 think they would vary by much.
- 16 Q. And the next three pens, would you expect the shelf
17 price to differ if the only thing that is different is the
18 color of ink, which appears to be the case; that they are
19 blue and black and red?
- 20 A. I wouldn't think it would vary very much if that is the
21 only difference.
- 22 Q. Let's move down to the exhibit. The next two SKUs are
23 Papermate pens. One is a medium point and one is a fine
24 point.
- 25 A. Where are you looking? I'm sorry. Oh, yes, I am sorry.

1 Q. Two of the SKUs, sir, are Papermate pens, isn't that
2 right?

3 A. That's right.

4 Q. If we go through this exhibit, we will find four Sharpie
5 markers. There are two that are the next SKUs, and if you
6 zip down towards the middle of the bottom you will pick up
7 two more Sharpie markers. Isn't that correct?

8 A. I do see two further down. Where are the ones on the
9 top? There. I see. Okay. Yes. Yes. Two further down.

10 Q. Altogether, there are four Sharpie markers under the 40
11 SKUs?

12 A. Yes.

13 Q. And when we add all of the pens together, the total
14 number of pens, of the 30 SKUs, is 17. Isn't that correct,
15 doctor?

16 A. Yes. That is at the bottom of the table.

17 Q. So the majority of the SKUs are pens; isn't that
18 correct?

19 A. Yes.

20 Q. You don't know what percentage of Staples' sales those
21 pens represent, do you?

22 A. Yes. I don't know.

23 Q. Have you been informed that pens make up 2.3 percent of
24 Staples' sales?

25 A. No.

- 1 Q. How many of these items are price-sensitive items?
- 2 A. I think most of them are considered price-sensitive
3 items.
- 4 Q. Were you aware that 27 of the 30 were price-sensitive
5 items?
- 6 A. I may have been. I don't remember that exact number.
- 7 Q. When we exclude variances in style and colors, were you
8 aware that there were really only 20 SKUs under the 30? Were
9 you aware of that?
- 10 A. I knew it was a small number. There were only 30 SKUs
11 to start because of the fact that you have to match Office
12 Depot and Staples' products to be the same. So -- and I knew
13 there was some duplication, sure. They are not exactly the
14 same products, but they are similar.
- 15 Q. Now, Doctor, isn't it true that the quality of a
16 regression is the function of the data that you have?
- 17 A. Say that again.
- 18 Q. Isn't it true that the quality of a regression is a
19 function of the data that you have?
- 20 A. Yes. Yes, a regression is a way to summarize data, so
21 the data has a big effect on the regression, certainly.
- 22 Q. In your professional capacity, do you ever use the
23 expression "garbage in, garbage out"?
- 24 A. I certainly have heard it and I may have, although it is
25 not something that I normally say.

1 MR. GIDLEY: No further questions.

2 THE COURT: Mr. Cary. Are you ready?

3 MR. CARY: Yes.

4 THE COURT: Thank you, sir.

5 REDIRECT EXAMINATION

6 BY MR. CARY:

7 Q. Professor Ashenfelter, referring your attention back to
8 what we have marked as PX 400, do you remember that chart,
9 sir?

10 A. Yes.

11 Q. Where did the data come from for this chart?

12 A. These data were provided by the parties to the FTC and
13 then to me.

14 Q. Mr. Gidley just asked you about the pass-through
15 analysis. Did you run a pass-through analysis on any other
16 sample of products?

17 A. Yes.

18 Q. Which sample was that?

19 A. I used a sample of products that Professor Hausman had
20 used for a different analysis, but where he had matched
21 similar products.

22 Q. What result did you get using the sample that Professor
23 Hausman had selected?

24 A. The same. The same results.

25 Q. The same results?

- 1 A. Almost exactly the same results.
- 2 Q. As the --
- 3 A. As the ones that are in this study, which I forgot what
4 the number was. The one that we just reviewed with
5 Mr. Gidley.
- 6 Q. Now, Mr. Gidley asked you a question about a Chow test.
7 Do you recall that?
- 8 A. Yes, he did.
- 9 Q. What is a Chow test?
- 10 A. A Chow test is kind of a jargon word. Chow is a
11 colleague of mine at Princeton, and there is a test named
12 after him, which is a test for whether the coefficients in a
13 regression are the same under two different circumstances.
- 14 So there are a lot of examples where this is used.
15 The common one would say, say the relationship between wages
16 and pay -- I'm sorry, between wages and education. Is that
17 different as between men and women? You could test whether
18 the regression coefficient would be different for the two
19 groups. Chow found a way to test that when there are many
20 regression coefficients. Maybe not-- many might be a strong
21 word, but he certainly wrote a paper in which he showed
22 people how to do it.
- 23 Q. Professor Hausman originally provided a sample from
24 which he calculated an expected price effect from the merger;
25 is that correct?

1 A. Yes.

2 Q. But that sample was only part of the complete set of
3 data available to him; correct?

4 A. Yes. As I understand it.

5 Q. He didn't report the results for the complete set of
6 data, did he?

7 MR. GIDLEY: Objection, leading.

8 THE COURT: All right. I will sustain.

9 BY MR. CARY:

10 Q. Did he report the results for the complete set of data?

11 A. No.

12 Q. If you were to take the data that was missing from
13 Professor Hausman's analysis, and if you were to look at that
14 as one subset of a sample and then look at the sample that
15 Professor Hausman took, is that another way that one could
16 estimate the national price effect from the transaction?

17 A. Yes. You could estimate the effect for the separate
18 areas and then average the two together to get a national
19 estimate.

20 MR. CARY: Your Honor, may I approach the witness?

21 THE COURT: All right.

22 BY MR. CARY:

23 Q. Do you recognize this piece of paper, Professor?

24 A. Yes.

25 Q. Do you recognize the handwriting on it?

1 A. Yes, I do.

2 Q. Whose handwriting is that?

3 A. It is David Ashmore's.

4 Q. Did David Ashmore is your colleague?

5 A. Yes. He and I do a lot of things together. We publish
6 a newsletter about wine auction prices. We do some
7 consulting together, lots of things.

8 Q. He was responsible in large part for actually doing the
9 computer work on this assignment for you?

10 A. Yes. He did virtually all of the computer.

11 MR. GIDLEY: Objection, Your Honor. We have never
12 seen this document before, and it is outside of the scope of
13 the direct testimony of this witness.

14 MR. CARY: Your Honor, they have seen this document
15 before, because we produced it on Monday evening. And
16 second, it is directly relevant to the inquiry Mr. Gidley
17 raised about the Chow test. Mr. Gidley was suggesting that
18 there was something wrong with not running a Chow test, and
19 this runs directly to that testimony.

20 MR. GIDLEY: Would you supply the number?

21 MR. CARY: PX 3

22 BY MR. CARY:

23 Q. If one were to take Professor Hausman's sample -- let me
24 back up again.

25 The reason for the Chow test is to determine

1 whether you should mix all of the results of the two samples
2 together or to keep them separate; is that right?

3 A. Yes. It is to determine whether the regression
4 coefficients are the same in the two areas.

5 Q. All right. Now, if we were to -- instead of taking all
6 of the results in the sample and throwing them together, if
7 we were instead to take the results outside of Professor
8 Hausman's sample and average it with the results in the areas
9 inside his sample, can you also figure out a national price
10 effect from that methodology?

11 A. Yes.

12 Q. Can you describe how you would do that?

13 A. Well, what you would do is simulate the price effect for
14 the areas in question. So if you took the primary area that
15 Professor Hausman used, you could add on other areas and
16 simulate a price effect for any component that you would like
17 and then average the results together to get a national
18 estimate.

19 Q. If you were to do that in this case, would the national
20 estimate be bigger or smaller than the estimate that you have
21 presented here today from your methodology?

22 A. It would be larger.

23 Q. What would the result be if you were to use that
24 methodology rather than the methodology that you used?

25 A. Well, it depends on how you simulate the merger and what

1 groups you put together, but it is between 9 and 10 percent.

2 Q. Rather than the approximately 7 and a half percent
3 that's your methodology?

4 A. Rather than the 8.6 percent that was in the previous
5 table.

6 Q. I would like to go back to the chart, PX 400 for a
7 minute.

8 Mr. Gidley asked you a series of questions or a
9 couple of questions at least, about a Sam's Club that might
10 be 25 miles from a particular location, as opposed to one
11 that might be closer. And he asked you whether your
12 methodology didn't in fact treat those equally. Do you
13 recall that line of inquiry?

14 A. I think so.

15 Q. Now, isn't it true -- let me rephrase that question.
16 Strike that. If you use only the -- strike that.

17 Is it your opinion that it is preferable to use
18 both the MSA data and the Hausman data rather than using only
19 the Hausman data?

20 A. Yes.

21 Q. And why is that?

22 A. Because if you include both sets of variables in the
23 regression, they both pass a test for -- taken as a group
24 separately, for statistical significance. So the data seems
25 to suggest that both of them are useful predictors of

1 Staples' prices.

2 Q. Is it the case that if you use both the MSA data and the
3 Hausman data you get results very similar to using just the
4 MSA data alone?

5 A. Yes, they are quite similar, not identical.

6 Q. Now, you also testified that you have recently received
7 additional information for the rest of the sample that would
8 allow you to use both the MSA data and the Hausman data and
9 to create from that a new Column 8 with a new result; is that
10 correct?

11 A. Yes.

12 Q. And that new result was how much, on the top line,
13 again?

14 A. I think it was, depending how you did it, but similar to
15 this. But between 6 and 7 percent.

16 Q. Now, using -- with respect to that figure, you did in
17 fact use both the MSA and the Hausman variables; correct?

18 A. Yes. That's the figure you get if you do this
19 hypothetical Column 8.

20 Q. And if you do the hypothetical Column 8 and get those
21 numbers, in that case you are not treating the Sam's Club 20
22 miles away equally with the Sam's Club that is two miles
23 away?

24 A. That is exactly right.

25 Q. Mr. Gidley asked you about the significance of the

1 coefficients with respect to some of the other possible
2 competitors that are included in your regression. Do you
3 recall that?

4 A. Yes, I do.

5 Q. What is the difference between statistically significant
6 and economically significant?

7 A. This is a distinction used in any substantive field
8 where statistical analysis is used. Statistical significance
9 is about the chance probability associated with getting that
10 result. Economic significance has to do with the magnitude
11 of a response, and it has to be judged outside of statistical
12 criteria. It has to be judged by maybe a judge. You have to
13 make some decision about whether the magnitude of an effect
14 is large compared to the subject matter that you used. Each
15 area that you work in has its own idea of what is
16 economically significant or not. And it is somewhat
17 different concept from statistical significance, because it
18 tells you about magnitudes and it requires judgment.

19 Q. If one were to evaluate the economic significance of one
20 of these possible alleged competitors, one would want to look
21 at the simulation result rather than merely one coefficient;
22 is that right?

23 MR. GIDLEY: Objection, leading, and foundation.

24 THE COURT: All right. I will sustain as to the
25 leading.

1 BY MR. CARY:

2 Q. Let me ask the question differently. What would one
3 look to in order to determine the economic significance of a
4 possible alleged potential competitor?

5 A. I think the best way to do that would be to simulate the
6 effect of eliminating the competitor or increasing the
7 competitor's presence, on the prices. That would give you
8 some idea of the magnitude of the impact of the competitor.
9 And then test whether such an effect is statistically
10 significant.

11 And in addition, of course, make some judgment
12 about the economic significance of it. It would be -- you
13 have to make some -- in my response to Mr. Gidley I was
14 telling -- just reading coefficients where T values were
15 bigger than two. A better way to judge that would be, at the
16 minimum, to test the joint significance of all of the
17 variables relevant to that particular possible competitor.
18 And another thing would be to know what the magnitude of the
19 effect was. You could do that by simulating the effect.

20 Q. Were you in the courtroom yesterday when Professor
21 Warren-Boulton testified as to the economic significance of
22 these other competitors based upon your regression analysis?

23 A. I believe I was.

24 Q. Finally, Professor, if you keep getting additional data
25 from the parties in this case, will you continue to refine

1 your conclusions?

2 A. Yes. As best I can.

3 Q. And will you do that whether the conclusions go up or
4 down as a result?

5 A. I will do it whether they go up or down, yes.

6 MR. CARY: Thank you. No further questions.

7 THE COURT: All right, thank you. Anything else?

8 I have one question for the professor. What is a good price
9 for a bottle of pinot noir out of the Willamette Valley in
10 Oregon?

11 THE WITNESS: Are you after a fancy one?

12 (laughter)

13 THE COURT: Thank you, sir.

14 MR. ORLANS: Your Honor, before the FTC rests its
15 case-in-chief, I wanted to take up one housekeeping matter,
16 and that is the question of exhibits. I didn't know whether
17 Your Honor had in mind to formally move the admission of
18 exhibits or how you wanted to handle that.

