UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

FEDERAL TRADE COMMISSION,
Plaintiff,
v.
STAPLES, INC., et al.,
Defendants.

Docket No. CA 97-0701
Washington, D.C.
May 23 1997
9:30 a.m.

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

APPEARANCES:

For the Plaintiff:
GEORGE S. CARY, ESQ.
U.S. Federal Trade Commission
6th and Pennsylvania Avenue, N.W.
Washington, D.C. 20580

MELVIN H. ORLANS, ESQ.
JAMES A. FISHKIN, ESQ.
JOHN C. WEBER, ESQ.
PHILLIP L. BROYLES, ESQ.
U.S. Federal Trade Commission
Office of General Counsel
Washington, D.C. 20580

For the Defendant:
J. MARK GIDLEY, ESQ.
CHRISTOPHHER M. CURRAN, ESQ.
FRANCIS VASQUEZ, ESQ.
White & Case
601 13th Street, N.W.
Suite 600
Washington, D.C. 20005-3807

p. 19 - 50% SOHO
p. 107 - problems w/ efficiencies

DONALD G. KEMPF, JR., ESQ.
TEFFT W. SMITH, ESQ.
MICHAEL BECKER, ESQ.
ANDREW DANSICKER, ESQ.
Kirkland & Ellis
200 East Randolph Drive
Chicago, IL 60601

Court Reporter:
Dennis A. Dinkel
Official Court Reporter
Room 6818, U.S. Courthouse
Washington, D.C. 20001
(202) 289-8661

Proceedings reported by machine shorthand, transcript produced by computer-aided transcription

Data analysis
Efficiencies - how much will they be passed along
Common sense / lay witnesses
Bad documents
Lawyers
Judge's reaction - nothing yet
Maybe analogy

PROCEEDINGS

THE COURT: Good morning, counsel.

THE DEPUTY CLERK: Civil Action 97-0701, Federal Trade Commission versus Staples, Inc., et al. Counsel, please identify yourselves for the record.

MR. CARY: Good morning, Your Honor. George Cary for the plaintiff. Mel Orlans, Gary Roberts, ~~Jonathan Baker~~ of the Bureau of Economics. Jim Fishkin, John Weber, Bill Lingdorf.

THE COURT: Thank you, sir.

MR. KEMPF: Good morning, Your Honor. Don Kempf for the defendants. With me are Mr. Gidley, our clients Mr. Fuente and Mr. Stemberg. Mr. Gidley will be doing the examination of Professor Hausman this morning and working with him will be my associate Mike Becker over there, Frank Vasquez from White & Case and Andy Dansicker from White & Case and also Mr. Assaf is up here with us this morning.

THE COURT: Thank you.

What is your schedule for the morning if you look at your time and witnesses?

MR. KEMPF: We have, Your Honor.

Let me cover that right now.

As you know, the defendants fought hard to get this hearing, Your Honor. We appreciate the opportunity we have had this week. We have tried to use our time wisely and well

and we are not going to cause this hearing to go past today.

We are the persons what fought hard to get it. We know you have responsibilities next week. So we will make sure that it ends today on our side.

To that end, I have given the government our list of witnesses; and I will tell what you what that is, and then I will tell you what I told them in terms of my game plan. That is we are shifting things around. Last night, I mentioned to you we had originally two mail-order witnesses coming, the president of Viking and the CEO of Quill about whom you have heard testimony from others.

We decided we didn't need two. We dropped Mr. Helford earlier this week. Last night in view of our time schedule we dropped Mr. Miller. One lives in California the other in Illinois. There are lengthy declarations from both of them. I will give you the cites at the next break. Both have been deposed. In light of that and in light of the fact there have been an abundance of competitor witnesses, we have dropped both of those.

We also rearranged things particularly in light of the Court's questioning the other day of would we call economists, and if so, when.

We will call our economists, Professor Hausman, this morning. Thereafter, I will call the following witnesses: Mr. Smith will do a short presentation similar to the ones we have done on competitors and suppliers and analysts. This time on consumers.

We will then call Mr. Jacober, the head of SHOPA, which is the School and Home Office Purchasing Association, something like that. We thereafter would call Mr. Fuente, the CEO of Office Depot, Mr. Bennington, who is the pricing person at Depot, and, as Mr. Stemberg testified yesterday, will be the pricing person at the new company. Then we have a very short, I think, 20-minute deposition excerpt from the deposition of Boris Stephan, the principal preparer of the FTC's concentration charts. He has five declarations he submitted in this case and we would like to show that.

What I have said to them, as the Court will recognize that is an ambitious and I'm confident overly ambitious list. What I said to them particularly in light of Mr. Cary's comments in court yesterday if they were to finish today we would have to finish by noon, when I judged that, we are bumping up against that, I will rest at that point, Your Honor, and we will be content with that record.

We have -- will also submit today in light of this a few additional declarations. Mr. Becker, my colleague over there, in addition to being an outstanding young lawyer is also a Ph.D. in economics. There was a flap when I put the stock up there during Warren-Boulton's testimony, "Who made this," "Mr. Becker made it for me." I asked him for a

one-page declaration explaining how he did that. We have one from Mr. Helford that we will be submitting, a one-pageer explaining his non-declaration that he prepared at the FTC and decided to throw away.

I also asked the people out in California to go over and cherry-pick at the McWhorter's store and see if they could find products that went the opposite way. I heard back they did. I will do a short declaration on that.

I also have a short declaration on store openings; and in light of the fact that we probably will not hit Mr. Fuente, a very short declaration from him on one issue, which is the impact of the prolonged delay on his company and what that means going forward.

That is our schedule, Your Honor. We will adjust it, in light of the time schedules, to assure that we finish today. The only other thing I would add, Your Honor, is there was one problem we had. As the Court will recall earlier, when they -- the ever changing econometric data from the FTC was at issue. Dr. Ashenfelter was going to testify, we were concerned when we took his deposition that he really was -- when we took it it became clear that his real work was going to be done after the deposition; and we were then to have an opportunity to depose him. We didn't do that before his testimony; and there was a hassle over that.

It ended up, as the Court will recall, his charts

were ones that actually had been prepared the afternoon before that. We made arrangements to take his deposition last night, starting at 7:00 o'clock; but as the Court will recall, we were here at 7:00 o'clock. We were prepared to take it thereafter, and the government told us no, it was too late, they were tired, association we did not take his deposition.

The result of that is -- and this is something we got delivered to us in court yesterday at 3:15 in the afternoon. I can hand it up for the Court to look at. I'm not sure if I had a week to depose him on this, I could understand it. The point is Mr. Gidley -- who understands these things a little better than I do -- didn't have any opportunity to depose him. We might want to put in a surrebuttal affidavit or something on these after we take a look at them, Your Honor.

I will also say that it is our understanding that Dr. Ashenfelter may, in fact, not be called but that Dr. Warren-Boulton may sort of piggyback off of his work. If he's called to testify on this stuff today, because we didn't take his deposition either on this new stuff or on the stuff he testified about, we may want to do a surrebuttal affidavit on that, Your Honor. That's sort of the game plan for today. We do appreciate the Court's attention to this matter, including especially last night going late. In light

of that, we are going to accommodate our schedule to make sure we do not run over today, Your Honor.

THE COURT: Mr. Cary?

MR. CARY: A couple of brief comments, Your Honor. As you will recall during the course of Dr. Ashenfelter's deposition, the Court was involved on the question of Mr. Ashenfelter testifying to certain gross margin material that Professor Hausman was doing that we had gotten late, I think the night before Dr. Hausman's deposition. The outcome of that discussion was that the defendants would have an opportunity to depose Dr. Ashenfelter if he had an opportunity to complete that work. Dr. Ashenfelter was very clear on the record that given the amount of time left, it was unlikely that he would be able to complete that work and as it turns out, he was not able to complete that work and, therefore, we don't plan to bring him in on rebuttal. Given that, and the lateness of the hour last night, it didn't really make any sense to go ahead with the deposition.

We have informed the defendants that Dr. Ashenfelter will listen to the testimony of Mr. Hausman and to the extent that Mr. Hausman says anything that he would take issue with, without having done any additional work or -- on the gross margin material or having formed an opinion prior to Mr. Hausman's testimony, we reserve the right to call him to rebut specific portions of the.

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testimony, and that would be the limited purpose for which we would call him. We do plan to call Professor Warren-Boulton.

THE COURT: All right. Fine, thank you. We will try to move ahead then with the witnesses we can get to this morning on behalf of the defendants. Obviously, Dr. Hausman and maybe some of their other witnesses.

The deposition, the video excerpt it seems to me could be submitted for the record and I can watch it later if that is going to take up some time.

All right. We will go with the first witness, Mr. Gidley.

MR. KEMPF: If I have time, I would like to see that, Your Honor. It says a lot. It is the Sergeant Schultz deposition is what I call it on our side. It is the "I know nothing" type of deposition. That's my shorthand definition for it. It says a lot in not saying anything.

We would call as our next witness Professor Hausman. As I indicated, Mr. Gidley will do the examination.

THE COURT: All right. Thank you.

(GERRY A. HAUSMAN, DEFENDANT WITNESS, SWORN)

DIRECT EXAMINATION

BY MR. GIDLEY:

Q. Dr. Hausman would you please introduce yourself to the Court?

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A. My name is Gerry A. Hausman. I am the McDonald professor of economics at MIT. That's not hamburger McDonald's, it's oil McDonald's.

Q. Can you briefly describe your educational background start with college?

A. Yes, I was an undergraduate at Brown and then graduated in 1968 and went into the Army. I was stationed in Anchorage for two years and then I won a Marshall scholarship to Oxford and I was at Oxford for two years, where I did a Ph.D.

Q. And what have you done since graduation?

A. Since graduation, I started off as an assistant professor at MIT. Then I rose through the ranks, associate professor, full professor, McDonald professor. I have taken a leave twice, taught once at Harvard and once at Harvard Business School.

Q. Dr. Hausman, what courses did you teach at MIT?

A. I teach two courses each year to graduate students in econometrics, and I also teach a course to graduate students and to business students and people coming from Harvard to take it as well. It is a very large course in industrial organization, applied industrial organization as applied to the telecommunications industry.

Q. What economic subjects do you have expertise in?

A. Well, my main one is applied microeconomics which is looking at how firms behave and how consumers behave and also

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industrial organization which is part of that.

Q. Have you published any articles on antitrust or merger issues?

A. Yes. I have published a number. In 1995, I published an article in the Antitrust Bulletin on Antitrust and Competition in Telecommunications. Last year, in 1996, I published an article in the Antitrust Law Journal which came out of the case FTC versus Donnelly, pointing out that the Merger Guidelines were incorrect with respect to price discrimination.

I have an article coming out either this month or next month in the George Mason Law Review, and that looks at how mergers with differentiated products like beer or cereal should be looked at.

Q. Dr. Hausman, have you published any econometric articles?

A. Yes. I think I have published maybe 30, 40, maybe 50 econometrics articles.

Q. What journals have you served on in an editorial capacity?

A. I have been an associate editor of probably five or six journals over my career. One I was longest on was Econometrica for 10 years. That's certainly the boast econometrics journal and in my view certainly the best or the most cited economics journal in the world.

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Q. Professor Hausman, have you ever testified before Congress about antitrust or competition issues?

A. Yes. When asked, if I'm not teaching, I usually try to do so. Last year, for instance, I testified with respect to competition in the cellular and telecommunications industry and also about competition for things like cable TV and high-definition TV and satellite TV.

Q. Professor Hausman, could you briefly describe your experience testifying as an expert witness in antitrust cases?

A. Yes. Well, as I said, I testified for R. Donnelly in FTC versus Donnelly which was tried here about seven years ago before Judge Harris. I testified for the Chicago Bulls in -- the Chicago Bulls versus NBA. The NBA tried to keep Michael Jordan off TV, off WGN. I'm a big Michael Jordan fan, so I did that.

I testified in United States v. Kodak about getting rid of the consent decrees a couple of years ago. I testified in the State of New York versus Anheuser-Busch; I testified in Continental Airlines versus United Airlines, which was about computerized reservation systems. And then I testified also in a case called Moore versus Wallace in Delaware last year.

Q. Have you ever worked as an impartial expert for a Federal judge?

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A. Yes. I was a master or special witness, whatever it is called, for Judge Bartells in the Eastern District of New York about 15 years ago.
Q. Have you received any honors or awards in your academic career?
A. Yes. I received the John Bates Clark aware from the American Economics Association which is given every other year for the best economist under 40 years of age. Unfortunately, that was given about 10 years ago when I was still under 40.
Q. I would like to hand up to the Court Professor Hausman's CV. It is attached to his declaration as well.
THE COURT: All right.
BY MR. GIDLEY:
Q. Let's turn to the transaction at hand. Dr. Hausman, have you had an opportunity to familiarize yourself with this transaction?
A. Yes, I have.
Q. How long have you been studying this transaction?
A. Well, I was first hired by your law firm and Mr. Kempf's law firm back in -- it was right around Thanksgiving, so I -- I guess that's the end of November of last year.
Q. So was that five or six months?
A. Yes.
Q. In studying this transaction, what sources of

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information have you used?
A. Well, I originally started off and asked you to provide me with a lot of business documents and business plans which you did. And then I interviewed a number of people at Staples. I also interviewed a number of people at Office Depot. I've read a lot of the depositions in the case.
I read a lot of the production you gave to the government for their second request. I have to admit I didn't read it all. I think there were like 70 binders. I read quite a bit of it. I looked at the plaintiff's complaint and their exhibits and the defendant's responses and most of their exhibits.
Then I read a lot of third-party depositions. For instance, the person Mr. Glass who runs Wal-Mart and various people who work for Wal-Mart and Sam's and people like that. And then I read a lot of the declarations that both sides have submitted to the Court.
Q. Professor Hausman, have you prepared a declaration in this case?
A. Yes, I did.
MR. GIDLEY: Your Honor, I would note for the record that that is Defendant's Exhibit 18 70, for ease of reference.
BY MR. GIDLEY:
Q. Dr. Hausman have you been deposed in this matter?

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A. Twice. Yes. Once the night before last; and then about 10 days ago.
Q. Let's turn to the office products marketplace. Professor Hausman, what are your criteria for reviewing a merger?
A. Well, my overall criterion is whether consumers are going to be made better off by the merger. If consumers are made better off, either because they get lower prices or they have higher quality goods, then I think a merger should take place. Because the antitrust laws, in my view, are mainly here to help consumers.
Q. What should be the role, in your view, of efficiency claims?
A. Well, efficiencies have two aspects to them. The first is efficiencies, to the extent they bring down costs in the United States economy, make us a more productive economy, get better jobs for people, help people. Then the other things, efficiencies also are typically passed through in part by companies. When companies become more efficient, they keep some of it for their shareholders and have to help pay back their shareholders. But they often pass the majority of it on to consumers. And those lower prices help consumers.
Q. Two days before this action was filed the FTC amended their Merger Guidelines. Have you reviewed those Merger Guidelines on efficiency, the new ones?

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A. Yes, I have.
Q. Do you agree with the new efficiency guidelines?
A. No. I don't think they put consumers up front like they should. They have all this legal language about what's cognizable, not cognizable. What I think the bottom line is are consumers going to be helped by the efficiencies and also is the economy going to be helped. That's what we are here for.
Q. Could you briefly characterize the office products industry in terms of competition?
A. Yes. The office products industry -- of course, we are here to discuss superstores, so we have Staples and Office Depot and OfficeMax; but we also have Wal-Mart, Sam's competing, Best Buy competing; those are very successful stores. Wal-Mart, I think, is one of the 10 largest companies in the whole United States now, certainly the largest retailer in the world. I wish I'd bought their stock a long time ago.
Then you have the computer superstores out there competing. You have the electronics stores, and you have people like Quill and Viking who you can just call up and they will deliver, Hammett Office Supply, for instance, that's another one. Then you have rapidly growing companies like U.S. Office Supply; and then lastly you have sometimes what are called the mom-and-pops, they stationery stores. I

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think Ginns is one in Washington which try to be sort of high service type firms.
Q. So in your view who are the competitors in the office supplies industry?
A. I think all of the ones I just mentioned are competitors. Some perhaps compete more strongly than others, but they all certainly compete. They are out there serving customers; and if they weren't offering something the customers wanted to buy, they'd be out of business or they wouldn't be offering office supplies, one or the other.
Q. Are you familiar with the term one-stop shopping?
A. Yes, I am.
Q. Could you describe one-stop shopping in the context of the office supplies industry?
A. Yes. Well, one-stop shopping as used in this case some people have contended that Staples and Office Depot have this big advantage because you can go and buy your office supplies there. So that's sort of a one-stop shopping type idea; but you also have to realize that Sam's and Wal-Mart and these other stores also offer one-stop shopping because we are talking a lot here about small businesses and single office, home office type people -- SOHO -- and they have to buy other things. They often go to Sam's and Wal-Mart to buy other products, and when they are there they can also pick up their office supplies. I call that superior or even better

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one-stop shopping. Of course, that's exactly their business plan, for Wal-Mart and Sam's, as their executives testified in this case, and that's why they have been so successful.
Q. Are you familiar with the term zero-stop shopping?
A. Yes. Zero-stop shopping is when you can call up and have the stuff delivered. In this case some people call it mail-order, but I don't think many people have mailed a letter off to an office supply store for many a year and said please send me some stuff. What you do is you call up. If you call before noon, for instance, for Viking they deliver the same day. If you call up in the afternoon, they will deliver the next morning. I have a small consulting company, economics consulting company. We have about 10 people. We use Hammett Office Supply in Boston. We are small but their prices are very competitive with Staples. I'm sorry to have to say this in front of Mr. Stemberg. But they are competitive. My office manager just calls; and if she calls in the morning, they are there the next morning.
When I went to work in this case I said you better check the prices and make sure they are competitive with Staples, or I will be in big trouble. She did a comparison of what we buy, and she said actually they were a tiny bit cheaper than Staples, so she's continued to use them.
Q. Let's talk a little about about who shops at Staples. Have you evaluated any information on the types of customers

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Staples and Office Depot have?
A. Yes. There are a lot of surveys that both companies have done; and they serve a wide range of customers, but more than half their business typically are small firms or single home operators usually with about less than 20, 20 employees.
Q. Let me show you what has been marked as DX-3-128. Can you give me a little bit of a breakdown on the shoppers at an office superstore such as Staples?
A. Yes. This is a Staples survey; and it was an exit survey done. What it demonstrates is, as I said, about -- here we have 41 percent are consumers or home offices and 52 percent is business. And a large part of that business are small businesses. Then 7 percent, of course, is both. What this demonstrates is that you have both these consumer home office people, of course, as I testified will often go to Wal-Marts.
You have small businesses, and Sam's as their executive testified, said their major focus is on small business. So Staples is serving these same customers that these other competitive stores also try to serve.
Q. What do the data show about cross shopping between this channel and any other channel for office supplies?
A. What it demonstrates is that these same customers as I said also buy office supplies at Sam's, and at Wal-Mart, and

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these other type of stores; so that I guess if we look at this next graph, what it demonstrates is that even within Staples, we have the delivery shoppers; they buy some through the retail; 20 percent of Staples overall retail sales; and then you have contract shoppers which are much smaller; but again most -- 75 percent are bought by walk-in, but you still have a lot, 25 percent, who are bought by delivery; and, of course, these are just the people that Viking and Quill and Hammett Office Supply and all these other zero-stop competitors also are providing office supplies for.
Q. Dr. Warren-Boulton, the economics expert for the FTC, testified that stores that charge different prices for office products are not competitors of office superstores. Do you agree with that statement?
A. No. That statement does not make economic sense.
If we said that stores which charge higher or lower prices don't compete, we'd come to the wrong conclusion, because different stores offer different types of services; and so they offer a different service price trade-off; and I'll give you a real world example.
The town I live in, the gas stations -- and I presume this is true about Washington -- they have both self-serve and they will fill it up for you. There's a difference of about two cents a gallon. It is sometimes the same service station or sometimes it is a service station

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across the street.

Now, I just can't believe any economist would say that those two don't compete with each other. Some people are willing to pay the 2 cents a gallon for better service. Some people will fill it up for themselves. They are still competing. It's just a question of do you get slightly better service or do you fill it up yourself. Here it is very similar. Do you go to Staples and Office Depot and pick this stuff up yourself?

We economists think everything should be changed into money. There's this old saying time is money. So you go and pick it up yourself or get Hammett Office Supply to deliver it for you. You might pay a little more money, but overall you could be saving money because you don't have to spend gas, wear and tear on your car; and instead of going there, they deliver it so you can do other things with your time.

So these differences in prices, you cannot conclude from that that they don't compete with each other. I just can't believe that.

Q. Let's talk about breadth of product selection. I believe Dr. Warren-Boulton also testified that these stores do not stock as many SKUs of office products, don't compete with the office superstores. Do you agree with that assessment?

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A. No, I don't. I mean he is correct that the -- the other retail stores typically have less; although I might note that Viking and Quill have more SKUs; but if you go to Wal-Mart they will have 3- to 4,000 SKUs versus perhaps 7,000, this is for office products as the FTC defines it, compared to a Staples or Office Depot there. But there is actually a rule in economics called the 80-20 rule. It is a rule in statistics for life. It is usually that 20 percent of the customers buy 80 percent of the product. Here it is that 20 percent of the SKUs lead to 80 percent of the volume. Actually the gentleman for Sam's testified that for office products it is a 5-95 rule. He testified that he believes5 percent of the SKUs lead to 95 percent of the sales.