19 THE COURT: All right. The pretrial order
20 indicated and there was some argument we had the other day
21 about the interpretation of that order. That these exhibits
22 would be submitted, and then the authenticity would not be
23 challenged, but it would go to the weight unless there was
24 clear forgeries or other substantial concerns over the
25 integrity of the document. There have been some objections

1 to the defense exhibits, that they were created for
2 litigation as opposed to real business exhibits.

3 Do you have any particular ones that you are going
4 to move in, other than all of those that have been submitted
5 here? I mean, are there new ones that have been added?

6 MR. ORLANS: There are a few. Of course, there
7 were a few added today, I believe 400 to 403. Other than
8 that, Your Honor, all of the exhibits that we have offered,
9 we have filed exhibit lists. Those exhibit lists are found
10 at PX 1, PX 225, PX 281, PX 350, and PX 315. So those
11 exhibit lists encompass all of our exhibits, plus not
12 counting the ones that were offered in court today or
13 identified in court today.

14 THE COURT: All right. Let me hear from the
15 Defendants as to their position in this matter. If
16 necessary, we can take it up after the regular court day, if
17 there is an argument as to certain of these exhibits.

18 MR. KEMPF: I think I have a simple straightforward
19 position with a footnote. We have no objection to any of it,
20 except as to weight, but in our objections that we filed in
21 view of the possibility there may be some out of sync on it,
22 what we have said is that if the kind of objections they had
23 there is going to be a change of the ground rules, then I
24 want to go back and revisit that. I think the order in terms
25 of that part of it is clear and I am very comfortable with

1 it. The only thing I don't want to do, Your Honor, is to say
2 everything of theirs is in and all of a sudden turn around
3 and have them say, "None of yours gets in," because the
4 ground rule is different.

5 THE COURT: What I am going to do is this. I'm
6 going to, pursuant to the pretrial order, admit their
7 exhibits, subject to if there is a concern later that arises
8 to these exhibits or any of these exhibits to being moved out
9 that they be stricken at a later time. I will admit them at
10 this time as has been proffered, and I would include those of
11 today

12 (Government's exhibits
13 received into evidence.)

14 MR. KEMPF: And that is fine with us, Your Honor.

15 MR. ORLANS: Thank you, Your Honor. Subject to
16 that, the FTC rests their case-in-chief.

17 THE COURT: They rest the preliminary injunction
18 primary case. Thank you.

19 MR. KEMPF: As our first order of business I would
20 like to move to make a motion for partial judgment as a
21 matter of law on the FTC's late arriving and quickly
22 abandoned second argument. First they had one, and next they
23 have two, and it has never been heard from again. We have a
24 paper that sort of tracks that, and I don't propose to argue
25 it now. Maybe we need overnight to respond or something. I

1 would like to --

2 THE COURT: Let me have the record, the judgment of
3 a matter of law as to this secondary product market. Do you
4 have a document to submit on that?

5 MR. KEMPF: I do. We have not filed it
6 downstairs. Obviously they just rested just now, Your
7 Honor. But that is one. Does the Court want two copies? I
8 could do that here.

9 THE COURT: That is fine. Thank you.

10 All right. I will take that up tomorrow if the FTC
11 will be ready to address it at that time.

12 MR. KEMPF: We are ready then to proceed, Your
13 Honor.

14 THE COURT: All right. As I understand it, am I
15 correct, counsel, the first piece of business will be a
16 videotape deposition?

17 MR. KEMPF: It will be what I would call the
18 competitor presentation segment of declarations, and it
19 includes one videotape, Your Honor. And we have worked out
20 with the FTC the videotape. This is a videotape of David
21 Glass, who is the chief executive officer of Wal-Mart. All
22 told, it runs a little less than one half-hour. One portion
23 includes some confidential information with respect to
24 Wal-Mart, and by agreement of the parties we have put that at
25 the very end.

1 We have a procedure that we would jointly suggest
2 to the Court, that the screen would have something on it
3 saying "highly confidential." And it would black out, but
4 the Court could see that portion. It is very short, right at
5 the tail end of it, Your Honor. And you could listen to it
6 on the earphones up there.

7 THE COURT: It addresses your under seal?

8 MR. KEMPF: It does.

9 THE COURT: I will grant that motion to keep the
10 Wal-Mart -- to keep under seal at this time, at least, the
11 contents of the material that was originally filed under seal
12 and used in the opening statement and was to be referred to
13 briefly in the depositions of the president of Wal-Mart as
14 confidential business information that contains business
15 sensitive information that would be harmful to Wal-Mart if
16 notice is given to its competitors of its business plans in
17 the future. So I will keep that under seal at this time and
18 not allow it to be made public.

19 MR. KEMPF: All right. Your Honor, with that, I
20 would at this point launch our case by introducing two of my
21 partners that have been up here before, Jim Basile on the
22 right and Gene Assaf on the left. They sort of headed up our
23 competitor group working on that, pulled together the
24 declarations and took the number of depositions. And they
25 will present that evidence to the Court at this time.

1 MR. ASSAF: Your Honor, with your indulgence, may
2 we have two minutes, simply to set up some of the posters?

3 THE COURT: Yes.

4 (Brief pause in the proceedings.)

5 THE COURT: Are we ready to go, sir?

6 MR. BASILE: Yes. As we told you in our opening
7 statement, we have done a lot of discovery and done a lot of
8 evidence regarding competition in the office supply industry
9 and the competitors of Staples and Office Depot in the office
10 supply industry. And a lot of that is in the binders that
11 you have that we submitted to you. And you heard some of it
12 in the case-in-chief presented by the FTC. Today we will
13 march through some of that in a detailed way with you. We
14 have organized it by issue. The binder that you have there
15 contains the information that we will be showing on the
16 screen so you can follow us. We will march through some of
17 the details of the testimony that has been given. We have
18 gotten declaration after declaration, and deposition
19 testimony from people. And then at the end you are going to
20 see the videotape deposition segments of Mr. David Glass, who
21 is the president and CEO of Wal-Mart.

22 First issue, Your Honor, that we want to discuss
23 is, as Mr. Kempf called it, the rest of the story regarding
24 the FTC declarants. And for seven months the FTC
25 investigated this case and talked with a number of

1 competitors. And by the time they filed their Complaint in
2 this case they had declarations from a number of them, and
3 you can see them on the screen. After that seven-month
4 investigation was completed, we were given a month to start
5 talking with these people.

6 And as Mr. Kempf told you, we did go out and talk
7 with a lot of them. And as we talked with them, we found
8 that a lot of them had additional information to give in
9 terms of declarations to the Defendants. We talked with the
10 people who were listed on this screen: Wal-Mart, BJ's, Best
11 Buy, Boise Cascade, Target, Office Superstore, Office
12 Network, and OfficeMax.

13 And within the month of discovery we had, we
14 eventually got declarations or deposition testimonies from
15 all of these people and all of them told us about additional
16 things and additional information on their view of the
17 market.

18 I would like to show you one example of that, Your
19 Honor, which is Wal-Mart. And this was a declaration that
20 Wal-Mart gave voluntarily, after they had already given a
21 preliminary declaration to the FTC. This was a letter sent
22 to Mr. Broyles of the FTC from Wal-Mart's counsel.

23 And it says, quote, Please find enclosed the
24 revised affidavit of Bill Long. As we discussed, after very
25 close examination of the affidavit, I felt that certain

1 revisions were necessary to accurately reflect Mr. Long's
2 conversation with Mr. Jim Fishkin.

3 Now, Wal-Mart did this themselves. We didn't
4 present this as a Defendants' declaration initially.

5 MR. CARY: Your Honor, at this point, I will have
6 to interject an objection. We've been listening to the
7 introduction, waiting to see where this is going; but at this
8 point we have counsel testifying. We are no longer in the
9 opening argument phase of this proceeding, and --

10 THE COURT: All right. Counsel, just get to the
11 evidence, then.

12 MR. BASILE: Yes, Your Honor. And this is the
13 thing that Wal-Mart said in the revised affidavit, Your
14 Honor. Quote, Wal-Mart's competitors in specific product
15 categories like office supplies would include specialty
16 retailers like Staples, Office Depot and OfficeMax.

17 Now, Your Honor, OfficeMax also gave an additional
18 affidavit when we spoke with them. And Mr. Feuer, the chief
19 executive officer of OfficeMax, said, quote, In my prior
20 declaration provided to the FTC, I was not asked to
21 specifically address the question of what impact I thought
22 the merger of Staples and Office Depot would have on prices.
23 For the reasons outlined above I believe that Staples/Office
24 Depot is likely to lower prices as a result of the merger.

25 Your Honor, in addition, one of the issues we

1 raised in our opening is whether many companies compete with
2 Staples and Office Depot. And here is some of the evidence
3 that we were able to develop in the course of our discovery.
4 We talked with all of the competitors listed on this screen,
5 Your Honor, and we are going to present you with some of the
6 things they had to say.

7 First is OfficeMax. As you know, OfficeMax is a
8 major superstore competitor. And their view regarding
9 discounters and warehouse clubs, through Mr. Feuer was,
10 quote, Mass merchandisers and wholesale clubs also compete
11 with the superstores in the sale of office products.

12 You can find that evidence, Your Honor, in the
13 binders we provided you, at DX 1607, Paragraph 12.

14 Best Buy, which supplies home electronics and
15 office supplies, was also a declarant for the FTC.

16 MR. CARY: Your Honor, again counsel is
17 embellishing and testifying himself. If he wants to read
18 from the declaration, he should confine himself to the
19 evidence.

20 THE COURT: Just point out each one of these for
21 the record in the declaration.

22 MR. BASILE: And Best Buy testified in their
23 declaration, quote, Best Buy competes with office supply
24 superstores including Staples, Office Depot, and OfficeMax.

25 You can find that evidence at DX 1783, paragraph

1 17, as noted on the slide, Your Honor.

2 Target store also provided testimony. Same quote,
3 While my prior declaration refers to Wal-Mart and Kmart as,
4 quote, primary competitors, unquote, of Target, it is also
5 true that for the SKUs of office supplies that we both sell
6 we are competitors of office supply superstores.

7 In deposition testimony given by Wal-Mart, again
8 Mr. Long, which you can find at DX 1858.

9 "Q: And the reason Wal-Mart price checks Staples
10 and Depot and OfficeMax is because Wal-Mart views Staples and
11 Depot and OfficeMax as competitors in the sale of office
12 supplies?

13 "A: Yes."

14 Sam's also competes. This is a deposition of
15 Mr. Pratt of Sam's Club.

16 "Q: Is it fair to say in the sale of office
17 supplies that the office superstores are some of your main
18 competitors?

19 "A: That is correct."

20 DX 602, which you will find in the binders we gave
21 you, Your Honor is a May 14, 1992, letter from the president
22 of Office Depot to Sam's Club regarding competitive
23 advertising.

24 MR. CARY: Your Honor, I object. A letter from
25 another vendor is not evidence. It is not verified. It is

1 not under oath and it doesn't meet the rules.

2 MR. BASILE: This evidence is in, Your Honor, and
3 we just want to draw it to your attention.

4 THE COURT: I will allow him to go ahead and lay
5 this area for the record.

6 MR. BASILE: What the president of Office Depot
7 said to the president of Sam's Club is quoted there. Quote,
8 As you know, Office Depot competes with Sam's Wholesale Club
9 in the sale of office supplies throughout the United States.

10 And that correspondence is dated May 14, 1992, at
11 DX 602.

12 In 1997, Your Honor, you will see at DX 2007, a
13 Sam's Club flyer that is sent out to business customers. And
14 it says, quote, Dear business manager, At Sam's Club we are
15 in business for your business.

16 PriceCostco, the warehouse club has also given
17 testimony but this was in another case. DX 1843 is the
18 testimony of Mr. James Senagal, who is the head of
19 PriceCostco. And this was testimony given in the case of
20 FTC v. Toys "R" Us and Mr. Senegal's testimony in FTC's
21 case-in-chief is cited here, Your Honor.

22 And he said, quote, We compete with the category
23 killers, people like Office Depot and Staples, in the office
24 supply business.

25 Mail-order competes, Your Honor. DX 857 is the

1 declaration of Mr. Jack Miller, the president of Quill.

2 MR. CARY: Can I object? My understanding is that
3 Quill is on the witness list. Why don't we hear from the
4 gentleman in person so we can cross-examine him?

5 THE COURT: He may be called. I don't know. I
6 will allow him to use the declaration at this time.

7 MR. BASILE: Mr. Miller, the president of Quill
8 mail order said in his declaration provided, quote, I
9 certainly consider Quill to be in direct competition with the
10 office superstores.

11 Your Honor, we gathered evidence regarding regional
12 superstores. This is a statement from Mr. O'Hanlan at Avery,
13 which you will find at DX 1774. He says, quote, In light of
14 the fact that approximately 75 to 80 percent of Avery's
15 business comes from products also sold in office supply
16 superstores, I consider Avery almost a direct competitor of
17 office supply superstores, including Staples and Office
18 Depot.