So what does this really mean? If you walk into a Staples, they will have 50 types of Post-It notes. They will have recycled Post-It notes, in every different color under the some. Sometimes they even have polka dot Post-It notes. They will have 50 types. If you walk into a Wal-Mart they might have 35 Post-It notes. They might have fewer SKUs. Does that mean they don't compete? Not at all. People can still buy perfectly good Post-It notes. They don't offer quite as wide a variety; but for most customers that simply doesn't matter.

So, again, just because you have fewer SKUs doesn't matter. I will give you another example along those lines.

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When I stay in Washington I often go to a bookstore in Georgetown, and it is not a very big bookstore. Two blocks away there's a Barnes & Noble, that giant Barnes & Noble.

Now the question is does this small bookstore compete with them? It is true that they don't have as a big a selection, why do I go there, why not go to Barnes & Noble? Barnes & Noble even has a Starbucks in it which, of course, I like. I go to the smaller bookstore because when I walk in there they provide better service. I say to the guy who runs it -- and he's a very nice guy -- what are the new novels you have. I go in once a month, and he sort of remembers me. He will have remembered one or two. He will say Professor Hausman you might like these. I buy them. I just can't get that type of service at Barnes & Noble. They are perfectly nice there, but nobody is going to tell me what types of books to buy. I will go to the small bookstore. It certainly competes. It has the best sellers, but it has fewer SKUs than Barnes & Noble. These small bookstores continue to survive. The competition is tougher or them than it used to many. You can to to Cambridge, Georgetown, Washington, anywhere. They certainly compete.

Q. Have you reviewed any market share data in connection with your review of this transaction?

A. Yes, I have.

Q. How does Staples and Office Depot's market shares affect your views?

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A. If you look at the overall office supply industry, pretty much all the data shows that Staples and Office Depot combined are probably less than 10 percent. They may only be 5 or 6 percent; but even even if you do an estimate and say let's just look at the small businesses and home office people, even then it doesn't get above 10 or 15 percent. So no matter how you cut it, they have a very small share. So I know that you have another slide for me.

Q. Another excerpt from DX-3, yes.

A. What it demonstrates here is that across all the U.S. office products sales they a 3.9 percent share; but it really doesn't matter whether it is 3.9, 10 or 15 percent. It is if you have a small share, a share of less than 30, 35 percent, even 50 percent, in my view, there just can't be a competitive problem, because that means if you look up here, there's 96 percent of the rest is being sold by other people, or if it is 80 percent, it doesn't really matter.

That means the consumers have a lot of choices. It is not just theoretical choices, it is actual choices. In fact, with these type of shares the Merger Guidelines which, of course, have come up in this case should be no problem and the merger should be allowed to go through. That's because economics says when you have a small share you can't act as a monopolist you can't control the price, you can't charge high

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prices to consumers.
Q. Let me show you another excerpt from DX-3 in terms of manufacturer sales data. Have you reviewed some of this data?
A. Yes, I have.
Q. Could you just walk us through one example? This is DX-3-83. There are a number of other examples in the DX-3 book.
A. Yes. What happens here is that this is just the combined Staples-Office Depot share for various products. The one you have up is printer and toner cartridges. This is called an office supply consumable. Pretty much everybody who has a home office now has a computer. It is rare not to have one. A printer and toner cartridge, most people have a HP printer. All this is is the toner that goes into it. When you run out of ink, you buy one of these, hopefully put it in right. I don't always succeed, but I think most people can.
What this shows is that Staples and Office Depot together are selling less than 10 percent; and you see the computer superstores are selling a lot, warehouse clubs, mail-order catalogs, specialty dealers, and so on. I don't need to go through all these. Consumers have all these choices.
And they are actually voting with their dollars.

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Sometimes they find it worthwhile to buy it from Staples and Office Depot. But in nine out of 10 times, they are buying it from another competitor.
Q. Sometimes the FTC case sounds like it is more of a traditional pen and paper office supply. Let me show you one other slide. I believe this is going to be cut-sheet paper, Professor Hausman. This is also from DX-3. Again I will note for the record we submitted an affidavit on the underlying data from CAP Research. Could you briefly describe what is going on here?
A. Well, office superstores certainly sell a lot of paper. I think by revenue this is probably their biggest category. Again this is the type of thing you put into a Hewlett-Packard printer or depending on the type of fax machine you have, you might use it there.
Pretty much everybody has these now. The old type of dot matrix printers have sort of disappeared. What this shows is that even in the biggest category by revenue they sell, they are only selling 6 percent. Again computer superstores sell it, warehouse clubs sell it, Sam's, the Wal-Marts of the world. Computer people sell it. Sold by paper merchants as well.
This is a very competitive commodity and as prices go up and down over time depending upon the pulp cycle, what is called the pulp cycle, you can see that Staples and Office

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Depot really sell a small amount of it. Excuse me, they sell a large amount of it, but a very small proportion of it.
Q. Let's return to the FTC's theory of things. The FTC suggests that office superstores operate as monopolies in the so-called single office superstore markets. Do you agree with that?
A. No. It doesn't make sense from a business point of view, and it doesn't make sense from an economic theory point of view. Let me do the real world first.
It doesn't make sense from a business point of view because if you go to Bangor, Maine where there's only one office superstore, a Staples, you will see there's a warehouse club there that sells it as well; that various other people sell it; so they certainly don't have a monopoly on cut-sheet paper or anything else. But also the economic theory is wrong because if Staples were really a monopolist in Bangor, we could look at what is called their profit margin, their gross margin and it should just be very, very high. Monopolists s typically have high margins compared to what the margin would be in a two-store area or three-store area. We actually see the margins are about the same, maybe a little bit higher or a little bit lower. If they were really a monopoly, the margin should be maybe two times as big. If they are about the same, it means that Staples is facing a lot of competition in places like Bangor, Maine and

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they really can't get high profit margins.
Q. Let's turn to economic analyses. I don't mean to contrast that too much with the real world, but what economic analyses have you performed in connection with this theory?
A. What I have done is I have done some -- looked at the margins as I just said. I have also done an econometric analysis which may not have the best name but I usually call it the hits analysis. The hits analysis looks at what happens when one of these competitors opens within a 20 mile radius of a Staples store. What happens if a Wal-Mart opens, what happens if a Best Buy opens, that's what the analysis looks at.
Q. And what were the results of that analysis?
A. Well, in the analysis what I find is when a store like Best Buy opens it has a very large negative effect on Staples. If you look at a Best Buy opening within 20 miles, it has a large negative effect. As I remember, it is about 7 percent. So the Staples store will lose about 7 percent of its revenue. Now, of course, when an Office Depot opens nearby, it affects Staples as well. So I'm not saying that it doesn't compete, of course it does. But a Best Buy competes. Similarly, when a Wal-Mart or a Sam's opens nearby, it has an effect. So these various other competitors also the computer superstores.
What you can see is when they open they have a hit

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on Staples sales so that's a pretty good sign that they are competing.

Q. Just so I have this clear, this is sort of a before-and-after study that determines whether before and after the opening of a Best Buy or a Sam's or a Computer U.S.A., whether those have an effect on Staples sales; is that correct?

A. Yes. It is before and after. You see how well a Staples store is doing. You need a regression to control for other factors such as seasonal effects. It might be the back-to-school season when the new store opens. But you basically see how the Staples store is doing before, how much it is selling, and how much it sells, let's say, after the Best Buy opens. What you notice is that I even wait a while to make sure it is not just a grand opening sale. That could be an affect of the grand opening sale. I wait and look. And after about 6 months later, the Staples store sales usually are down by about 7 percent which definitely shows these other people are competing and competing hard. Seven percent is a really big hit for a store.

Q. Let's talk about entry. You have talked about the large number of competitors in the office products industry. How would you characterize the opportunities for entry and expansion in the office products industry?

A. I think they are quite good. George Stigler who won the

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Nobel Prize about 10 or 15 years ago in his book often stated the most important factor in entry and expansion is how fast an industry is growing. If an industry is growing, people want to come in because there's a lot of new business. If an industry is declining, people don't want to come in because you have to fight it out, and it is harder to make profits. In this industry, for instance, the gentleman from Wal-Mart testified that their office supply sales are going up 10 to 12 percent a year. Because of this type of growth, they find it profitable to expand. He testified in his deposition they were expanding. Here again if you look at the graph up on the board DX-1839 --

Q. It is actually DX-6067. I think the underlying data comes from 1839.

A. Excuse me about that. You will see Stockwell Associates estimates a 5 to 10 percent growth rate. Smith Barney, 9.3. Staples 10 to 11 percent. As I said, Wal-Mart says their own sales are expanding at 10 to 12 percent. What Professor Stigler said is if you are growing faster than the real interest rate, which now is probably about 3 or 4 percent, that that is a big impetus or big incentive for growth and that, of course, exactly is what is going on here. We know this also. You don't have to look at the data.

A lot of companies have downsized. People have gone into running their own small businesses. I remember

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AT&T announced last year they would lay off 40,000 people. A lot of those people became consultants to AT&T and consultants to other telecommunications companies. We know this sector of the economy is growing, both from what we read in the newspaper and also the data show us growth prospects here are very good which is a good thing for entry and expansion.

Q. Relative to other industries, how would you characterize a growth rate of 9.3 percent or 10 to 11 percent?

A. For retailing, it is excellent. I mean this isn't growing as fast as Intel is growing, producing computer chips; but certainly for retailing this would be at the top end of the scale, so this is quite high.

Q. Professor Hausman, have you studied the ability of firms that are currently are selling office supplies to expand their sales of office supplies?

A. Yes. As I said, Wal-Mart, which anybody who is in retailing anywhere is always frightened of -- as they well should be be since Wal-Mart is a fierce competitor -- they said they were going at 10 to 12 percent and they were expanding. And there's other record testimony that other large retailers are entering the business as well. And that's all on the record.

Q. What is it about office products that seems to make entry relatively easy for firms?

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A. Well, I think the main thing is that there are no fashions in it. In other words, it is not -- some retailing you have men's fashions, wide ties, small ties; I guess women's fashions might be more fashionable. But if you pick the wrong products, you are in big trouble. You lose a lot of money, and you go out of business. Toys perhaps are the same way.

But here we are talking about Post-It notes and stuff which really don't go out of fashion. A Post-It note, maybe they will come out with a new color, but it is still a Post-It note. The second thing is the product doesn't spoil. If you try to go into the food business and don't do as well, your inventory spoils, and you are in bad trouble. Here you can keep it on the shelf. If you don't sell it right away, if it takes you a little longer to get going, you will do okay.

So it doesn't take special skills to sell. There's no fashions. All you have to do is increase your shelf space. You don't even have to do that. If somebody like Wal-Mart wants to sell more, they can just some more advertisements on this and use their same shelf space so long as the inventory keeps up they will be okay. So it is really quite easy to expand here.

Q. From your review of the competitive forces in office products, what is your conclusion with respect to the ability

of the merged firm to raise prices?
A. I think it would be suicide if they tried to raise prices. Their whole reputation is built on being competitive and low prices. If they raise prices and all at once Wal-Mart started to be significantly less than them, it would be the end of them because Wal-Mart is already expanding. They would just expand more. The computer superstores would. Everybody could expand their office supplies. I think these companies would stop growing if they tried to raise prices and that would be sort of their economic death knell.
Q. Professor Warren-Boulton testified that entry was difficult into office superstores, his product market definition. He cited three factors. Let's walk through each of the three factors if we could.
First, he cited that the number of office superstores has declined from 23 firms at one point to, I guess in the early '90s or late '80s to three firms today. What about that factor?
A. Well, that's a true fact, but at the same time the computer superstores have increased a lot. It has just increased competition. As I said, other people have expanded. There's major new entry going on with one of the largest retailers in the country as the record shows here. We don't even have to talk about potential entry. We know

actual entry is occurring. There can't be important barriers just because the number of superstores increased. That just shows the increase in competition.
Q. The second point Professor Warren-Boulton was making was in terms of economies of scale and the fact that large amounts of capital would be necessary for a firm to start de novo, that is from scratch as an office superstore. What about that factor?
A. To start with, that's pretty strange, I think, because capital markets in this country work very well. We have this whole venture capital industry in Boston, San Francisco, New York. If you have a good idea, you can raise money. Especially now that the economy is doing well. It is quite easy to raise money.
But I will give you two real world examples. Number 1, 10 or 11 years ago, Mr. Stemberg was, as I understand it, unemployed and living in West Hartford, Connecticut. He was able to raise money, and he's done gangbusters. Started Staples. Also, U.S. Office Products just got going two or three years ago. They are between $2 and $3 billion. They were able to raise money and grow. Lastly, OfficeMax has had no trouble getting money so that this idea that it is hard to raise money just doesn't hold true.
Now it may be the case that the first venture

capitalist you go to or the second or third won't give you the money, but if you have a good idea in this country, you will get the money. That's why our economy -- that's, in my view, probably the major reason that our economy is doing so well is all these start-up firms are able to raise money. They offer employment to people, produce new products. That's what is the growth of the U.S. economy.
MR. ORLANS: I did want to note an objection to the last question. I didn't want to interrupt. But I do think that's a mischaracterization of Dr. Warren-Boulton's testimony.
MR. GIDLEY: I am simply trying to reference his testimony.
MR. ORLANS: I understand.
THE COURT: Just so the record will preserve it.
MR. GIDLEY: It's preserved.
BY MR. GIDLEY:
Q. The third factor Professor Warren-Boulton makes reference to market saturation statistics for office superstores. What's your view of that?
A. When I look at the growth just of the office superstores alone, I note that they are growing at between 15 to 20 percent a year in terms of new stores. I think OfficeMax said they are going to open 120 new stores about this year alone which is a good 20 percent. So it certainly doesn't

look saturated but furthermore again the Sam's and Wal-Marts at all are expanding or entering. Again, that's another indication that the market is not saturated.
I do know there are documents out there and that at times Mr. Stemberg thought there would only be 80 superstores in the whole United States, but we have just grown and grown and grown; and other people such as Wal-Mart have had no trouble expanding as well.
What really is going on, since you have this graph up on the board, if you have 10 percent growth rate, you don't get saturated because people are buying more and more, and there is room for more competitors in that type of situation.
Q. Let's move on to the subject of pricing. Are you familiar with the history of pricing in the office products industry?
A. Yes. There is a simple way to explain it. One word. Down. What do I mean by that? What I mean is prices have just decreased and decreased and decreased among the office superstores and made consumers a heck of a lot better off.
Q. We are showing you Defendant's Exhibit 6054. Could you describe your work in connection with this exhibit?
A. Yes. This was a graph that was put together by a consulting firm on my behalf. What this does is looks at all the office supplies, not the computers, but just the office

supplies as the FTC defines it apart from paper. You will see in the bottom left, it says excluding paper. The reason I excluded paper is that paper goes up and down as I testified earlier, Your Honor. There is this paper cycle, sometimes prices are high, sometimes low. The superstores don't compare paper. It depends on how the newspapers are going, how the pulp cycle is going. So I took out paper.

What you see in this index is you start off in 1993 at a hundred. That's just how an index works. You start it off at a hundred in the upper left. What you see is in the one firm areas have fallen to about 87 percent. In four years, adjusted for inflation, they have fallen by about 13 percent; and you will see the two-firm and three-firm areas have fallen a little bit more. But all three prices are down. This says consumers are made better off. Lower prices help consumers. More money in their pocket.

Q. The one-firm markets, those are what kind of markets?

A. Those are markets where there's only Staples and no other superstore. They have other competitors like Wal-Mart and all. That's the reason they are dropping their prices along with the lower costs they get. But there's no Office Depot or OfficeMax competition there.

Q. Could you pill your microphone a little bit closer? I note you are going in and out.

A. I'm sorry.

Q. Professor Hausman, what significance is there economically to the fact that the prices in the three-office superstore markets have fallen along with the one-office superstore markets?

A. Well, it says that there's somewhat more competition in the three-firm areas. That's what my econometrics demonstrates that we will talk about later. It is just not competition from OfficeMax and Office Depot. It is also that as my report shows that in the three-firm areas you typically have more office supply competitors. You have more computer superstores, you have more Wal-Marts, you have more Sam's.

So the three-firm areas, you know, the place to think about is Los Angeles. There is a lot of competition there. The two-firm areas are places like Boston and Washington, which are somewhat in the middle. The one-firm area is West Lebanon, New Hampshire, Bangor, Maine and so on.

We know Los Angeles has the most retail competition. It is known as the most highly competitive place in the country. Washington and Boston are in the middle. Bangor, Maine probably has the least competition.

Q. Let's move on to market definition. Dr. Hausman, the FTC is attempting to prove that the relevant product market in this case is what they call the sale of office supplies by office superstores. In brief, what is your opinion of that definition?

A. Well, that's incorrect because, they are leaving out a lot of the important competitors. There's a lot of testimony that the competitors certainly believe they compete. The Sam's, the Wal-Marts, the computer superstores. Staples and Office Depot respond to their prices of these other competitors. The hits analysis, the econometric analysis demonstrates that; but also they just have the economic theory wrong, again. If there were an office supply superstore market, Your Honor, see this one firm, if there were only an office supply supermarket, that would be a monopoly.

Q. That's the red line?

A. The red line would be a monopoly. I would typically not expect to see the prices coming down just about as fast in a one-store area because they wouldn't have any competition. They would just put it into their pocket. It would drop prices somewhat, but not nearly as much. That goes back to the gross margin point I made before that if the FTC were correct and only the office superstores were the market, we would expect the margins in this one-firm area to be much higher than in the three-firm area; but it is just not so. That again demonstrates that there are other competitors out there.

Q. Dr. Hausman, now let's move to your work on pricing.

Have you conducted any econometric analysis of the likely effect of the merger on pricing?

A. Yes. I've done two such studies.

Q. Briefly, what was the first analysis that you did?

A. The first analysis was a study I did back in February and submitted to the FTC staff. I looked at a price index there.

Q. What was your result?

A. My result there was that overall, that if -- this is a hypothetical example -- if all the Office Depot stores were to close, and there were no new entry or no new expansion which, of course, are contrary to fact but that's how you do it with an econometric model, you do a simulation, that prices would go up by 0.9 percent, just a little bit less than 1 percent.

Q. That's before considering the effects of entry and efficiencies; is that correct?

A. Yes. If you take into account efficiencies and cost saving pass-through, the price change will actually be negative. Prices will go down to consumers from the merger and they will be made better off.

Q. We will get to this in a minute. But have you had a chance to review PX-400 Dr. Ashenfelter's seven-column simulations?

A. Yes.

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Q. All right. What's your understanding of columns 1 and 2, Professor?
A. Well, here Dr. Ashenfelter was trying to reproduce my results; and as I understand it, he got 1.1 percent and 0.8 percent. He found results very similar to mine right around 0.9 percent.
Q. We had a lot of testimony on Wednesday, Professor Hausman, about the Hausman sample and the complete sample. Do you see those lines?
A. Yes.
Q. Dr. Hausman, did you include California in your 0.9 percent result?
A. Yes. I had two models for reasons I'll explain shortly. Ut I had a model for California and a model for the rest of the United States.
When Dr. Ashenfelter did this, this is actually mislabeled. It is not the Hausman sample. He left out the California stores in what he called the Hausman sample. He wasn't informed, I presume, by the FTC -- there must have been some kind of foul up -- there were actually two models, one for California, one for the rest of the country. What he calls the Hausman sample is only the rest of the country. So I guess California is left out of what he did. I don't guess, I know that California is left out in what he calls the Hausman sample. So that's mislabeled.

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Q. Dr. Hausman, you mentioned you have done two analyses. What is your more recent analysis?
A. Well, I did an analysis this month or after the complaint was filed by the FTC and it is a gross margin analysis.
Q. What were your results?
A. My results there are again if you do this plot experiment of what would happen if all the Office Depot stores were to close and there was no entry and no efficiencies, prices would go up by about 1.3 percent which is very close to the 0.9. Once you take efficiencies into account, we will explain here on the right-hand side, prices will actually be down to consumers by about 2.2 percent.
Q. We are showing you now for the record DX-6222. Could you briefly walk through the results?
A. Yes. If you look at the left-most bar, Your Honor, you will see --
Q. Why don't you move your mike closer?
A. Okay. If you look at the left-most bar, it is labeled overlap stores. These are only the stores where Office Depot and Staples compete. And this is no entry, no efficiencies. The model predicts 2.4 percent price increase. In my view, that's not the correct way to look at things. If you go to the next bar, you get 1.3 percent. These are all the Staples stores.