19 We talked with local stationers, Your Honor.
20 Leimkuhler, in Baltimore, Mr. Robert Buttner of Leimkuhler,
21 which will you find at DX 1787 which we provided to you. He
22 says, quote, Leimkuhler competes with the office superstores
23 for customers and Leimkuhler's pricing is influenced by
24 superstore prices. Moreover, other independent retailers of
25 office supplies frequently tell me they are competing with

1 the superstores for customers.

2 Your Honor, we also developed evidence regarding
3 price checking by competitors and I will show you some of
4 that right now. The slide on the board, Your Honor, shows
5 competitors who price-check, and the Defendants' exhibits
6 showing the price checking are listed below.

7 MR. CARY: Your Honor, I object. Again, this is a
8 demonstrative exhibit. It is not evidence. We are in the
9 evidentiary phase.

10 THE COURT: He can show it to me and give his
11 sources.

12 MR. BASILE: If you look below, I can point them
13 out to you. Wal-Mart's price-checking is at DX 863,
14 paragraph 10. The evidence showing that Sam's Club
15 price-checks at the superstores is at DX 1568. The evidence
16 that shows that PriceCostco warehouse club price-checks the
17 superstores is at DX 1783, paragraph 8. The evidence that
18 BJ's Wholesale Club price-checks the office supply
19 superstores is at DX 1864, paragraph 37. The evidence that
20 Kmart price-checks the office supply superstores is at PX
21 199. The evidence that Target price-checks the office
22 superstores is at DX 1821, paragraph 2. Best Buy and Viking
23 are also listed there, and you can find the citations at the
24 bottom of that chart that we provided to you, Your Honor.

25 THE COURT: All right.

1 MR. BASILE: Best Buy price-checks, the declaration
2 of Mr. London, DX 1783. He says, quote, Contrary to the
3 incorrect statements made in the draft declaration the FTC
4 wanted me to sign, Best Buy actively price-checks our
5 competitors, including price-checks of the office
6 superstores.

7 BJ's price-checks, Your Honor. The declaration of
8 Mr. Atkinson at DX 1821, says, quote, I also consider the
9 office supply superstores as competitors of BJ's in the sale
10 of office supplies, with respect to certain customers of BJ's
11 such as home offices and small businesses. Indeed, because
12 we consider Staples, Office Depot and OfficeMax as
13 competitors of BJ's, we price-check these office supply
14 superstores.

15 Target says they price-check the superstores. The
16 declaration of Mr. Nelson at DX 1799, paragraph 6, quote, I
17 believe that individual Target stores do price-check office
18 supply superstores.

19 Mr. Assaf.

20 MR. ASSAF: Your Honor, Mr. Kempf also mentioned in
21 his opening the selection of office supplies SKUs offered by
22 various stores. And again, here is a selection of the
23 evidence gathered during the last month regarding that
24 topic.

25 From Best Buy, the declaration of Mr. London at DX

1 1783, paragraph 5. Quote, I have reviewed the listing of
2 SKUs carried by Best Buy, considering those that are office
3 supply items purchased on a recurrent or periodic basis. As
4 of April 24th, 1997, Best Buy carries well over 2000 such
5 SKUs.

6 The most popular SKUs also, from BJ's, Mr. Kempf
7 referred to the 80/20 rule.

8 MR. CARY: Your Honor -- again, Your Honor, I am
9 objecting to the argument here. This is supposed to be part
10 of the evidentiary phase. It is not supposed to be oral
11 argument.

12 THE COURT: All right. Just put it in context. I
13 will allow him to go ahead. Go ahead.

14 MR. ASSAF: From DX 1821, the declaration of
15 Mr. Atkinson. Quote, BJ's objective is to offer the most
16 popular office supply products but not necessarily the
17 different varieties of each products.

18 Wal-Mart, which we are going to talk about in more
19 detail momentarily, says in a deposition:

20 "Q: When we talk about office supplies in your
21 additional 180 or 200 SKUs, that will bring Wal-Mart up to,
22 in your view, 2600 SKUs of office supplies?

23 "A: In that range."

24 DX 1858, the long deposition, at 95. And, Your
25 Honor, we also refer to DX 2007, which will be a listing of

1 Wal-Mart's SKUs later on. And we will -- as the evidence
2 will come in, that number may even get higher.

3 Mr. Kempf also mentioned in his opening about the
4 constraints on Staples/Depot pricing. Well, competitors
5 offered evidence on this topic also. From OfficeMax, the
6 declaration of its chief executive officer, Michael Feuer, DX
7 178. Quote, While I do not believe that Staples/Office Depot
8 will engage in a round of price increases, if they did,
9 OfficeMax would eat their lunch from coast to coast.

10 From others in the industry, Corporate Express,
11 which is a contract stationer, Mr. Rysary, the president and
12 chief executive officer, quote, I do not expect that a new
13 combined Staples/Depot could raise prices meaningfully, if at
14 all. In my view, such a price increase would be a
15 questionable move. Other powerful retailers -- OfficeMax,
16 Wal-Mart, CompUSA, Kmart, Target, Best Buy, PriceCostco,
17 Sam's, BJ's, Viking, Quill, et cetera, would take advantage
18 of such a development.

19 And that is at DX 859, Paragraph 13.

20 Mr. Helford, chief executive officer of Viking
21 Office Products, a mail-order group, observes that market
22 forces constrain prices. Mr. Helford's quote, "Neither
23 Staples nor Office Depot, nor the new combined company, nor
24 any other major player in this market, can in my view sustain
25 price hikes without losing business."

1 Mr. Miller, the president and CEO of Quill, another
2 mail-order office supply group, observes that consumers
3 constrain prices. Quote, from DX 857, paragraph 3: "I
4 cannot see Staples, or any other major seller of office
5 products implementing a sustainable price hike in any
6 meaningful product category, let alone across the board. The
7 reason is simple -- consumers will go elsewhere."

8 Boise Cascade, which owns a contract stationery
9 business, as well as a mail order group called Reliable.
10 Mr. Milligan, the senior vice-president, at DX 1775,
11 paragraph 6: "Indeed, in response to any purported price
12 rise, Boise and Reliable would seek to gain customers,
13 especially small businesses."

14 Mr. James Halpin", DX 853, paragraph 8, the
15 president of CompUSA. Quote, I do not believe that
16 Staples/Office Depot will be able to raise prices if the
17 merger is permitted to go forward. Given the realities of
18 competition in this market, any attempt to rise prices would
19 provide immense opportunities to Staples/Office Depot
20 competition, including CompUSA.

21 Office 1 Superstore - and even risking objection, I
22 must put this in context. Office 1 Superstore is no longer
23 in business. It is bankrupt. It used to be an original
24 superstore, and there is evidence in DX 1828 of that, Your
25 Honor. But Mr. Zenner, the president of this entity, says,

1 quote, If after the merger, Staples/Office Depot raises
2 prices, consumers will seek lower prices from smaller
3 outlets, warehouses, mail-order catalogs or the Internet and
4 buy their office supplies elsewhere.

5 Your Honor, Mr. Kempf during his opening also
6 talked about efficiencies, and some of the testimony in the
7 last day and a half concerns efficiencies. We also obtained
8 declarations from competitors, people in the real world
9 regarding their view of efficiencies. From the president of
10 OfficeMax, Mr. Feuer, DX 1788, "I believe that the
11 efficiencies derived from the merger and the resulting price
12 competitiveness of the combined entity will be substantial."

13 From Computer City, Mr. Gellman testified
14 yesterday. He also put in a declaration. This is DX 1794 at
15 paragraph 4: "I would expect, based on my experience, that
16 Staples/Office Depot should be able to negotiate greater
17 discounts from their suppliers, and could pass those savings
18 on to consumers."

19 From regional superstores, Your Honor, Avery -- and
20 there is evidence in the record to talk about Avery.

21 MR. CARY: Your Honor --

22 MR. ASSAF: If we want to read the entire
23 affidavit, what we have done is provide both the FTC and the
24 Court with every declaration and every piece of evidence
25 referred to in this trial.

1 THE COURT: This is non-jury. Go ahead and put it
2 in context.

3 MR. ASSAF: As I mentioned before, Mr. Zenner and
4 Office 1 went bankrupt. Avery has a regional list and has a
5 superstore.

6 MR. CARY: Can we get a cite for that?

7 MR. ASSAF: Mr. O'Hanlan's declaration at DX 1774,
8 counselor, and it is in your backup.

9 MR. CARY: Thank you.

10 THE COURT: Go ahead.

11 MR. ASSAF: From Mr. O'Hanlan, "The Staples/Office
12 Depot merger should result in even greater efficiencies which
13 will enable the new company to lower prices even further
14 should they choose to do so."

15 U.S. Office Products, Mr. Ledecy, quote: I have
16 to believe that a chief purpose of the proposed transaction
17 is to combine the two entities' buying power with the goal of
18 extracting lower prices from manufacturers.

19 Again from Mr. Milligan at DX 1775, from Boise
20 Cascade and Reliable, quote: Based on my experience in and
21 understanding of the office supply market, the purchasing
22 power of a combined Staples/Depot should be able to obtain
23 better prices from suppliers because of the volume of
24 purchase.

25 Mail-order expects efficiencies. From Mr. Miller,

1 president of Quill, DX 857.

2 MR. CARY: Your Honor, I will object to this as
3 sheer speculation, as evidenced by the first two words.

4 THE COURT: I will let it go to weight. Go ahead.

5 MR. ASSAF: My guess is that Staples hopes to
6 increase its buying power very substantially to enable it to

1 president of Quill, DX 857.

2 MR. CARY: Your Honor, I will object to this as
3 sheer speculation, as evidenced by the first two words.

4 THE COURT: I will let it go to weight. Go ahead.

5 MR. ASSAF: My guess is that Staples hopes to
6 increase its buying power very substantially to enable it to
7 continue doing what it has been doing all along; i.e., drive
8 down manufacturers' prices. Parenthetical, From what I hear
9 from my vendors this is certainly the perception that
10 manufacturers have of the merger.

11 From Corporate Express, a national contract
12 stationer, Mr. Rysary, the president, DX 859, paragraph 11.
13 Quote, I believe they wish to combine their two organizations
14 into one in order to achieve new efficiencies, with the
15 intent that cost savings will enable them to achieve greater
16 market share.

17 Dynamic efficiencies. Your Honor may have heard
18 testimony and you will continue to hear testimony. Mr. Kempf
19 referred to it in his opening statement, the efficiencies
20 that go to others in the industry.

21 From Michael Feuer, the CEO of OfficeMax, at DX
22 1788, paragraph 46, quote: I believe that the merger will
23 create pressures that will lead to a general decrease of
24 supplier costs throughout the office supplies industry.

25 United Stationers, from Mr. Fitts: Fast price

1 competition has caused office products companies at all
2 levels to look for economies, seek greater efficiencies;
3 i.e., to streamline. The proposed merger would no doubt
4 cause a continuation of this trend, with the retail public
5 being the beneficiary.

6 MR. BASILE: Your Honor, we gathered evidence
7 regarding whether the competitors perceived there to be an
8 office supply superstore market, and here is what that
9 evidence shows: First, from Mr. Feuer of OfficeMax. And at
10 DX 1788, paragraph 26, quote: Competition in the office
11 products business is highly fragmented and highly
12 competitive, and extends far beyond the superstores.

13 Mr. Helford, the head of Viking, at DX 854,
14 paragraph 10, quote: There is no office products superstore
15 market or market segment around which some boundary exists
16 protecting stores from the competition that the rest of us in
17 the industry face.

18 Mr. Leducky of U.S. Office Products at DX 856: "I
19 don't believe there can properly be said to be an office
20 superstore market. Office superstores face competition from
21 a variety of other sources."

22 Mr. Halpin, the head of CompUSA, at DX 853, "It is
23 my view that there cannot properly be said to be a separate
24 office superstore market in the United States."

25 Your Honor, you heard testimony about expansion and

1 ease of entry and barriers to entry. This is what the
2 evidence we have gathered has shown regarding that.
3 Mr. Ledecky of U.S. Office Products sees no significant
4 barriers to entry. Quote, There are no significant barriers
5 to entry into that business and there are existing players in
6 that office products market who have the expertise and
7 capacity to move into the office superstore business
8 quickly. Most merchandisers, for example, might well pursue
9 that opportunity.

10 Warehouse clubs easily expand. Mr. Atkinson of
11 BJ's, DX 1821, says, "Given BJ's business philosophy to
12 provide its members with access to low-cost merchandise for
13 the home and office and BJ's capacity to expand its selling
14 space within given categories, I would respond appropriately
15 to any market demand in the sale of office supplies. Indeed,
16 I would welcome the opportunity to take customers away from
17 Staples and Office Depot."