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The reason that this is the right thing to look at is because the efficiencies will be passed on to all the consumers, just not where they compete with Office Depot. So this is the model's main result before you take into account efficiencies. It is 1.3 percent.
Q. Let me stop you there. The differences between the two left-hand bars are related to whether it is overlap or not overlap?
A. Yes. The left-most bar is only where Office Depot and Staples compete, but the middle bar is where they -- where Staples competes with, of course, OfficeMax and all the computer superstores and everybody else.
Q. Why don't you take us through the third bar, it's blue?
A. The third bar says -- this is what the model would predict overall for price increases, because I don't think the FTC has contended that for non-office supplies sold by the superstore, things like computers, it would go up. So you take that share, put it in, it goes down to 0.8 percent.
If you put into account the efficiencies, which everybody gets, they are about 3 percent. If you subtract 3 percent from 0.8 percent, these are the efficiencies that will be passed through to consumers. There was testimony yesterday, I'm sure, that the overall efficiencies would be larger. But these are just the efficiencies that at a minimum I think would be passed on to consumers. That's

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about 3 percent. So you end up with a negative 2.2 percent. So what this says is that the econometric estimates lead to the conclusion that because of the efficiencies that would be passed on, consumers will get lower prices.
Q. What are the effects -- excuse me. Strike that.
What are the benefits of using the gross margin model? What advantages does it have?
A. I think there are three main advantages. If we go back to the first model I used and also the one Professor Ashenfelter testified to, that was the so-called price index model.
And to do a price index, you have to do it on the SKUs; but unfortunately at least for the econometrician, not for the consumer, SKUs come and go. You come out with new SKUs all the time. It was limited to 200 SKUs.
The gross margin, on the other hand, takes account of all the 7,000 office supply SKUs that Staples sells. Rather than focusing only on 200 SKUs of office supplies, I look at all 7,000. Before me. Let me finish. This is the definition the FTC uses in its complaint about office supplies, general office supplies. I'm not looking at computers here. I'm tying to follow what the FTC does. I can look at all 7,000 approximately. Excuse me, Mr. Gidley.
Q. DX-6222, the gold bar, does that take into accouunt the effects of entry or expansion?

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A. No. But you haven't let me finish why the gross margins are better.
Q. Why don't you finish your answer?
A. The first reason is you can look at all the SKUs. You don't look at 200. You look at 7,000. The next thing is when you do a price index, you have to assume that everybody at every Staples store in the country has the same buying pattern.
So in other words the price index uses weights. You have to assume that its the same. But we actually know, for instance, that people in Los Angeles buy a different mix of office supplies than people in Bangor, Maine. To use the old saying of the 1930s, the way that Maine goes is not the way California goes; at least in terms of buying office supplies. So if you do the gross margins, each store you actually are looking at what people buy.
Then the third thing that it allowed me to do was rather than using two years of data, it allowed me to use four years of data. So you just get a lot more data, you can get a better econometric model because of that as well.
Q. Let me direct your attention to PX-3. Dr. Hausman, have you reviewed PX-3?
A. Yes, I have. I think the FTC calls that their main exhibit or something.
Q. Right. PX-3 is a whole bunch of charts, but I want to

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direct your attention and focus you in on one of the early charts in PX-3 which basically buckets prices into one office superstore, Staples-Office Depot, two, Staples-OfficeMax, and three-office superstores. What kind of an analysis is this, Dr. Hausman?
A. Well, that might be called a cross-section analysis. It is comparing different areas of the country although it is really not a correct cross-section analysis because it leaves out all sorts of competitive variables. We might call that it.
Q. What variables does it leave out, for instance?
A. It leaves out all the competitors, it leaves out all the differences in costs, it leaves out all the differences in commuting patterns. So everything that makes for competition, it leaves out.
Q. Should we use PX-3 to predict the effect of this merger?
A. No. That would be absolutely wrong to do so because it leaves out all these different competitive effects. It assumes, for instance, after the merger that Washington D.C. which currently has an Office Depot and -- excuse me, an Office -- an Office Depot and a Staples, it predicts or assumes that Washington, D.C. will become Bangor, Maine and there will only be Staples. If we know anything about Washington, it is not going to become Bangor next week in any respect, certainly not in terms of competition; because in

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Washington, for instance, there are seven Best Buys, as I remember, there are none up around Bangor. There are a lot more Wal-Marts and Sam's and all. So this idea that after the merger that Washington becomes Bangor or West Lebanon doesn't make economic sense.
Q. I have seen some cross-sectional analyses that are in PX-400. What's your view of cross-sectional analyses in connection with trying to analyze this merger?
A. I don't think they are a very good idea because it is hard to get all the competitive factors. There's actually a way to test this. And this is not self-serving PR, I hope, but there's a test out there called the Hausman specification test which I invented and published in Econometrica back in 1978. It is a pretty famous test.
You can test whether you should use cross-sections. And if you test it, you will soon come to the conclusion that cross-section leads to biased and inconsistent results. You can't use it. So this is a standard test in econometrics. It is in all the textbooks. You will just conclude you can't use cross-section analysis.
Q. Let's go back to PX-400. This is Dr. Ashenfelter's seven simulation runs. Let's put that back up. Just to be clear, Dr. Hausman, you created two models in connection with your February work. One for California and one for the rest of the country; is that correct?

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A. Yes.
Q. And you combined the results after running the two pools of data separately in different models; is that correct?
A. Yes. What you do is you do one model, get predictions, do the other model, get the predictions and then take an average. There is no problem at all.
Q. So is it correct that you left out California?
A. No. It is incorrect. I definitely took into account California and I sent the FTC the California model. I went back and checked. On February 18 I Federal Expressed them the disk to Dr. Levinson there. I know they have the data because when they did their production to us, the data were there. So they certainly received it.
Q. How did you determine that California should be modeled separately when you did this work in February?
A. The most famous test in econometrics is called the Chow test, not the Hausman test, the Chow test. Professor Chow actually teaches at Princeton; and what it does, the Chow test says can you pool the data together or is it a mistake to pull it in. It is a test to allow you to test that. If you incorrectly pool data together, aggregate it together when you shouldn't, you get biased and inconsistent results.
Q. Let's finish up our tour of statistical tests. Did you include all of the Staples stores in your February work?
A. No. I left out a few stores. I left out 15 stores in

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California which are in rural areas, again based on a Chow test, and I left out 35 stores in Pennsylvania where there were no Office Depots with one exception. There was one Office Depot that competed with Staples within 20 miles. Again, a Chow test said those shouldn't be included. But I had all the other stores, except for those two groups that I left out.
Q. Why did you exclude the 16 California stores?
A. Well, in talking to Mr. Stemberg when I was first trying to understand competition, he said there were some rural stores in California that they thought behaved differently. And I said well, what criterion do you use? He said well, if there are less than 4 computer superstores within 20 or 25 miles, we consider those to be rural stores.
So I just didn't take Mr. Stemberg's word for it. So I went off and did this Chow test to see whether these stores did behave differently. The Chow test said there was a one in 10,000 chance of them behaving the same, so they should be treated separately.
Q. Suppose you included those 16 stores, would your results have changed dramatically?
A. No. In fact, I went back and checked. If you put all the stores back in, so if you put in the 16 from California that I dropped out, and the 35 from Pennsylvania that I chopped out, based on the Chow test, you get exactly the same

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result, 0.9 percent. It actually goes up a bit. It goes from 0.9 to 0.91 percent.
But I mean in these type of econometrics, as Dr. Ashenfelter testified, a difference of one one-hundredth of one percent certainly doesn't matter. I certainly agree with him on that.
Q. I want to direct your attention back to the screen on PX-400. I apologize because this is not up there. But Dr. Ashenfelter testified about a hypothetical column 8. So I'm going to ask you to envision that, even though it is not on the exhibit. Have you considered his so-called column 8 analysis?
A. Yes, I have.
Q. And what did you conclude from analyzing that?
A. Well, if you do his column 8 and start off with that and then put the efficiencies and all in, and the cost savings and how much is passed on to consumers, you would still end up predicting that the merger will lead to lower prices to consumers.
Because the efficiencies in cost savings are high enough that as I remember when I did this, the prediction is that the prices would go down to consumers between 1 and 1.5 percent.
So here is how I did it. If you start off again and you use Dr. Ashenfelter's analysis but you add my

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variables because he testified that he would like to add them, he thought it was a good idea, I agree you should also.
You start off with 6.4 percent. Those are only the stores -- those are the stores where Staples competes with Office Depot. Then if you look at all the stores again, go down to 3.36 percent; then if you look at all the items Staples sells, it is 2 percent. If you subtract off pretty much 3 percent, you get minus 1.05 percent.
So even if you started off with Dr. Ashenfelter's analysis and apply the efficiencies and cost savings, that will be passed on to consumers, prices still end up going down for consumers.
Q. Let's go back to DX-400. Let's put that one back up. You said you ran the Chow test. Can you explain what results you got running the Chow test on the inclusion of those stores, the California stores?
A. Well, I think the first thing I should do is explain to His Honor what a Chow test is and why you need it.
Q. If you can do so briefly, that would be fine?
A. I doubt if he has looked in his econometrics textbook recently, if he has one.
Q. Nor has somewhat learned counsel.
A. Here is the reason you might need a Chow test. Let's see the government changes the subsidy program for dairy

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farmers. So we have a sample of the dairy farmers in the United States. Well, each state has different regulations for dairy farmers. And you might say to yourself, well, will dairy farmers in Vermont react the same way as dairy farmers in Alabama given that they are very different regulations?
So what you do is you say I'm going to run it separately for Vermont, separately for Alabama, or there could be states around Vermont like New Hampshire, Maine, and so on. Then what you say is do you get approximately the same results. If you do get approximately the same results, the Chow test says it is okay to put them together. If you get very different results, it says no, there's really something different about Alabama than from New Hampshire or Vermont and your model can't pick it up because econometric models aren't perfect. If they were we would all be rich on Wall Street. It allows you to test to see if you can do it. As I said it is the most famous test published in Econometrica 20 years ago and in every textbook.
Q. More famous than the Hausman test, is it?
A. Right. I admit to that.
Q. Let me direct your attention to 6220. Would you describe for the court what that refers to?
A. Sure. This is a curve which determines the probability that the Chow test says you can add together California and the rest of the country which is what Professor Ashenfelter

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did. This curve is called an F curve after the most famous statistician in this century, R.A. Fischer who was English. If we could pull them together, if Dr. Ashenfelter what he did was right, the expected value was one, so that means that the value should be way over here on the left, Your Honor, where one is.

But what you find is the actual value of the Chow test is 26.6, which is, of course, a lot bigger than one. This is an astronomical Chow test statistic. If you look at the heading, it says The Probability of Incorrectly Rejecting the Pooling is Less Than One in a Million. It is actually, I think, less than one in a hundred million. So the Chow test says that the way that the FTC did this and put the data together for California and the rest of the country has one in a hundred million chance of being correct.

Q. Quite apart from a statistical test, is there a common-sense test we could apply to the result that Dr. Ashenfelter got in his regression and simulation?

A. Well, I'm not quite sure I like the common sense as opposed to statistics, if my students find out about this. But the answer is yes. There is another way to look at it. Actually, Chow in his original paper said another thing you can do is to look at the predictions and the predictions from the rest of the model that you pool together, California, Pennsylvania here, should be the same -- or not the same but

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very similar to what you get from the first model; and if they are very different, that's just another way the Chow test says that you can't put the models together. That's what I did.

Q. Let me show you Defendant's Exhibit 6215. Could you describe what work you have done here?

A. Yes. This is the other side of the Chow test. It is really just doing the same thing. What this says is if you take those other areas that I left out based on a Chow test and do the predictions based on them, what you will see is that the FTC's model leads to a 73 percent prediction of price increases of stores in Los Angeles. Now, that just can't be realistic.

If Staples tried to raise its prices by 73 percent, everybody would agree that there would be a lot of plywood being used in Los Angeles because they would just close down. People would go to all the computer superstores, wherever. It leads to unrealistic predictions. So this is just another reason of saying, this is why my Chow test said you couldn't pool them together. Because when you do it separately here, you get these unrealistic predictions.

Q. Let's go to one last difference. We had a lot of testimony previously about -- I believe you were here for it -- about the MSA competitor measure, the competitor variable versus distance bands. Could you first just

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describe your methodology in terms of distance?

A. My original model had stores within five miles, 10 miles, 20 miles because I think that's where most of the competition comes from.

And I think that Dr. Warren-Boulton agreed with that. He said that his secretary wouldn't drive all the way to Germantown or something to go shopping.

Q. In fact, I believe we have an excerpt from Dr. Warren-Boulton's testimony. I think I have to go over here to read it, but -- here we go. It is much easier with the white back.

Basically, I think he said specifically if Staples and Office Depot raised prices in downtown D.C., and you wanted to somehow escape from that price increase, you have to drive to Germantown which is a fair distance; and it does seem to me that no matter what Wal-Mart does in Germantown, it is unlikely, for example, that my office manager for example is going to be willing to drive up to Germantown to visit a new office supply store.

A. Well, I don't agree that people are going to drive to Germantown, but it is true that the more nearby stores are -- the more important competitors, I would certainly agree with that. That's why in my original model, I did it. Subsequently -- I also didn't have the MSA data. Subsequently the FTC through its subpoena power was able to

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get MSA data. So in my new model, my gross margin, I have the MSA variable as well. So I have taken into account both ways just like Professor Ashenfelter did.

Q. So even if you accept Professor Ashenfelter's assumption, what result do you get?

A. Again, it would be that exhibit we had before. It doesn't matter whether you just put a dummy variable in the MSA or put in the number of stores. Although I think just the indicated variable is better for economic reasons. Even if you put them both in, you get the prediction of 1.3 percent; and then after the efficiencies, prices go down to consumers by about 2 percent.

Q. At the outset of your testimony you suggested that the standard for merger analysis was the impact on consumers. What is your conclusion?

A. Well, my conclusion is that prices are going to go down to consumers. Consumers are made better off by this merger. So it should definitely be allowed to happen. Secondarily, there are going to be huge efficiencies to the U.S. economy from this merger. Cost savings. And that helps the economy. That is going to produce more jobs for people by and large, and that's another reason to let the merger go through.

Q. What accounts,, what drives your conclusion? What are the main factors?

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A. The main factors are this industry has a history of lower prices. That's their whole reason for existence. Lower prices. They are small. They still only have 5 or 10 percent. They want to expand. That's how they are going to raise their stock price. That's how all these executive options are going to work, and that's how the shareholders are going to get rich.

They wand to expand. The way they are going to expand is by having lower prices. They face potentially the fiercest retail competition in the history of this country which is Wal-Mart and Sam's. If they try to raise prices, as my daughter would say -- who is in high school, so I will attribute this to her -- they will be dead meat.

MR. GIDLEY: Thank you, Dr. Hausman.

THE COURT: Mr. Orlans, are you up?

MR. ORLANS: Yes, Your Honor.

THE COURT: Thank you.

CROSS EXAMINATION

BY MR. ORLANS:

Q. Good morning, Professor Hausman?

A. Hi, Mr. Orlans.

Q. Now, sir, in early February when the Commission was conducting its investigation, you presented the Commission with an econometric study; is that correct?

A. Well, more than one, but yes.

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Q. Okay. The one that we are talking about is the one that showed a .9 percent price increase; is that correct?

A. Yes.

Q. And you suggested to the Commission that that was the appropriate point to take and the Commission should rely on that and not bring the case; right?

A. Among other things, yes.

Q. And the Commission asked for the underlying data; isn't that correct?

A. Yes.

Q. Isn't it true, sir, around February 12 when you provided that underlying data, the data you provided did not include California?

A. Right. It was on February 18 that I provided the California data to Dr. Levinson.

Q. And on February 12, when you provided the data that underlay, was underlying your study, you didn't say that you were excluding the California data, did you?

MR. GIDLEY: Objection.

THE COURT: Let him answer. THIS is cross. He can answer.

THE WITNESS: I think I told the people yes, there were two models. It would take me a while to get the data ready. It was within a week that I sent it. So I think I told them at the time. They have known the whole time. When I sent the data to Mr. Levinson, I sent him a letter saying here is the California model, so I can't understand why there could be any confusion.

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BY MR. ORLANS:

Q. Did you explain how that fit in with the rest of the data?

A. Yes. Yes. I said here is the California model. Here is a model for the rest of the country. Here it is. I mean. I think the letter itself is self-explanatory saying here is the California model. You know, I said California model. I sent him the data. I sent him a computer file. All they had to do was put it on a PC, and the data would come out -- excuse me, the results would come out. In a phone call I specifically said to them, Did you have any trouble running the models. They said, No, the computer programs worked fine. We were able to get you your results. We had about three or four phone calls; and if they had a problem, I presume they would have told me. I had conversations with John Baker whom I have known for years, the chief economist, and asked him point blank were you able to reproduce my results; he said well not absolutely exactly, but very closely; so we didn't have a problem.

Q. Sir, to this day you know we haven't been able to reproduce your results, isn't that right?

A. I think you can. Dr. Ashenfelter came very close. You never get it exactly to a hundred decimal points. In fact, it depends just on what computer software you use. But as I understand it, you have the California data, you have the California model; you have the rest of the country. I sent you a SAS program which is the most widely used computer software. All you do is put it on a PC and you get the results.

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Q. Didn't people tell you they were having trouble getting your results?

A. No. That's absolutely untrue. I asked him point blank were you able o run the computer blanks to get the results. They said yes. John Baker told me, not to a hundred decimal places but close enough, we were able to get your results. We had a meeting. I asked him just as we walked out of Mr. Pitofsky's office and he told me that.

Q. Isn't it true, sir, that if you include the California data in Dr. Ashenfelter's results, we didn't even come anywhere year your .9 percent number; isn't that right?

A. No. If you put in -- if you run the regressions together, of course, you won't because you flunk the Chow test. You have to run them separately. So the idea is when you run them separately, and then take the average, you get 0.9 percent. If you do the wrong thing, of course you get the wrong results. But I didn't certainly confuse the FTC. I said here is the California model, here is the other

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model. I didn't say to run them together. That would be the wrong thing to do.
Q. Did you ever explain how to put the two together? You didn't, did you?
A. Why, you just take an average. That's straightforward econometrics. You don't put them together. You run them separately. See, I think we are misunderstanding here. You have to run the models separately. If you run them separately, you get 0.9 percent. If you put them all together, yes, you go the wrong result.
The Chow test tells you that. But I never told the staff to put them together. That's why I said here is a separate California model.
Q. You never explained they were put together anyway, did you?
A. Yes. When I gave the stuff to the staff. I said overall I get 0.9 percent. I'm taking an average.
Q. Sir, doesn't your cover letter simply say here is the California regression; isn't that all you said?
A. Yes. But we had a meeting the previous week with the staff. I said I ran these models. I got the results. The prediction was 0.9 percent. It was at 601 Pennsylvania Avenue, across from the main building. We were sitting there. I said I will send you the data. Oftentimes in these matters, you don't even send the data. I sent them the data

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and the computer programs and they could run them.
Q. Let's talk about California a little bit, sir.
A. Sure.
Q. Even when we got the California regression, it turned out that you excluded California stores; isn't that right?
A. That's as I testified. On the basis of the Chow test, I excluded 15 rural stores.
Q. In fact, sir, you testified 16; isn't that right?
A. If I said 16, it is 16.
Q. Isn't the number 24, sir?
A. No. It is not.
Q. Have you verified that?
A. Yes, I have.
Q. Once again, sir, it appears your number is different from ours. You never provided any Pennsylvania data, did you?
A. No. Again the Depot stores aren't there. So it is not going to affect things. If anything, it will lead to a lower prediction. Again, as I told you in my deposition the Chow test said those should not be included.
Q. Sir, there are Depot stores in Pennsylvania that are in price centers are there not?
A. For my data, there was one Depot store within 20 miles of a Staples store. There are Depot stores elsewhere --
Q. My question is there are Depot stores in Pennsylvania

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that are in Staples price zones; isn't that right?
A. Now there are even more, because more and more stores have opened.
Q. You never provided data for Pennsylvania, did you?
A. No. I left out -- those out.
Q. Uh-huh. You also left out the data for August, and September of '96, didn't you?
A. Well, you can't do the price index for those because you can't -- I checked on this after my deposition. You actually can't do the required extrapolation to get the price index. But that's very clear. You know, the results say here is the data. Those last two months couldn't be done.
Q. Did you ever explain that to anyone?
A. No. I don't think I did.
Q. Sir, by contrast isn't it true when we gave you Dr. Ashenfelter's results, that you were able to replicate them exactly; isn't that right?
A. No. He had made some mistakes. We had to figure out -- so we -- actually what he did was wrong, and he testified to that.
Q. Once he corrected the mistakes, sir, you were able to replicate his results exactly, were you not; yes or no?
A. Excuse me. We had to correct his mistakes. Once we corrected his mistakes, we could replicate his results, yes.
Q. Did you ever give us any Chow test results on your price

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model?
A. Back in February, you mean?
Q. In February and up until today?
A. Yes. When you deposed me the other night there was sheets with the Chow tests. When you deposed me 10 days ago there were sheets with the Chow test. And back in February, I certainly told Dr. Baker and the staff the reason I had the two models was on the basis of the Chow tests. Everybody knows about Chow tests. All economists. Those are very famous.
Q. Now, Dr. Ashenfelter essentially followed your results, started out with your approach to the price equation, didn't he?
A. His left-most column did, yes.
Q. And then what he did was to add in the MSA variables as a proxy; is that correct? Or zones?
A. Yes, that's what he did.
Q. And you agree that's a reasonable thing to do?
A. I agree that's reasonable. I didn't have the data to do so. But you were able to get it, by subpoena I imagine. So that's why I included in it my subsequent model, my margin model.
Q. All right. Dr. Ashenfelter, using the full sample, including California and Pennsylvania got a price increase of 8.6 percent in the overlap markets; isn't that right?