18 OfficeMax, the other superstore competitor,
19 continues to expand. Mr. Feuer, in his declaration --

20 MR. CARY: I will object. This is a press release,
21 which is typical of these guys' case.

22 MR. BASILE: Well, Your Honor, this is a press
23 release issued by OfficeMax that details their expansion
24 plans, and that is DX --

25 THE COURT: I will give it the weight I think it is

1 entitled to.

2 MR. BASILE: DX 5023. And what they're talking
3 about there are the stores they are opening this year, Your
4 Honor. And they say, quote, OfficeMax also said it set a
5 first-quarter opening record by launching 23 new superstores
6 versus seven during the same period a year ago. We are well
7 on our way to achieving our fiscal 1997 goal of opening
8 125-150 stores.

9 Your Honor, we have talked about the Internet.
10 Professor Warren-Boulton referred to the declaration
11 yesterday of Dr. Gould. And I would refer you to that
12 declaration, which is at DX 1873. I would ask you to read
13 that and I would ask you to look at this, which is
14 OfficeMax's Internet site, a videotape of how you can do
15 one-stop/no-stop shopping on the Internet at OfficeMax.

16 Your Honor, this shows the entry page to the
17 OfficeMax Internet site. This shows the page where you pick
18 the type of supply that you are interested in. There is a
19 stapler, in particular. You can go back to the office
20 supplies category, shop for categories. Note cards, and the
21 varieties and prices. Going back to the menu, you can pick
22 quantity. And you can add to your basket, you can keep a
23 running total of what you are buying. Back to the main
24 menu. (Indicating throughout)

25 An example of the quantity and variety of binders

1 you can purchase off the Internet site for OfficeMax. Again,
2 you have a quantity that you purchase in your basket, and you
3 keep a running total. Example of the variety of markers and
4 highlighters.

5 And back to the main menu, going to paper
6 supplies. Xerox paper, copy paper, adding it to your
7 basket.

8 THE COURT: Why don't we check out -- (Laughter)

9 MR. BASILE: Your Honor, this is what OfficeMax
10 says about their Internet shopping, and this again can be
11 found at DX 1873.

12 MR. CARY: Your Honor, just to make sure we have a
13 complete context here, can we have a specification of the
14 type of computer equipment that is necessary in order to go
15 through these steps as quickly as they have done here?

16 THE COURT: Surely. Maybe at the break you can get
17 that.

18 MR. BASILE: This is taken directly off the
19 Internet. It is a video print from the Internet. Anybody on
20 the Internet can do this.

21 At DX 1873, OfficeMax talks about their zero-stop
22 shopping. And they say, "With our over 500 store buying
23 power we can buy in huge quantities and pass the savings on
24 to you. And now, with OfficeMax on line you can instantly
25 buy our products from your keyboard and we will deliver the

1 order directly to your door. We will match any competitor's
2 price on an identical item, or we will cheerfully refund the
3 difference. If the item was purchased from us on America
4 Online, simply send us an on-line message and we will be
5 happy to take care of your request."

6 MR. ASSAF: Your Honor, again, to put things in
7 context, Mr. Atkinson of BJ's referenced Wal-Mart as the
8 silent killer during his testimony. We went out and we took
9 discovery from Wal-Mart. We took four depositions. And we
10 are going to show you some of the evidence that we developed
11 about Wal-Mart and their offering of office supplies.

12 Again, I come back to Office 1. And to put it in
13 context, this is the bankrupt company in the mid-west.
14 Mr. Zenner at DX 1824 -- 1828, paragraph 4, says, "Now that I
15 am advised that Wal-Mart carries 2600 SKUs of office supplies
16 and Wal-Mart is expanding its sale of office supplies, I
17 believe that Wal-Mart poses a competitive threat to office
18 superstores. Indeed, since Wal-Mart has tremendous
19 purchasing power and distribution efficiencies, office supply
20 superstores should consider Wal-Mart as a competitive
21 threat."

22 And again, for context, I point the Court to PX
23 174. That is the declaration of Mr. Long of Wal-Mart
24 obtained by the FTC, in which he says that Wal-Mart is adding
25 180 SKUs to its already 2800 SKUs in its one department.

1 Mr. Long's deposition, DX 1858, at 41, line 16
2 through 22.

3 "Q: In fact, isn't it fair to say that based on
4 your experience in 1996, that if Wal-Mart generates even
5 greater revenues in office supplies, you are certainly going
6 to recommend you increase Wal-Mart's shelf space and SKUs
7 even more?

8 "A: Yes.

9 And Wal-Mart beats office superstores on prices,
10 according to the Wal-Mart.

11 "Q: Based on Wal-Mart's pricing philosophy and its
12 view that Staples, Depot and Max are Wal-Mart's competitors,
13 Wal-Mart tries to beat Staples, Depot and Max prices" --
14 prices, Your Honor -- "for office supplies, doesn't it?"

15 "A: Yes. We have a sign on the outside of our
16 building that says 'We sell for less.'"

17 Wal-Mart, on one stop shopping:

18 "Q: Isn't it fair to say, based on your
19 understanding of Wal-Mart's philosophy, that Wal-Mart would
20 like nothing better to become the one-stop shopping place for
21 home offices and small businesses?"

22 "A:" -- from Mr. Long -- "Yes."

23 Again, Your Honor, to put this in context, in
24 Mr. Long's deposition in 1858 and at DX 2007 and DX 2002, is
25 reference to Wal-Mart's expansion of their office supply

1 department, today, in May of 1997. And the FTC's witness,
2 Dr. Warren-Boulton, said yesterday one of the best things you
3 can do is go out and take a look at this stuff. Well, the
4 Wal-Mart Department 3s are opening up this summer. But
5 Wal-Mart has allowed us in the discovery to obtain
6 photographs of the new SKUs they will be carrying in
7 Department 3 and this is at DX 2002.

8 Over the weekend Wal-Mart's counsel and after
9 consultation with Wal-Mart allowed the photos of Department 3
10 in Wal-Mart to be used as demonstrative exhibits and Your
11 Honor, we put up some of these. And --

12 MR. CARY: Your Honor, before we proceed to publish
13 these, since they are apparently brand-new, we would like to
14 check with Wal-Mart and see what kind of foundation there is
15 for this and exactly what they are showing.

16 MR. ASSAF: Mr. Broyles and Mr. Doyle were at the
17 depositions. I talked to Mr. Orlans at length over the
18 weekend. I copied him on the letter to Mr. Weinschel. These
19 are exhibits from the depositions at DX 2002, and DX 2002a.
20 They were produced by Wal-Mart as part of our discovery and
21 Mr. Broyles and Mr. --

22 THE COURT: These are blown up.

23 MR. ASSAF: Yes, Your Honor, in fact the original
24 photographs are in your backup book, the color photographs at
25 2002a. And again, to address Mr. Cary's point, these are not

1 all of the photographs. We actually left some out.

2 THE COURT: All right.

3 MR. ASSAF: At the Court's discretion it may, of
4 course, review the SKUs. But I would point out one thing,
5 Your Honor --

6 MR. CARY: Again, Your Honor, the problem is that
7 it is completely unclear except for more argument from
8 counsel exactly what this is. My understanding would be this
9 is the entire department, not just the new SKUs that has been
10 represented. That is why it would be useful for us to verify
11 the deposition transcript.

12 MR. ASSAF: Your Honor, it is my understanding that
13 this is the entire department. That doesn't include toner
14 and cartridges, but some office supplies. The bulk of their
15 office supplies.

16 MR. CARY: But the evidence is there are only 180
17 new Stock Keeping Units, and you can put up 180 Stock Keeping
18 Units --

19 THE COURT: Let's not get distracted from the main
20 issue for the Court. I will accept this as a mass of
21 evidence. If there is evidence FTC gets out that this is not
22 accurate, we can hear that, but it seems to me this is
23 supposed to be pictures of the Wal-Mart office SKUs as
24 additive, but consisting of the older SKUs and all of the
25 newer ones.

1 MR. ASSAF: I would point out, Your Honor, one
2 point which we will come back to during our hearing. And it
3 also is referenced at 2007, which is the listing of
4 Wal-Mart's office supplies by SKU number, the new SKUs. And
5 that is over here under file folders, Section 2. If you look
6 at that, Your Honor, you will see that there is a box of file
7 folders that say "manila folders, one-third cut, 100 count."
8 And as we go through the hearing, we refer back to the fact
9 that Wal-Mart has those in their new Department 3.

10 Wal-Mart's emphasis on office supplies, Wal-Mart
11 recruits office superstore employees for its organization.
12 And the citations for this evidence, Your Honor, DX 1814.
13 DX 1858, the Long deposition at 29 through 30, and the Voss
14 deposition at 2935. And what does that evidence say? That
15 this fall Wal-Mart hired Office Depot's office supplies
16 buyer. That Sam's Club --

17 MR. CARY: I will object again. We are not getting
18 a reading of the declarations, which is what this is supposed
19 to be. We are getting argument.

20 THE COURT: Okay. You have a quote where they say
21 that?

22 MR. ASSAF: Yes, Your Honor, it is absolutely in
23 the backup. If you want me to go through the Q and A of
24 their hiring Ms. Donovan and Mr. Alexander, I will do that.

25 THE COURT: I think Mr. Cary is right to this

1 tent. The other exhibit that you have had, you have the
2 tes there and you have shown them, you just have not told
3 that they said. So I think we should have exactly what
4 was said.

5 MR. ASSAF: For ease of reference, we will provide
6 Mr. Cary and the Court with selection of the quotes tomorrow
7 morning.

8 THE COURT: All right.

9 MR. ASSAF: Now, Judge --

10 THE COURT: I missed it in that discussion. Who
11 was represented to be the buyer from Office Depot that was
12 hired?

13 MR. ASSAF: Oh, yes. Julie Donovan is the buyer
14 from Office Depot, who was hired in October, 1996, from
15 Office Depot. And she was hired by Wal-Mart. Mr. Harry
16 Alexander is also an office supplies executive, the manager
17 of office supplies of Office Depot, and he was hired by Sam's
18 Club now, approximately three weeks ago, although in candor
19 it may be four weeks ago. Lost track.

20 Mr. Mayer was not hired. He was recruited by
21 Wal-Mart to focus on small business sales then, and he was
22 recruited by an organization, a recruitment agency. And this
23 is in his deposition at 1814. He was recruited by a
24 recruitment agency in Dallas, Texas, by Sam's.

25 Now, Your Honor, the parties have agreed on

1 designations and counter-designations to a video and we have
2 also agreed to split the time, the running time of the video
3 of Mr. David Glass of Wal-Mart. 18 minutes will be charged
4 to the Defendants, six minutes -- I have spoken to Mr. Orlans
5 about this. Six minutes will be charged to the Plaintiff.

6 Your Honor, again, the headphones simply need to be
7 turned on. If you listen to the video, and as we get to the
8 highly confidential portion, the sound will be killed in the
9 courtroom and the video will also.

10 THE COURT: All right. And you will submit for the
11 record not only a deposition transcript but the part that has
12 been kept confidential under seal for the transcript, the
13 official transcript.

14 MR. ASSAF: Yes, sir.

15 (David Glass video played.)

16 MR. KEMPF: Your Honor, I believe that concludes
17 the presentation, and this might be a good time for our
18 afternoon break.

19 THE COURT: All right. Ladies and gentlemen, we
20 will take our afternoon break for 15 minutes. Be back about
21 18 minutes before 3:00. Please.

22 (Brief recess)

23 MR. KEMPF: Your Honor, let me tell you the next
24 two things we are going to do. There has been a lot of
25 discussion of analysts. Mr. Smith will be doing a short

1 presentation on analysts' evidence. Similar to Mr. Basile
2 and Mr. Assaf did, except a lot shorter. And then we will
3 call Mr. Steve Mandel. I referred to him as "the
4 productivity speech in 1990." Mr. Smith, my partner will do
5 both of those.

6 MR. SMITH: Good afternoon, Your Honor. I think we
7 are up, Your Honor.

8 I am going to make an analysts presentation
9 covering briefly what it is that the FTC says and what
10 analysts from whom we have obtained declarations. And Your
11 Honor, I have for you a copy of the presentation with all of
12 the declarations that are bound up, and the articles that are
13 backed up to that for the Court.

14 In the FTC's brief they said the investment
15 community says reduced competition as a result of this
16 merger. Ursula Moran, the first person cited -- in her
17 declaration, DX 1890, at paragraph 2, says, "I have never
18 been contacted by anyone at FTC to talk to me about my
19 opinions regarding the SOD merger." Her affidavit also says,
20 "I was surprised when I learned the FTC has tried to use my
21 report" -- A merged Staples/Office Depot is the title of the
22 report -- "greater than the sum of its parts to claim support
23 for that statement. The FTC has selected and quoted out of
24 context one sentence from my eight-page report."