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A. Well, I thought he was now saying he thought 6 percent was better when he put mine in. His exhibit said 8 percent. If he incorrectly adds all the data into one model.
Q. Didn't Dr. Ashenfelter also look at various sections of the country, that is he broke it up section-by-section; is that right?
A. Not that I'm aware of no.
Q. Were you here when he testified?
A. Not to that effect, no. I was here for his main testimony. He never testified that he had done that.
Q. So you didn't hear him testify that when he did break it up region-by-region the effect in California was 17 percent not 71 percent?
A. He may get 17 percent. That's again unbelievably large in my view. They could not raise prices in Los Angeles, which is the most competitive retail market in the country, by 17 percent. That defies economic reason. If he testified to that, it's fine with me.
Q. You do agree there is a large percentage effect in California; isn't there, sir?
A. Large, but it can't be as large as 17 percent. Staples can't raise prices by 17 percent. It just doesn't make economic sense.
Q. After you took Dr. Ashenfelter's results and tinkered with them a little bit, you still concluded there would be a

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price increase in the overlap markets of about 4 percent isn't that right?
A. If you incorrectly pool the data together, yes. You would be flunking the Chow test; but, yes, you could do it.
Q. The overlap market, sir -- strike that. Isn't it true that in terms of price effects, all you can really look at are the overlap markets? That's the only place where the merger has an effect?
A. No, that's incorrect.
Q. Why is that, sir?
A. Because the cost savings are passed along to everybody. The price effect is the overall price effect to consumers. So the -- it would incorrect to look only at the overlap markets because other places consumers are being helped, and you would be forgetting about all these consumers and acting as if they didn't exist.
Q. So the only reason you did this was to take account of the efficiencies; is that right?
A. It's not the only reason. I'm trying to figure out if the consumers are helped or hurt by the merger. You want to take into effect the total effect on consumers.
Q. But, sir, if there is a merger between company A and company B and company A has a store in Pennsylvania as does company B, and company A also has a store in New York and the two merge, the only possible price effect is going to be

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where they overlap isn't that right?
A. No. That's just wrong as a matter of economics. In New York, if the price goes down, those people are certainly made better off. If you get efficiencies, they are helped.
Q. I understand?
A. Excuse me. Why would you want to forget about people in New York. They are voters.
Q. I understand your view on efficiencies, sir. What we are talking about right now is the question of price effects. The price effects in a merger occur in the overlap areas, don't they?
A. No, they don't. The price effects come from two things. They come from the combination, and they come from efficiencies that are passed through to consumers. That's the price effects. All economists would agree to that. I don't think there could be a disagreement. So you need to take into account both the effect of the merger from the point of view of the stores coming together but also in view of the prices going down because of the efficiencies.
Q. Isn't there significant disagreement, sir, in the antitrust community as to whether you can look at efficiencies that are outside the merger areas' price effects?
A. No. What the -- as I understand it, what people say is what you should do is to look overall. Your complaint

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certainly looks at the whole country. You know, you are just not saying we are only going to look at one section of the country. So in my view, you should look at the overall effect and see what's going to happen.
Q. If you look at the overall effect -- strike that.
Isn't it true, sir, that in the non-overlap markets, if this merger does not take place, that those markets will become more competitive markets? There will be more superstore entry; isn't that right?
A. That can happen but consumers will be hurt because you will lose the efficiencies and the cost pass-throughs. So they will face higher prices than they would have instead of the merger, so the FTC will have harmed those consumers if the merger is stopped.
Q. That's not what I asked you sir. Did you make any effort to take account of the benefits of competition in those areas, the areas where in the future there will be increasing superstore competition?
A. Sure. I certainly thought bit. The econometric model doesn't do that because the future hasn't happened yet.
Q. Okay.
A. But, yes, I thought about it.
Q. It is true, sir, that by spreading the effects that is the increase in price over the whole country, you about halve the percentage price increase; isn't that right?

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A. Approximately yes. Or it is not the real price increase, it is the price increase that comes out of the econometric model before you take into account entry and expansion and the cost savings from efficiencies. But if you only look at the econometric model to do the experiment, that's approximately right, yes.
Q. Now the inclusion of California changes the results by increasing or raising the amount of the price increase isn't that right?
A. If you do it the way that Dr. Ashenfelter does, yes, it does because you get these very large price increases. He would get 17 percent I guess you are telling me. If you actually do it by the Chow test, you get very high changes. So it leads to an increase, yes.
Q. The last time I checked California was part of the country, right?
A. Yes. I'm taking account of California, too. Absolutely. Definitely part of the country. Growing the fastest of any state.
Q. Isn't it true when you split off California, that you didn't do a Chow test splitting off any other states; isn't that correct?
A. No. I looked at Pennsylvania as I I've testified as well. At the time you know how these go. You are in a big rush. I didn't check all the other states. I definitely had

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reason to believe -- as I told you I lived in California. There are different commuter patterns. It seemed to me quite likely it would be different. So that California and Pennsylvania were the only two, as I remember, at the time back in February that I checked.
Q. Sir, didn't you testify at page 167 of your deposition, your first deposition: "Question: Did you do any tests on splitting any of the rest of the states or part of the country up? Answer: No. I really didn't have time at that time. I've done that subsequently in this study. We were rather short of time to present stuff. I had clear reason to think that merely from talking to Staples people that I should check for this and so I did"?
MR. GIDLEY: Your Honor, this is not impeachment. That's exactly what he said.
MR. ORLANS: I don't believe that's true.
THE COURT: I can make up my mind. Let him go ahead. That's all right.
You answered that? Did you answer his question?
THE WITNESS: Yes, I did, Your Honor. California I did and I also did Pennsylvania, as I did at my deposition.
THE COURT: All right.
BY MR. ORLANS:
Q. And you did the Chow test because people at Staples suggested that the California data might be different; is

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that right?
A. No, that's incorrect. I think you are getting confused. I did the California myself. The rural stores in California, the 15 stores I did because people at Staples said they might well be different. So, remember, there are two sets of California stores. There's all of California. I did that myself. The 15 stores I did. Of course, people at Staples didn't tell me to do a Chow test, but they hat said those stores might be differ.
Q. Sir, again I'm going to read the same passage. Did I not ask you this question and did you not provide this answer: "Question: Did you do any tests on splitting any of the rest of the states or part of the country up? Answer: No, I really didn't have time at that time. I've done that subsequently in this study. We were rather short of time to try to present stuff. I had clear reason to think that mainly from talking to Staples people that I should check for this and so I did."
Is that your testimony?
A. Those are the 15 stores.
Q. Is that your testimony?
A. Yes, it is.
Q. Now, we've checked those stores, sir, we came up with 24. Are you telling me that we are wrong; is that correct?
A. No. I think where you may be going wrong is more stores

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have opened in the meantime. You know what I did was I was following stores every time. I'd count 16. There could well be further openings. I stand by 16. I've counted them twice. That's how many there are.
Q. So the people at Staples would know how different stores behave in terms of pricing wouldn't they?
A. I mainly got this from from Mr. Stemberg, but he said the rural stores might well be different. Yes, and he does understand I think pretty well how this works.
Q. Uh-huh. And you agree that it is inappropriate to peek at the data and drop out observations you don't like; isn't that right?
A. Yes. That's why I did the Chow test. It allows you to do a scientific basis of whether or not you can exclude them. You can't just look at the results and say, gee I don't know that Dr. Chow existed. I'm just going to drop them out. That's why you have Chow tests.
Q. Sir it true if you slice and dice the data in different ways you will always find portions of it that will fail the Chow test?
A. Not to the point of one in a hundred million. If you slice and dice it, you will find some rejections. One in a hundred million is big enough that you just don't get that from slicing and dicing. You can find minor failures. In fact, if you do a hundred Chow tests, five will fail just the

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way you do the test; but I will not get failures at the rate of one in a hundred million.
Q. If you do a hundred tests, five will fail; is that right?
A. Yes. On average.
Q. Now you said these were rural stores in small California towns; is that correct?
A. Well, Staples has -- no. They are not necessarily small California towns but they are typically not in the major MSAs. And as I told you, I had this rule if there were less than four computer superstores, that was the rule Staples used and I followed that. I didn't know it exactly at the time I talked to you. I forgot. I went back and checked and that's what it is. Four. Four computer superstores.
Q. In fact, sir, aren't these stores found around Los Angeles and around San Francisco? They are hardly rural, are they?
A. Well, they are like an hour-and-a-half outside. I don't know what you mean by near. But they are typically fairly far out.
Q. Isn't it true you included stores in your sample that were farther away from Los Angeles and San Francisco than the stores that you excluded?
A. Oh, sure because around San Diego which would be further away, they are going to have four or more more

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computer superstores around Sacramento. So, of course, I included those. I just had a rule for computer superstores, either in the sample or not, for California.
Q. And you did in the price model exclude those small California stores; is that right?
A. Yes.
Q. You said that your rule of thumb was if they had less than four computer superstores, you excluded them?
A. It wasn't my rule of thumb. It was the way Staples actually looked at these stores. That's the way they classified them. I just followed their classification and then did a Chow test to see whether it worked.
Q. How many other stores included in your material included in your data would also have failed this test of less than four computer superstores?
A. Oh, I don't know.
Q. A lot; isn't that right?
A. Oh, Bangor, Maine and places like, of course. But Staples people thought that Bangor, Maine didn't have this different pattern.
Q. I see. So what Staples people thought determined how you applied the Chow test; is that right?
A. For California yes, sir. They said they thought these stores behaved differently. I did a Chow test on them. I used their business judgment and experience to do it, yes.

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Q. And because their business judgment and experience never told you that Bangor, Maine was a problem, you didn't do a Chow test there; right?
A. I couldn't do it for every store. I've looked at it since and broken it up MSA by MSA and got very different results. You can do it on a MAS by MSA basis but certainly back in February, I didn't have time to do every Chow test one can conceive of.
Q. Did you leave out Basalia?
A. Oh, I can't remember store-by-store. I'm sorry.
Q. In fact, sir, isn't it true the stores you left out have results that are supportive of the FTC's position and unfavorable to yours?
A. No. Because as I testified, if you put them back in along with the Pennsylvania stores, you still get 0.9. Yes, they do have somewhat bigger price predictions. Not that big; but when you put them and Pennsylvania back in, you still get the 0.9; but they are higher than the other California stores. I would agree with that.
Q. You never provided us with those data, did you, that showed there was no different?
A. Sorry.
Q. You never provided us with data to indicate there was no difference when those stores were put back in? We have to take your word for that?