25 She goes on to say, as the next page indicates in

1 paragraph 4, "The very first sentence in my report states
2 that the Staples/Office Depot merger is a positive
3 development for both the companies and the industry," citing
4 her report.

5 She indicates in paragraph 3 that, "We at Stanford
6 and Bernstein Co. expect competition in office supplies will
7 be intense following the Staples/Office Depot merger."

8 Mr. Wewer at paragraph 3 says, "I was surprised to
9 see that the FTC cited my report" -- PX 55 -- "in its brief
10 as supposed support for its motion and specifically for that
11 assertion. That is not an accurate reflection of my views.
12 I do not believe that the Staples/Office Depot merger will
13 reduce price competition as implied by the FTC."

14 Mr. Wewer went on to note, "It should be noted no
15 one from FTC ever contacted me or attempted to talk to me
16 about my views. Had they, I would have claimed to the
17 contrary, I believe that the merger will enhance price
18 competition and enable Staples/Office Depot to reduce prices
19 below current levels."

20 The FTC says what it says. And Mr. Balter, another
21 person they cite, in his declaration at 1882, paragraph 3,
22 says, "FTC's assertion blocking the transaction will lead to
23 lower prices is wrong and reflects a fundamental
24 misunderstanding how the competitive cycle in retailing
25 works."

1 Mr. Aram Rubinson from Paine Webber states, "I
2 . expect that Staples and Office Depot will seek to keep prices
3 low in order to continue utilizing the productivity loop as I
4 explained in an article in the December 1996 issue of Office
5 Products International," which is in the record and in your
6 book at DX 290 at page 51.

7 THE COURT: Did Rubinson -- DX 1820 or 18 --

8 MR. SMITH: They are -- his declaration is 1820.
9 And the article that he cited, his December 1996 article is
10 in DX 290, which is that Office Products International
11 publication. But both items are in the book that I have
12 handed up to the Court.

13 THE COURT: Would you wait one second.

14 (Pause, Court conferring with court reporter.)

15 THE COURT: It will be up to speed in a second.

16 MR. SMITH: Technology is great, but sometimes you
17 have to take time to save time.

18 THE COURT: Go ahead, that is fine.

19 MR. SMITH: Amy Ryan from Prudential Securities,
20 another person they cite, in her declaration at DX 1176 says,
21 "Based upon my knowledge and research I believe that the
22 mergers between Staples and Office Depot should yield
23 synergistic savings in several important cost categories,
24 including better buying, an integrated uniform product mix,
25 combined advertising and marketing efforts, and general and

1 administrative economies. The combined company seems likely
2 to pass on some of the resultant savings to consumers as it
3 strives to enhance sales and profits. I also think that
4 consumers will benefit from the combined firm's top-notch
5 managerial team."

6 Mr. Wewer we referred to in DX 1840, states, "As my
7 report itself states, regardless of how big you believe the
8 total industry is, Staples/Office Depot should generate only
9 10 billion in annual sales, which at the most would represent
10 8 percent of the total industry." Citing his article at PX
11 55, which is one of Plaintiff's exhibits: "With all of this
12 competition and a small market share, Staples/Office Depot
13 cannot just raise prices."

14 Ursula Moran, we also indicated in DX 1890, states
15 in paragraph 8, "As I estimated in my report, Staples/Office
16 Depot would have only 10 percent of the total office supplies
17 industry."

18 Amy Ryan expresses basically the same view in the
19 article she wrote at DX 293, "Staples and Office Depot
20 announced they intend to merge, creating a company that will
21 have about 10 percent of the small business and home office
22 worker market of the office supply industry, 6 percent of the
23 contract stationer industry and about 5 percent of the direct
24 delivery segment of the office supply industry."

25 Aram Rubinson spoke about the competition. DX

1 1820, again. "Based on my observation as a retail analyst, I
2 do not see a separate office supply superstore market.
3 Office products are commodities. They are sold at many large
4 retailers such as Staples, Office Depot, OfficeMax, Wal-Mart,
5 Kmart, and PriceCostco. They are also sold at numerous other
6 retailers, including, for example, drug stores, convenience
7 stores, supermarkets and thousands of smaller office supply
8 dealers and retailers nationwide."

9 He went on to explain some of the other companies
10 that are involved, and he said, "The merger's likely affects
11 should be assessed in the light of the multitude of
12 competitors in the highly competitive office products
13 industry," at paragraph 5.

14 Ursula Moran similarly noted the large number of
15 competitors in DX 1890, paragraph 7, as the Court can see.

16 Gary Balter, another person cited by FTC, in DX
17 1882, paragraph 10, also lists the various competitors that
18 he saw to the combined entity, stating, "Staples/Office Depot
19 in my judgment must find ways to keep its prices competitive
20 in order to avoid the ever-expanding reach of Wal-Mart,
21 Target, Best Buy and these other competitors."

22 Amy Ryan spoke at DX 293 in her Office Products
23 Industry Update. This is a publication. "Consumers will
24 continue to have many alternative sources of supply for their
25 office products needs." Listing again the various different

1 companies.

2 As Mr. Rubinson explained in DX 1820, "The
3 Staples/Office Depot merger should produce benefits that
4 extend beyond the merged entity. In the course of my analyst
5 work I have spoken with a number of office products
6 suppliers. Many of them view the merger as an opportunity to
7 globalize their brands sooner than they would otherwise be
8 able to do, as the combined company will likely expand
9 internationally on a larger scale than they would
10 separately."

11 Mr. Rubinson went on to explain, "Also, other
12 retailers should be able to reduce their costs by virtue of
13 their ability to piggyback off the lower prices that the new
14 entity will be able to obtain from its suppliers because of
15 the new entity's enhanced marketing power."

16 Ursula Moran, in DX 1890, said, "The two companies
17 are joining together two retail chains with only minimal
18 store overlap and with two of the strongest management teams
19 in the industry. They have complementary strengths in
20 merchandising, selling and operations."

21 She went on to explain in DX 1890, as I also
22 explained, "As a combined company, Staples/Office Depot will
23 be able to realize significant synergies and efficiencies and
24 cut costs to a much greater degree than the companies
25 otherwise would if they remain separate. One of the many

1 benefits of the deal is that the merger will enable the
2 companies' warehouses to achieve greater capacity,
3 utilization, and cost leverage than they would otherwise."

4 In paragraph 5 she went on to talk about the
5 specific ways in which that could be accomplished, and
6 concluded that, "With the buying power of 1100 stores and 10
7 billion in sales, Staples/Office Depot can realize
8 significant savings in costs of goods sold. I also expect
9 Staples/Office Depot to have large savings of advertising and
10 other marketing cost and in general in administrative
11 expenses as it eliminates redundant programs and functions."

12 Mr. Wewer, DX 1840, paragraphs 3 and 8, stated, "I
13 believe that the merger will enhance price competition and
14 enable Staples and Office Depot to reduce prices below
15 current levels. Based upon my experience of judgment as an
16 analyst, I believe that if allowed the merger should lower
17 prices for consumers in the near and long term."

18 Amy Ryan again, and this is from her Office Supply
19 Industry Update and her statement at paragraph 4, "The
20 combined company seems likely to pass on some of the result
21 in savings to consumers as it strives to enhance sales and
22 profits."

23 We have more from Mr. Balter, and I would like with
24 Your Honor's permission to get to Mr. Mandel. We can go
25 through the rest of this, but I think the last point, if we

1 can go ahead several pages, Your Honor, if you have it, so
2 that we can move forward and it might make it easier, I would
3 like to go to the point at the end.

4 The continued delay will harm Office Depot. If we
5 just go to that point and we will just do it up there.

6 Mr. Balter said one other important thing. He
7 said, "In my opinion Office Depot will be in a very tough
8 spot if this deal is not approved. Unlike Staples and
9 OfficeMax, Office Depot's numbers have been deteriorating
10 over the past two years and its growth has slowed. Without
11 this deal, Office Depot will have to undertake the crucial
12 step of rebuilding a management team and then resurrecting an
13 expansion strategy to provide future growth."

14 Mr. Balter concluded that, "Office Depot will also
15 have to deal with its contract stationer business, which has
16 been its Achilles heel over the past three years. As I
17 stated in my April 7 report, I believe that if this deal
18 falls through, Office Depot's stock will trade at 10 to 12
19 dollars a share."

20 Your Honor, we would like to call Mr. Mandel.

21 THE COURT: Fine. Everybody ready, then.

22 MR. SMITH: All right, Mr. Mandel. They asked he
23 be excluded from the courtroom for that presentation, so we
24 will get this man up. Mr. Mandel has come down from New York
25 this afternoon, to testify here and, we are hopeful we can --

1 the direct should be, I hope, no more than half an hour. And
2 that we, if the Court can -- we could get Mr. Mandel's cross
3 in today if that is at all possible.

4 STEPHEN MANDEL, JR., GOVERNMENT'S WITNESS, SWORN

5 MR. SMITH: I do have a set of exhibits that we
6 will use for Mr. Mandel for the Court, and for you.

7 THE COURT: Will he need the monitor?

8 MR. SMITH: Will he need the monitor? Is the
9 monitor not working --

10 THE COURT: They can use the exhibit book.

11 MR. SMITH: He has his set of exhibits here. These
12 are not his exhibits. I believe these belong to you people.

13 If I can have just one minute.

14 THE COURT: Sure.

15 MR. SMITH: Good afternoon, Mr. Mandel. Thank you
16 very much for coming down. Would you please introduce
17 yourself to the Court?

18 THE WITNESS: Yes.

19 THE COURT: Go ahead. He is sworn?

20 THE DEPUTY CLERK: Yes, I have already sworn him.

21 DIRECT EXAMINATION

22 BY MR. SMITH:

23 Q. Would you please introduce yourself to the Court.

24 A. My name is Steven Mandel. I am a senior managing
25 director at Tiger Management Corp, which is a New York-based

1 money manager running about 9 billion dollars in client
2 assets.

3 Q. And you said that you were a senior managing director at
4 Tiger Management. What does that mean, when you say you are
5 a senior management director?

6 A. It means we have a firm of about 160 people and we have
7 a small management committee of six people, of which I am one
8 of those six.

9 Q. Now, does Tiger currently have an investment position in
10 either Staples or Office Depot?

11 A. No, it does not.

12 Q. Has Tiger ever had a position in Staples' or Office
13 Depot's stock?

14 A. Yes. Several times. Most notably back in the late '80s
15 and early '90s when we were significant shareholders of both
16 companies.

17 Q. Sometimes it helps to take a drink of water when you get
18 started here.

19 A. There we go.

20 Q. I didn't give you time.

21 By the way, Mr. Mandel, have you ever testified as
22 an expert witness, or anything ever?

23 A. I have not. The first time in a court of law.

24 Q. What was the largest position that Tiger Management ever
25 had in Staples or Office Depot?

1 A. In percentage terms, back I guess in '90, '91, we owned
2 9 percent of Staples and 4 or 5 percent of Office Depot;
3 which translated to, you know, at that time about 20- to
4 40-million-dollar investments in the companies.

5 Q. Now, why did you close out your investment in Staples
6 and Office Depot?

7 A. In hindsight that was a mistake, but we invest in a wide
8 variety of things. We had done very well in both stocks, and
9 we thought at the time they were a bit ahead of themselves,
10 and reallocated the money into other things.

11 Q. I would like to show you and I think that you have it
12 there, an excerpt from what has been marked DX 1734, which is
13 a December 15th, 1993, article from Chain Store Age, entitled
14 "Winning in the 21st Century, Slimmed Down, Ready for
15 Action, Retail Management in the 21st Century." And there it
16 indicates, when it talks about, "More companies will be
17 focusing in the footsteps of the industry leaders, such as
18 Wal-Mart, which has succeeded in continually driving down
19 costs so that the savings can be passed on to consumers.
20 This in turn increases sales, providing Wal-Mart with greater
21 profits to reinvest in achieving further cost efficiencies.
22 This is commonly referred to as the productivity loop, a term
23 generally credited to Goldman Sachs."

24 Are you the person that is at Goldman Sachs to whom
25 this term is generally credited?

1 A. Yes. My colleagues and I kind of came up with that. I
2 talked about it a lot, so I get the credit.

3 Q. Before we go into the productivity loop, could you
4 please detail for us your background, and particularly your
5 background in mass merchandise retailing.

6 A. I guess I will begin with I went to Dartmouth College,
7 graduated 1978. I worked for two years at an investment bank
8 named Warburg Paribas Becker, later bought by Merrill Lynch,
9 as a merger and acquisitions analyst. Went to Harvard
10 Business School, class of 1982. Worked for a consulting firm
11 named Mars and Company from 1982 to 1984. That is really
12 where I got my feet wet in mass merchandise retailing. I
13 worked a lot with a number of supermarket chains while I was
14 there.

15 Joined Goldman Sachs in October of 1984 as an
16 analyst covering, initially, supermarkets and drugstores.
17 And that role grew to cover basically all aspects of mass
18 merchandise retailing, discount stores, warehouse clubs, what
19 are commonly referred to as category killers or superstores.
20 And I worked at Goldman until June of 1990.

21 And June of 1990 I joined Tiger Management where I
22 work today. And basically started there, responsible for
23 their investments in retailing on a global basis, and have
24 kind of progressed to do everything that we do in the
25 consumer area, which would include retailing and package

1 goods, gaming, other things consumer.

2 Q. Taking you back to 1984, when you started at Goldman
3 Sachs, what did you do in order to learn the retailing
4 business?

5 A. Involved a number of things. One was speaking to lots
6 of people in the business, spending a bunch of time with
7 management, not just at the top levels but all through these
8 organizations. Spending a lot of time in stores. Seeing
9 exactly what people were doing, how people were competing.
10 Checking prices. Talking to suppliers, and of course, doing
11 the financial analysis that is typical of our job from 10 K's
12 and 10 Q's and the reports and everything.

13 Q. Based on that analysis, Mr. Mandel, what did you observe
14 about retailing competition that was ongoing during that
15 period of time?

16 A. I guess the prime thing which I wrote about kind of ad
17 nauseum was one thing that I observed starting -- it's really
18 been going on for about the last 50 years in U.S. retailing
19 is that new lower-cost formats in mass merchandising
20 retailing get invented by people, and they substitute for
21 higher-cost forms of retailing those same products. So that
22 really kind of started with supermarkets in the '50s, or it
23 really started in the '40s, substituting for butcher, baker,
24 candlestick makers, and corner grocery stores.

25 And that had the effect of taking a lot of cost out

1 of the system. And those stores operated at a much lower
2 gross margin structure than the corner grocery stores, and
3 offered consumers a broader selection and much lower prices.

4 That happened in the discount store business
5 starting in the '60s. All of the major discounters that are
6 big today started in the early '60s, and they basically
7 replaced dime stores. So Wal-Mart and Kmart and Target all
8 started then. And, same thing: Much broader selection, much
9 lower prices, much lower cost structure. As we moved into
10 the '70s and '80s we saw the advent of the warehouse clubs,
11 which turned out to be the lowest cost form of distributing
12 these goods, and also the category killers in home
13 improvement, Home Depot, Toys "R" Us. And in the office
14 supply superstores, and in a number of other segments;
15 sporting goods, et cetera.

16 And the analogy is the same. They drove costs down
17 through an invention of a newer, better mouse trap, which
18 offered the consumer a better experience than what was there
19 before. So that is kind of what has been going on for the
20 past 50 years.

21 Q. And are these observations that you made, you continue
22 to look at these kinds of businesses today; is that correct?

23 A. That's right.

24 Q. That is your job; right?

25 A. That is what I do.

1 Q. Now, I would like to show Your Honor -- and this is in
2 DX 308. If the Court wants, I have an original copy. We
3 obviously think it is an important article. If the Court
4 cares for it, I have an original that I can pass up to the
5 Court. There is a good copy in the binder, but there is
6 Exhibit 308. And I would like to put up from -- this is from
7 page 3 of that report, which is Exhibit 308, is a speech
8 Mr. Mandel gave in London in April of, I believe it was,
9 1990. And the productivity loop is shown in there.

10 Could you explain for us with reference to this
11 exhibit from DX 308 how the productivity loop works?

12 A. Do this without the mike here, but it is really --

13 Q. Do you need some water first? I know, if you don't need
14 some, I do. And I am not even doing the talking.

15 A. All right. Basically, this sort of has two levels. The
16 first was where new formats come in and they substitute for
17 older less-efficient formats, and they take a lot of the cost
18 out of the system. Then within any of those new formats --
19 being an office supply superstore, it doesn't matter. There
20 are a number of ways they can continue to take cost out of
21 the system, which are typically driven by technology. Such
22 obvious things as scanning, what is called an electronic data
23 interchange, paperless invoices between vendors and
24 retailers, better labor scheduling. There are a number of
25 things they can do to help them lower their cost structure.

1 In turn, they take that lower cost structure and
2 pass it on to consumers in the form of lower prices and/or
3 better customer service; driving a better shopping experience
4 for the consumer, primarily driven by pricing, but also
5 driven by other factors to enhance that experience. That
6 better experience, those lower prices, drive higher sales
7 productivity. By that I mean higher sales per square foot,
8 which in turn has the effect of driving lower cost structure
9 as a percentage of sales. As your sales go up at a faster
10 rate than your costs, your expense ratio -- your expense
11 ratio goes down, and that completes the loop. That lower
12 expense ratio allows you to do this again, and you get into
13 this virtuous circle. So that is what.

14 Q. "Virtuous circle," is what you called it?

15 A. That is what it has been called, yes. That is sort of
16 this concept. The idea is to stay in it for a long time.

17 Q. What is the role of superior execution in the
18 productivity loop?

19 A. Excuse me. The role of superior execution is really it
20 allows you to get in there. This is a little bit of a
21 chicken and egg thing, and superior execution is kind of a
22 catchall phrase for doing all of those little things 1
23 percent better or 10 percent better than the other guy to
24 enable you to drive those costs down. A lot of them are
25 technologically driven, but some aren't.

1 Q. What are some of those little things?

2 A. As I mentioned before, things such as scheduling labor.

3 It might be things such as having a better energy recovery

4 system. It might be things such as getting on a paperless

5 invoicing system with suppliers. There is a myriad of

6 things, largely technologically driven.

7 Q. I am sure this question is obvious, but what should be

8 the pricing strategy for a firm operating in the productivity

9 loop?

10 A. The basic pricing strategy is to try and take those

11 lower costs and put them through to the consumer continually,

12 in the form of better values, lower prices, to drive your

13 sales productivity.

14 Q. What are the consequences to competition as you observe

15 it when a firm is operating in the productivity loop?

16 A. Because retailing is an intensely competitive business,

17 and because it's a zero-sum game, basically -- I mean,

18 overall sales in the United States grow 2 to 3 percent a year

19 in real terms. It is a fairly fixed pie. If somebody is

20 gaining share, somebody else is losing it. And if somebody

21 is losing share, in terms of their sales per store are going

22 down, that means their expenses as a percentage of sales are

23 going up. And they have little choice but to try to tweak

24 their gross margins up to try to respond to that.

25 Q. Is the productivity loop a long or short-term strategy?

1 A. Properly executed it is a long-term strategy. I guess
2 the best example of that has been Wal-Mart. It is really a
3 foundation of the company, doing it, you know, since the
4 '60s. And they have kind of hit a little bit of a wall
5 recently, but they have been in it for the last 25-plus
6 years. And I would say most of the very good hard lines mass
7 merchandising retailers have been following this strategy
8 throughout their existence, and it is kind of a core
9 principle by which they operate.

10 Q. Now, as an investment analyst, why do you care whether a
11 company is operating in the productivity loop?

12 A. Well, it -- we like to invest in companies that win, and
13 companies that are in this loop tend to be the ones taking
14 market share. And we want to be on those horses, and we
15 don't want to be on the horses that are losing share. I
16 mean, that is the way retailing basically works.

17 Q. As an investment analyst, how do you analyze whether a
18 firm is operating in or plans to operate within the
19 productivity loop?

20 A. Looking at their financial results here, there are
21 really three things that I would look at. First and foremost
22 would be their sales productivity. And by that I mean their
23 comparable store sales, their sales increases in existing
24 stores and their sales per square foot, which are probably
25 the best measures of the productivity -- sales productivity

1 increases of the retailer.

2 Q. The first one would comparable sales --

3 A. Comparable store sales or sales productivity.

4 Q. What would be the second factor?

5 A. Second factor would be to make sure that is in fact
6 translating into a declining expense ratio, which as an
7 outside observer not privy to the internal financial
8 statements of the companies would be measured looking at
9 their total expenses divided by their total sales, what I
10 call their expense ratio; and to make sure that is
11 declining. So I called that "declining expense ratio."

12 Q. Declining expense ratio. And what is the third thing?

13 A. The third thing would be to see whether -- and this is
14 the fuzziest. But to see whether the first two also
15 translated into declining gross margin, which is the only
16 proxy I really have for declining prices to consumers.
17 Obviously in gross margin there are a lot of things that go
18 in there, but that is the proxy that I would have from public
19 documents.

20 MR. SMITH: Your Honor, if I can have leave later
21 to mark that as an exhibit and print it out?

22 THE COURT: All right.

23 BY MR. SMITH:

24 Q. Now, in terms of your observation of Staples over time,
25 can you tell us how you first found out about Staples?

1 A. As I said before, the first thing I really did at
2 Goldman was follow the supermarket industry. And I used to
3 read all this trade research, and there is this obscure trade
4 magazine called The Griffin report -- I don't know if it
5 still exists today -- which covers supermarkets in New
6 England, believe it or not. And I read in there there was a
7 story about Leo Caan and Tom Stenberg, both of whom had come
8 from the supermarket industry in New England founding an
9 office supplies superstore, or planning to found one. And I
10 thought personally this was one of the great unexplored
11 frontiers of retailing; a very big category that was very
12 poorly done.

13 So I was quite excited by that, so I called up. I
14 didn't know Tom or Leo, and I just called up and I introduced
15 myself. And I was up on a business trip in Boston once, and
16 I had lunch with Tom at McDonald's that's right near the
17 first Brighton store, I guess it was maybe six months before
18 the store opened. And just sort of have been following the
19 business ever since.

20 Q. Now, based upon your observations, has Staples been
21 operating in the productivity loop?

22 A. Yes, they have.

23 Q. Has Office Depot been operating in the productivity
24 loop?

25 A. Yeah. I would say Office Depot was, has been throughout

1 its career a very strong adherent to it. It has been a core
2 principle I would say. Staples, it has been a core principle
3 more in the last three or four years; but, you know, was a
4 principle in the early going as well, but just not as strong
5 a core value as it has become in the last three or four
6 years.

7 Q. Now, has there been any firm that you observed that was
8 in the productivity loop and fell off the productivity loop?

9 A. Yeah. That has happened in a number of cases. I would
10 say the one that I think about most is Toys "R" Us, which is
11 a company I have also followed for a long time; which, as you
12 all probably know, is probably the most dominant in terms of
13 its market share of its category of any company in the
14 specialty retailing. And Toys "R" Us during the period of
15 the mid to late '80s was very much in the productivity loop.
16 Nice sales gains driving their cost down, driving the margins
17 down. And they just didn't adhere to it quite as strongly,
18 felt that they could take little more liberties on pricing
19 because, you know, we have all of the toys and nobody else
20 does. And they would -- I mean, not big things. But they
21 would do things such as Duracell batteries at Wal-Mart might
22 sell for 2.78, they might sell for 3.99 for a four-pack of
23 double A batteries. And they felt they were entitled to that
24 because it was a convenience item.

25 What this did was this provided a little opening

1 for Wal-Mart in particular to go more aggressively after the
2 toy business, and that has kind of resulted in Toys "R" Us
3 having fairly stagnant earnings and share price for the past
4 five or six years or so. And they are recognizing this and
5 trying to deal with it now, but they created the opportunity
6 themselves for somebody else to dive in there and take some
7 market share from them.

8 Q. And who was the person who took market share from them?

9 A. Most -- Wal-Mart would be the largest. Target would
10 probably be the other one who has done it in a fairly
11 significant way. But Wal-Mart by far would be the --
12 Wal-Mart is the second-largest seller of toys in the United
13 States.

14 Q. Have you ever used a term to describe Wal-Mart?

15 A. Yeah. In these various articles. Really, it was more
16 initially related to describing warehouse clubs, which would
17 describe them as silent killers. And the reason for that
18 would be that they, you know, sell lots of different things.
19 Many, many different categories. In office supplies it may
20 account for, I don't know, 8 percent of their sales, 6
21 percent of their sales. And they carry two to 300 items, but
22 in those items they are very important and they are priced
23 very aggressively. But because it is a relatively small part
24 of their business, it is easy for the competitors to say they
25 are not really there. And "silent killer" means they are

1 just taking market share without people noticing.

2 Q. Did you ever lose faith in Staples?

3 A. Yes, for one brief period of time, which was costly.

4 In -- this was probably 1992. This was 1992. OfficeMax was
5 preparing to enter Boston, and I knew that Staples had higher
6 prices in Boston than they had in other markets. And I was,
7 you know, nervous about what was going to happen as a result
8 of OfficeMax's entry in Boston to Staples' profitability in
9 Boston, and actually made a bet on Staples' share price
10 declining. We do that as part of our money management
11 business. We bet on the stocks going up and we bet on them
12 going down.

13 Q. How do you do that?

14 A. You sell shares you do not own. And that turned out to
15 be costly. And the reason it turned out to be costly was
16 that, prior to OfficeMax's opening, Staples lowered prices
17 considerably in Boston. This, coupled with OfficeMax coming
18 to Boston, had the effect of heightening the awareness of
19 office supply superstores. There was a large and there still
20 is a large base of business done with stationers in the
21 Boston area who were much higher priced, and that fact
22 accelerated the market share shift from those stationers to
23 the office supply superstores and kind of pushed Staples into
24 the productivity loop. Their sales, because they lowered
25 prices in advance of OfficeMax coming, grew much faster than

1 they had been growing before. Their costs started going
2 down. They said, Gee, this is great. We ought to start
3 doing this. And it sort of pushed them into the loop and
4 caused me to lose money. That's all.

5 Q. Based upon your continuing analysis after OfficeMax
6 entered and established its presence in Boston, did Staples
7 continue to operate in the productivity loop and lower its
8 prices?

9 A. Yeah, it did. In fact, it realized that this was a good
10 thing and started doing it in its other markets as well.

11 Q. Now, are you familiar with the planned merger of Staples
12 and Office Depot?

13 A. Yes.

14 Q. And how are you familiar with that?

15 A. That is part of my job. I, you know, read the company
16 releases, the proxy statement, the press reports, listen to
17 conference calls. That is what I do.

18 Q. Are you familiar with the FTC's allegations in this
19 case?

20 A. Yes.

21 Q. How are you familiar with those allegations?

22 A. I have read the FTC's brief on the matter.

23 Q. And their reply brief; is that correct?

24 A. Yes.

25 Q. Now, let me show you what has been DX No. 3. You have a

1 copy of that right there?

2 A. Yes.

3 Q. Have you seen DX 3 before -- PX. For sure PX, although
4 maybe PX.

5 A. Yes, I have seen it.

6 Q. PX 3. Now, as an investment advisor analyzing these two
7 companies for the purposes of determining whether you would
8 want to invest in them for the future, does this chart tell
9 you anything?

10 A. No, it doesn't.

11 Q. Why not?

12 A. Because it indicates nothing about what the company,
13 combined company, would plan to do or individual companies
14 would plan to do in the future with their pricing in each of
15 these market situations, which I believe is continue in the
16 productivity loop and continue to try to drive prices down.

17 Q. But, for example, what are the things of the future you
18 as an analyst would want to know?

19 A. Well, certainly relative to the combined companies, you
20 know, the size of the savings they have to apply to their
21 costs. That would be the most significant thing.

22 Q. What about the differences in prices that may exist from
23 market to market? What is your experience in that regard?

24 A. My experience in that regard is that almost every
25 retailer I know employs different pricing across different

1 markets, what is commonly called zone pricing. And the two
2 primary reasons behind someone having zone pricing, one is
3 competition. The second is the different cost structures
4 that exist between markets. Typically a single-store market
5 is going to be a smaller market. And a smaller market has
6 less volume potential than a larger market. So in the case
7 of office supply superstores, a Staples or Office Depot might
8 go into a smaller market and have a volume expectation of
9 only doing 5, 6, 7 million dollars in a store. Or in the
10 larger market they might have an expectation of doing 10 or
11 15 million dollars. So even though the costs, rent and labor
12 may be lower in dollars in the smaller market, as a
13 percentage of sales they will be higher because the volumes
14 are lower. And in order to come out with a decent return on
15 investment, you will need to have a modestly higher gross
16 higher margin in those markets than in markets where you
17 expect to do higher volumes. Those are two factors.

18 Q. Now, I believe that you have in front of you some of the
19 charts that were used by Professor Warren-Boulton yesterday.

20 In PX 202, relating to this stock market analysis
21 that he did --

22 A. Correct.

23 Q. Have you reviewed those exhibits?

24 A. Yeah. I saw them for the first time this morning.

25 Q. And based upon your experience as an investment advisor,

1 does that make any sense at all?

2 A. Are you referring to the one with Costco, Wal-Mart, Best
3 Buy and CompUSA?

4 Q. Yes.

5 A. No, it does not. And the reason it doesn't is that the
6 sales in office supplies as done by Costco and Wal-Mart --
7 let's take those two, being the biggest two, are a very small
8 percentage of those overall guys' sales.

9 So let's just take Wal-Mart. These numbers could
10 be off, but Wal-Mart may do 3 percent of their sales in
11 office supplies, including Sam's. And so nobody is really
12 going to care, you know, if there is a change in the
13 competitive landscape in office supplies, about how that
14 affects Wal-Mart, because it is 3 percent of their business.

15 Q. When you say no one, you mean no one --

16 A. No one in the investment community who is an owner of
17 Wal-Mart stock or thinking to be an owner of Wal-Mart stock
18 will be too excited about what is going on in office
19 supplies, just like they won't get too excited about what is
20 going on in toys or health and beauty aids, because Wal-Mart
21 sells many many categories of goods. Each of them is
22 relatively small compared to Wal-Mart.

23 I used to know these numbers, but Wal-Mart used to
24 do 125 billion in sales. And 3 percent of 125 billion is
25 just under 4 billion, which is a lot of office supplies

1 relative to the other people; so it accounts for that, but
2 relative to Wal-Mart it is just not a big deal.

3 Q. Now, I think there was a chart that showed Office Depot
4 prices, and we had an exhibit which was DX 9,000 Mr. Kempf
5 put up yesterday. That is the one that we are talking about
6 there.

7 Now, what did you observe happened and what
8 affected OfficeMax's stock during this period of time?

9 A. Well, the most -- I guess the most significant -- when
10 the deal was announced, people perceived that as a
11 significant negative for OfficeMax, because they figured this
12 juggernaut was going to be created that would steamroll
13 OfficeMax. That was the first thing. The second thing was
14 when the deal to divest the 63 stores came about, and
15 OfficeMax held a lot of bargaining power in the deal, and was
16 able to in effect cut a deal to buy those stores at a very
17 cheap price. The stock market reacted positively to that,
18 because, you know, they would get these producing assets for
19 a very cheap value.

20 And then when the deal was scotched by the FTC, and
21 the 63-store deal was therefore off, OfficeMax's share price
22 fell because people realized that was not going to be a bonus
23 for OfficeMax anymore.

24 Q. I would like to show you what has been marked here as
25 Defendants' Exhibit 6045a, a chart, and just make a couple of

1 references to it just for convenience purposes here.

2 Now, this -- on this left-hand side are the sales
3 of the total enterprise, the 10.1 billion if you just take as
4 of year-end and add the sales. And the FTC's theory is that
5 as to a portion of these; that is, where there are overlap
6 markets, which they say is about 46 percent of these, or 48
7 percent, or whatever the relative number is -- of these
8 sales, these 2.27 billion of office supply sales. That they
9 are going to jack up the prices 8 percent on average of those
10 products, and not change the prices on any of these other
11 products. Is that a strategy that makes any sense?

12 A. No, I don't think the strategy makes any sense. If I
13 were an investor in the companies and I found out that they
14 were doing that, I would be quite upset. If I were Wal-Mart
15 or OfficeMax or anybody else competing with these guys, I
16 would be licking my chops.

17 Q. Why would that be a disastrous strategy for a retailer;
18 that is, like Staples or Office Depot?

19 A. Because it goes back to what I talked about with Toys
20 "R" Us before, it just provides a competitive opening for
21 someone to come and take market share.

22 Q. Is that market share from all of your products or just
23 from the --

24 A. Well, it would take from the whole thing, because
25 obviously people are coming in most frequently to buy these

1 consumable products, and but they also buy lots of other
2 things when they are there. If they are going to another
3 store to buy their consumables, they are also more likely to
4 buy their products while they are buying their consumables.

5 Q. Now, can you put back up this productivity loop here on
6 this -- and, Your Honor, I neglected -- I did not introduce
7 Mr. Sterling, who has worked very hard with me on this
8 matter.

9 THE COURT: All right. Thank you.

10 BY MR. SMITH:

11 Q. Now, what is the effect on the productivity loop of
12 realizing efficiencies from a merger?

13 A. It is really the same as -- it comes under that category
14 of superior execution. Basically what it does, is it
15 provides you a way of reducing costs to accelerate yourself
16 into the productivity loop. Basically, there is a large
17 block of cost savings that results from duplicative functions
18 at headquarters, results from better buying; and those cost
19 savings can be passed along to consumers in the form of lower
20 prices, which can then drive your sales productivity higher,
21 which can in turn drive your expenses lower and kind of give
22 you a step on the accelerator in that productivity loop.

23 Q. Now, are you familiar with the efficiencies that are
24 projected by Staples and Office Depot to result from this
25 merger?

1 A. Yeah, I am.

2 Q. How are you familiar with that?

3 A. Primarily through presentations they have made to the
4 investment community which outline their expectations for
5 those savings.

6 Q. And what is your and the investment community's -- using
7 you as a proxy, as a recipient of that -- understanding of
8 the magnitude of those projected efficiencies?

9 A. They are very large. You know, they have been spelled
10 out to be in the range of 4 to 5 billion over a five-year
11 period.

12 Q. Based upon your experience and observation in retailing
13 as an analyst, are those speculative or crazy, ridiculous
14 numbers?

15 A. No, they are not. I would really have to dig into it
16 deeply to know. It seems like a lot, but it is going to be a
17 very significant number; that is for sure.

18 Q. Now, is it your understanding and the investment
19 community's understanding that a significant portion of these
20 costs savings will be passed on to consumers?

21 A. Yes, it is.

22 Q. Why would they pass that on to consumers rather than
23 keep it for themselves?

24 A. There are two basic reasons. One is that they have been
25 very successful with being in the productivity loop for the

1 course of their existence, and this would seem like a silly
2 time to abandon that strategy. And second reason is that
3 they are -- I mean, which is really part and parcel of the
4 first. But they are publicly in ads saying it to their
5 consuming public, and there would be hell to pay if they, you
6 know, went up against that promise to their customers.

7 Q. I have only a few more questions.

8 What will happen to Office Depot if this deal does
9 not go through?

10 A. They will be --

11 MR. BROYLES: Objection, Your Honor, lacks
12 foundation.

13 MR. SMITH: I think this is his opinion as an
14 investment analyst looking at this stock. I think he has
15 certainly a basis for --

16 THE COURT: Ask him if he has done any studies on
17 this and looked at it.

18 BY MR. SMITH:

19 Q. Have you looked at and analyzed Office Depot in light of
20 the current situation over the past two years?

21 A. Yes.

22 Q. And what have you observed in that about Office Depot?

23 THE COURT: All right, go ahead.

24 THE WITNESS: Well, I think Office Depot will be
25 fine. It is a very strong and well-run company. It has

1 suffered some damage as a result of this. Things such as its
2 real estate opening program has been scaled back considerably
3 in anticipation of the merger. People who realize that they
4 are not going to be a big part of the combined company may
5 have left and found jobs elsewhere. So the company, if the
6 merger doesn't go through, would have a little bit of a hole
7 to dig out of, and its share value clearly would be down from
8 where it is today. My best guess, and it is a guess, would
9 be somewhere around \$12 or so.

10 Q. As a stand-alone company, in your judgment would Office
11 Depot be able to price as low its office supplies as the
12 combined entity will over the next coming years?

13 A. No.

14 MR. BROYLES: Objection, foundation.

15 THE COURT: Again, it is up to his background,
16 whether he has looked at it and studied it.

17 BY MR. SMITH:

18 Q. Have you analyzed the retail market as you project it
19 going forward?

20 A. That is what I do for my job, yes. That is my
21 livelihood, basically.

22 Q. No, I don't think --

23 MR. SMITH: Your Honor, is that --

24 Q. Okay. So would in your judgment, based upon your
25 experience and analysis, Office Depot be able to price as low

1 as the combined entity?

2 A. Their costs would not be as low as the combined entity,
3 and therefore to achieve the same profit margin they would
4 not be able to price as low as they could as a combined
5 entity.

6 Q. Would the same be true as Staples?

7 A. Yes, it is identical.

8 MR. SMITH: Your Honor, I have no further questions
9 of Mr. Mandel at this time.

10 CROSS-EXAMINATION

11 BY MR. BROYLES:

12 Q. Mr. Mandel, your productivity loop theory is based, as I
13 understand it, on the premise that lowering prices increases
14 the quantity sold by any retailer; is that correct?

15 A. That is part of it, yes.

16 Q. And as the quantities sold increase, the costs are
17 reduced, allowing prices to be lowered still further; is that
18 right?

19 A. Yes. As the dollars that are sold increase, the
20 expenses come down as a percentage of those dollars,
21 correct.

22 Q. And again, as I understand it then, lowering prices
23 would bring more customers into the store. Is that correct?

24 A. Correct.

25 Q. Would you agree, Mr. Mandel, that it would not make

1 sense, then, to lower prices on the productivity loop to the
2 extent that you didn't stand to gain more customers?

3 A. I'm sorry, I didn't quite understand that question.

4 Q. You would agree, wouldn't you, that it did not make
5 sense under a productivity loop theory if you did not stand
6 to gain any more customers?

7 A. Yeah. If you were, you know, if you had every customer
8 in town and you had all of their business, yeah, it would not
9 make sense to lower prices further.

10 Q. That is because you would be decreasing revenue; is that
11 correct?

12 A. That is correct.

13 Q. And in fact the prudent business decision would be to
14 lower your prices only to the extent that it increased your
15 volume customers; is that correct?

16 A. That is correct.

17 Q. Now, you have studied the office supply industry; is
18 that correct?

19 A. That is correct.

20 Q. And I believe that you --

21 THE COURT: He will have to take down these
22 slides. Do you want to take the charts down.

23 MR. SMITH: I apologize, Your Honor. I will move
24 these.

25 The most exercise in a little while.

1 BY MR. BROYLES:

2 Q. Now, I believe that you testified in your direct that
3 you were aware there are different prices for office supply
4 superstores in different cities; is that correct?

5 A. Correct. That is what your exhibit does show, yes.

6 Q. But you did testify that you were aware of that?

7 A. Yes.

8 Q. Now, the productivity loop theory itself doesn't explain
9 why there are different prices in different cities, does it?

10 A. Partially it does, because part of the explanation has
11 to do with different cost structures and different markets,
12 yeah.

13 Q. And part of the explanation has to do with competition;
14 is that correct?

15 A. Correct.

16 Q. Competition is one of the factors that companies must
17 assess when they are setting their prices; is that correct?

18 A. Correct.

19 Q. And competition is also important in driving down cost;
20 is that correct?

21 A. Yeah, I would say it is correct.

22 Q. And also in driving down prices; is that correct?

23 A. Correct.

24 Q. As a matter of fact, Mr. Mandel, you indicated that when
25 OfficeMax entered Boston, which was previously a Staples-only

- 1 market in terms of superstores, it compelled Staples to get
2 into this productivity loop; is that correct?
- 3 A. Yeah. It was one of the things that I think really
4 pushed Staples to realize that should be a core foundation of
5 their pricing strategy and business philosophy.
- 6 Q. And therefore to lower their prices in Boston as well?
- 7 A. Correct.
- 8 Q. Now, at the time -- I believe that you indicated
9 OfficeMax entered Boston in 1992?
- 10 A. My memory could be wrong on that, but I believe it was
11 '92.
- 12 Q. Around that time. Around that time Staples was in the
13 market selling office supplies?
- 14 A. Yes.
- 15 Q. Was Staples the only retailer in the market selling
16 office supplies?
- 17 A. There were tons of others.
- 18 Q. Now, isn't it true, Mr. Mandel, that the number of
19 office supply superstores has increased each year for the
20 last 10 years?
- 21 A. Yeah, the number of actual stores has increased. The
22 number of actual companies has gone down.
- 23 Q. The number of stores, I was asking about?
- 24 A. Right, right.
- 25 Q. And isn't it also true in this 10-year period Staples

- 1 itself has experienced dramatic growth?
- 2 A. Correct.
- 3 Q. And Office Depot in the same period also experienced
- 4 dramatic growth?
- 5 A. Absolutely.
- 6 Q. And adding these -- adding the number of stores that it
- 7 did, both companies added to their sales; is that correct?
- 8 A. Yes.
- 9 Q. And according to the productivity loop theory, this
- 10 additional sales volume from this internal expansion has led
- 11 to lower costs?
- 12 A. Not the sales volume in and of itself. It really would
- 13 have to be the sales volume on a per-store basis. If they
- 14 added a lot of stores and the stores did less volume than the
- 15 stores before them, the cost would have gone up. It is
- 16 really sales per store and per square foot which went up
- 17 fairly dramatically in most cases over that period.
- 18 Q. That is lower?
- 19 A. That is lower cost and ability to charge lower prices to
- 20 get into the loop.
- 21 Q. So each company in the past has used the productivity
- 22 loop to lower their costs on their own; is that correct?
- 23 A. That is correct.
- 24 Q. And there is no reason they can't continue to lower
- 25 their cost on their own; is that correct?

1 A. That is correct. Although I would say, as I mentioned a
2 little bit with Wal-Mart, before you start to hit the point
3 of diminishing returns. I would say Office Depot is a little
4 closer to that point of diminishing returns. High sales
5 volume per store. Your store is -- the parking lot gets more
6 crowded and the lines get longer and people say I have to go
7 someplace else.

8 Q. Now, is the basic tenet of the productivity loop that
9 bigger is better?

10 A. Not necessarily. The overall size of the enterprise. I
11 mean, in retailing there are two ways you drive your costs
12 down. One is driving your per-store volumes up, which drive
13 your store level costs down. And that is your biggest
14 component of cost. The second way to reduce cost is to drive
15 your overall volumes up, which drives your central cost
16 down. So bigger does affect your cost, but more important is
17 your volume per store.

18 Q. And the merger itself would allow the combined company
19 to increase its volume per store?

20 A. No, not right away that the merger would allow that.
21 The merger will allow them to drive down their central cost,
22 which will allow them to lower prices, which in turn will
23 allow them to drive up their volume per store. But the
24 immediate effect would not be to drive up the volume.

25 Q. The ultimate effect of combining Office Depot and

1 Staples will lead to that result; is that correct?

2 A. I believe so, correct.

3 Q. And would the combination of Staples and Office Depot
4 and OfficeMax lead to lower costs ultimately?

5 A. Again, you reach a point of diminishing returns on
6 that. But that probably would; but, I mean, it would be a
7 lot more marginal adding the third guy in. But --

8 Q. Now, I believe that you indicated that one of the ways
9 that companies get into the productivity loop is by
10 developing innovative format?

11 A. No. What I tried to say was there are two -- kind of
12 two methods that people drive costs down over time. One is
13 by inventing something new and different like the office
14 supply superstores were at their outset. And once you have
15 that format, doing a number of things to get in the
16 productivity loop to drive the cost down within that format.
17 So there is the quantum leap thing first, and the
18 productivity loop thing.

19 Q. But developing the format allows you to get into the
20 loop, is that correct, in the start of the process?

21 A. Not really. It just allows you to -- it does help you
22 do that, but it allows you to basically really make a quantum
23 leap over the existing type of competition that is out there
24 in the marketplace selling those goods.

25 Q. And the warehouse club concept was one such format; is

1 that correct?

2 A. That is correct.

3 Q. And as a matter of fact, you believe that it was one of
4 the most important innovations in the United States in the
5 past 25 years; is that correct?

6 A. You could say that, yes. I still believe that.

7 Q. Now, warehouse clubs carry a very narrow assortment of
8 merchandise and a wide variety of product categories; is that
9 correct?

10 A. They have a narrow assortment of merchandise within in
11 each category, but tons of categories, right.

12 Q. The warehouse stores themselves have enjoyed explosive
13 growth in stair steps. Is that correct?

14 A. It has slowed rather dramatically in the last three or
15 four years. It grew very fast from the mid-'70s and to the
16 early '90s, and then it's kind of slowed.

17 Q. Because of their format, warehouse clubs have not had a
18 profoundly negative impact on any single retailing format; is
19 that correct?

20 A. Not on any single one, right. That is where my "silent
21 killer" thing came up.

22 Q. And in your -- and in fact, Mr. Mandel, in your opinion
23 the impact of the warehouse clubs on other retail formats is
24 so small they don't even feel it; is that correct?

25 A. No. They delude themselves that they don't feel it.

1 That was the kind of the silent killer notion. They feel it
2 because, you know, warehouse clubs are doing, you know, 60,
3 70 billion dollars in sales in the United States. And so if
4 they are doing 8 percent in office supplies, that's, you
5 know, 5 billion dollars of office supplies. That is
6 definitely felt, but some people delude themselves into
7 thinking it is not really there.

8 Q. Now, you have identified Wal-Mart as also a silent
9 killer; is that correct?

10 A. It is a little less silent.

11 Q. And a company that is also in the product loop; is that
12 correct?

13 A. It's kind of the inventor and father of that; although,
14 if you look at their numbers for the last couple of years,
15 they have had trouble sustaining it.

16 Q. But it is in the productivity loop?

17 A. Yes, it has been, correct.

18 Q. Now, would it surprise you to learn that Wal-Mart
19 believes that it cannot constrain the office supply
20 superstores in raising prices?

21 MR. SMITH: Objection. I don't believe there is
22 any foundation in the record for that question. And if he
23 has a reference, I would like to see it.

24 THE COURT: We will hear it. Let me hear it. What
25 is the basis of that question that Wal-Mart has said that it

1 cannot constrain office supply superstores from raising
2 prices?

3 MR. BROYLES: Your Honor, there is a declaration,
4 PX 174 from Mr. Bill Long of Wal-Mart, who signed a
5 declaration three separate times with precisely that
6 statement. And I think it's paragraph 16.

7 THE COURT: I accept he has a good-faith basis for
8 asking the question. He can answer whether he is aware or
9 not aware.

10 THE WITNESS: I wasn't aware of that statement, and
11 I think that I mean I have known Wal-Mart for a long time and
12 I think that most people there would view it the opposite. I
13 mean, they would just kind of be licking their chops if they
14 saw somebody in one of their categories raising prices,
15 because they didn't do that. As I talked about with Toys "R"
16 Us, it was an opportunity to pick up some market share.

17 MR. BROYLES: I have nothing further, Your Honor.

18 THE COURT: All right. Thank you, Mr. Broyles.

19 MR. SMITH: I have two questions.

20 THE COURT: I will count them.

21 MR. SMITH: I promise.

22 REDIRECT EXAMINATION

23 BY MR. SMITH:

24 Q. In your judgment, will Staples, the Office Depot, grow
25 faster than the two companies -- in terms of number of new

1 stores, than the two companies would separately?

2 A. Probably slightly faster, yes.

3 Q. And would -- will the merger allow these two combined
4 firms to operate in the productivity loop longer than they
5 would on their own?

6 A. Yes, most definitely, because it provides cost savings
7 that each would not enjoy on their own.

8 MR. SMITH: No further questions, Your Honor.

9 THE COURT: All right. Thank you, sir. You are
10 free to go.

11 MR. SMITH: Your Honor, I have one detail. For the
12 record I would like to mark this as DX 9009, and I will have
13 a copy submitted for the record tomorrow.

14 THE COURT: For the record, this is the notes that
15 you put on the bulletin board about the productivity loop.
16 Productivity loop factors. Just so the record is clear what
17 it is marked.

18 MR. KEMPF: We are after 5:00, Your Honor. And I
19 guess that is all that we have today.

20 THE COURT: Where are you for tomorrow?

21 MR. KEMPF: We have given them a list of the people
22 tomorrow. We didn't hit a couple of witnesses who we were
23 going to take today, so we will reshuffle. And I think both
24 sides have some time issues. We need to reassess where we
25 are on time generally. But we will revise that and give

1 them -- it will be similar to what we gave them, tomorrow.
2 We hope to put on four or five witnesses tomorrow, if we can
3 speed things up.

4 THE COURT: Your experts are coming in tomorrow.

5 MR. KEMPF: Our economist will be here on Friday,
6 Your Honor.

7 THE COURT: You have gotten the list and you --

8 MR. CARY: We have gotten a list, Your Honor. If
9 they are planning to bring their economist on Friday, given
10 the list they have planned for tomorrow and given the
11 agreement and the Court's order with regard to an equal split
12 of the time, we are concerned they will run over.

13 THE COURT: Let me ask you.

14 MR. KEMPF: We will not run over on our time, Your
15 Honor.

16 THE COURT: Well, he is talking about finishing
17 Friday.

18 MR. KEMPF: So am I, Your Honor.

19 THE COURT: Fine. I have a trial set for Tuesday
20 that I just got a notice it is resolved, so if we have to we
21 can; because we have not used our 15 hours, each of you. But
22 I did want to finish Friday because of your briefing
23 schedules, and I don't want to see everything pushed back.

24 MR. KEMPF: I think both sides would like to finish
25 Friday as well.

1 THE COURT: I think you would like to get away from
2 the weekend.

3 MR. KEMPF: (laughter) I don't know about that. We
4 have a brief due the following Friday, Your Honor.

5 THE COURT: We are still heading for Friday and I
6 will be happy to sit tomorrow as late as we need to sit to
7 get your witnesses in.

8 MR. KEMPF: We will try to take advantage of that.

9 THE COURT: 9:30 then. Thank you.

10 (Which were all proceedings
11 had at this time.)

12

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14 C E R T I F I C A T E

15 I, PATRICIA J. YERKES, RMR-CRR, do hereby certify that
16 the foregoing transcript constitutes a full, true, and
17 correct report of the proceedings which then and there took
18 place.

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PATRICIA YERKES, RMR-CRR