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A. I will be glad to provide it to you or we can do it on redirect. It is the same.
Q. Would it surprise you if we get different results?
A. Well, I guess I don't want to speak about competence here, but you could. When I do it, I get 0.9.
Q. Uh-huh. So for your price study, you excluded Pennsylvania completely; is that right?
A. No. I think -- well, I may have; but the main rule I was using was I excluded the Office Depot stores that weren't within this range of Staples stores, 20-mile range which is how my model did it.
Q. Uh-huh. And you put California in in a separate regression; right?
A. Yes. Separate model.
Q. Uh-huh.
A. February 18 I sent to you.
Q. And even in the separate regression you included -- excuse me, you excluded 24 or maybe 15 stores because they were in small areas?
A. Fifteen or 16, yes. I know how many I excluded. I can't remember for sure, but I will take your word if you claim I said 16, that it was 16. It might be 15. It is certainly not 24.
Q. Isn't it true, sir, that those 15 or 16 or however many stores were in some instances closer to San Francisco and

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closer to Los Angeles than stores that you included?
A. I think I answered that question already. Yes. There were stores further away from Los Angeles and San Francisco and places like San Diego where there are more commuter superstores.
Q. You never applied that four computer superstore rule anywhere else?
A. No. That's just -- the Staples people thought California was different.
Q. Uh-huh. Did you include the California stores in your margin study, sir?
A. Yes. All the stores, every Staples store in the whole country is included. Now on the basis of a Chow test, again those rural stores in California have their own model; but every Staples store in the country is included. In fact, I have 65,000 observations in the study that I did since the complaint was filed. So there are 20 times as many as Professor Ashenfelter used. It is a full sample of every store.
Q. Did you do a Chow test at all in your margin study?
A. Yes, I did.
Q. What kind of a Chow test did you do there?
A. I broke the country into regions, four different regions, and I also did a Chow test on the small California stores and had a separate model for them.

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Q. Uh-huh. Uh-huh. So you didn't do a Chow test on the use of the '93- '94 data in addition to the '95-'96 data, did you?
A. You asked me that at my deposition. So I did it, and the Chow test would fail. Ut if you break it up and do the predictions separately, you get very much the same results.
Q. But you didn't do that Chow test until I asked you about it?
A. No.
Q. Uh-huh.
A. I can't think of every last Chow test.
Q. Uh-huh.
A. You get approximately the same results if you do it. Remember as I testified the Chow test, number one, you are looking at the statistics and number two, do you get very different result?
Q. So you can't think of everything to do a Chow test on, but you do it when Staples suggests doing it; is that right?
A. No. I think again what I said was when I talked to the Staples people, they said that they believed that these small California rural markets behaved differently, so all I did was the Chow test. You have -- you have a scientific basis for Chow tests. You get it from business experience or economic hypothesis. You have to understand the industry. When I was talking to them, I asked them. That's what they

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told me.
MR. ORLANS: I would like to see what constitutes a small rural market.
BY MR. ORLANS:
Q. Sir, I have a map that reflects -- why don't you go over there. Just be sure that Dr. Hausman can see it.
We have a map that reflects the stores we understood you dropped, sir. I noticed that they are basically around the same areas. For example, going down, you've included all these stores but excluded some of these. Is this what you meant by a small rural area? These are all around Los Angeles, aren't they?
A. No. The reds are the ones that you are claiming were left out?
Q. That's correct.
A. If you go to the greens again, that's San Diego. The two greens above are Orange County. I don't know whether you've been that's where O.J. was in the Bronco. My mother live down there. That's hardly rural down there. Newport Beach. It's very built up. There are a lot of office buildings. I will point to this.
MR. KEMPF: It was where Camp Pendleton is, where the First Marine Division is located.
THE WITNESS: If you go up here where I dropped the stores up here, north of San Francisco, there's sort of a

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mountain range. Yes. I have given a seminar here before. This its fairly rural. Again out here, this is in the boonies in California here. Again here this is outside Los Angeles.
If you drive northward up along the coast, this is Malibu, Ventura, there's a mountain range here along the coast. As as soon as you go over the mountain range again, it is not very populated at all.
So, this is Los Angeles. This is San Diego. Okay. Monterey. That's not a hot bed of office activity, Mr. Cary, hardly. There are a lot of hotels in Monterey, but not many offices.
I didn't look at these and say I didn't like Monterey, I'm going to drop it out. I had this rule, four or less computer superstores. That's what it leads to. These are quite rural. I don't think you can argue. These are quite rural. I would argue Monterey and Santa Cruz where I have been are rural as well, in terms of just not a lot of offices.
Q. In dropping these so-called rural stores, sir, isn't it your view that the gross margins of such stores tend to be lower because of the product mix?
A. Yes. Both overall and for office supplies, right.
Q. So, again, the stores that were dropped -- strike that.
A. No. The stores that were dropped, if anything, are less

profitable. That's what gross margins being smaller means; and so these were the less profitable stores at least you know from Staples point of view that I was dropping.
Q. Uh-huh. But, in fact, the data don't reflect that, do they? Some of the smaller stores are actually more profitable and have higher margins when there are monopoly markets; isn't that right?
A. You can always find a few stores to prove anything. But by and large they have lower gross margins. That's what the data show.
Q. Didn't Mr. Stemberg testify yesterday that Bangor was a very profitable store, sir?
A. He may well have. I wasn't here, I'm sorry.
Q. Now, let me talk about your margin study a little bit?
A. Sure.
Q. You knew that we were looking at your price study; right? You provided it? You knew the Commission was analyzing it?
A. Sure.
Q. You knew that we retained Dr. Ashenfelter? You learned that a while ago?
A. Yes.
Q. Uh-huh. And so after we had your price study for about two months, about two weeks ago, you came up with a new margin study; is that right?

A. Yes, it was about two weeks before I went to Australia, right.
Q. And now according to your margin study, the price increase is 2.4 percent not .9 percent?
A. You are comparing apples and oranges. It is 1.3 percent rather than 0.9 percent. So you are incorrect.
Q. Let me ask you this, sir: Under your new analysis, if costs fall at a Staples store, doesn't your equation predict the margin would not change?
A. No. If costs fall, prices would also fall, and that's what margins look at.
Q. Maybe I need to rephrase that.
A. I may have misunderstood you.
Q. Let me try it again. Under your new analysis, if costs fall at a Staples store, isn't it true that your equation predicts that the margin would not change?
A. No. That would be incorrect.
Q. Isn't that the way you specified the regression?
A. What happens is as costs change, holding everything else equal, but of course as costs change, other things change as well. That's why you do a regression, and the margins change as well.
Q. In terms of your sales hits study, sir, isn't it true that only Best Buy gave you a 7 percent number or close to a 7 percent number? All the other numbers were much lower?

A. Best Buy -- speaking from memory, I could be wrong, Best Buy gives you actually a bigger hit than either Office Depot or OfficeMax does. It gives you a real big hit. The other once like Wal-Mart and Sam's are lower than Office Depot and OfficeMax, but they are still significant. It is true Best Buy givdes you a very big hit of 7 percent.
Q. Isn't it true that from a historical perspective that Best Buy has pulled back from its expanded selection of traditional office products?
A. Well, there's testimony -- I believe his name is Mr. London from Best Buy -- I'm not the world's best person on names -- but Mr. London put in a revised affidavit in -- and said they had trouble because of the competition, and they pulled back, but they were offering more types of office supplies as going forward. They may have cut back on traditional, but they were offering more of other types. They are still expanding in this market. He did testify they found the competition very tough.
Q. And, in fact, didn't Mr. London conclude in paragraph 12 of his second declaration, and I quote -- I'm sorry. That's correct. Right at the end of paragraph 12, "As one Best Buy office supply expansion plan shows, we thought that to effectively compete with the office supply superstores, we would require 120 four-foot sections approximately 8,000 square feet. This would cover the vast majority of office

supplies found in the superstores. While our expansion plans ultimately did not pursue this course, if it had, we may have resulted in capturing more customers."
So the fact is that they didn't pursue that approach, did they?
A. But, speaking from memory, they still have 2- or 3,000 SKUs which is a whole lot, Mr. Orlans. Not everybody can be successful in business. They had a plan. They found the competition tough. They are still out there with 2- to 3,000 SKUs, if I remember correctly. He did say they pulled back. I certainly agree.
THE COURT: Mr. Orlans, I don't want to interrupt your cross. How much longer do you think you might be?
MR. ORLANS: I expect another 45 minutes to an hour, Your Honor.
THE COURT: Okay.
We are going to go with the other witnesses for the defendants. I'm going to take a short break. The reporter started at 9:30 and needs a break. Ladies and gentlemen, we will take a break until 11:30.
We will be
(Recess)
MR. ORLANS: May I approach, Your Honor.
THE COURT: Yes, sir.
BY MR. ORLANS:

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Q. Let me show you Plaintiff's Exhibit 18, sir?
A. Thank you.
Q. Plaintiff's Exhibit 18, if you will turn to the fourth page in, which is entitled '97 Budget Model Impact of Competition and Cannibalization, shows the impact on the company of various stores opening; is that correct?
A. I don't know actually.
Q. So you are not familiar with that document?
A. I will take your word for it.
Q. What I want to point you to, sir, is doesn't this document show the impact of a Best Buy is only .06 percent?
A. Well, what I don't know is whether this is across the whole company or for an individual store on average. If this is across a whole company -- if this is -- you know, I'm not sure exactly what it is saying. You know Mr. Stemberg would know this better than me, but, you know, if it is across the whole company, it depends where stores are opening.
Certainly, they went back and did the analysis after I presented stuff to the Commission and looked at what happened in places like in Pennsylvania when the Best Buy opened. I think they found that in Redding, as I remember, it was perhaps 13 percent. They found an even bigger effect than me. But as I say, I don't know exactly what this document is saying.
Q. In this document, sir, it shows that the impact of a

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Best Buy is .06 percent compared to a .55 percent impact of Office Depot and a 1.17 impact of OfficeMax; is that right?
A. Yes. But whether it is across the whole company or individual stores, as I said, I don't know.
Q. Is Wal-Mart mentioned on here, sir?
A. No, I don't see it.
Q. Okay. I have a couple of questions, sir, about material we already covered. I think they will be brief.
A. Sure.
Q. First of all, did I understand you in your testimony to say that the .9 percent number that you got in your price equation covered the entire country and not just the overlap markets?
A. Yes.
Q. Sir, let me read to you from the paper that you provided to the Commission entitled Post-merger Price Change Analysis: Discussion of Methodology, at the bottom of page 3, you stated, "The result of the experiment demonstrate that Staples would hypothetically be able to raise price on consumable office supplies by only a small amount at its stores with one or more Office Depot stores in the vicinity (.9 percent)." Those are the overlap markets aren't they?
A. That's a misstatement IF I said that.
Q. So this is wrong?
A. That's wrong. It is 0.9 across the whole country and

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1.3 percent if you just look at the overlap stores.
Q. Sir, would it surprise you to know that when we ran California separately with the original model, we got over 2 percent, as a number?
A. No. My memory again is if you do California separately, you get about -- I'm speaking from memory but I think it is closer to 1.3 or 1.4 percent.
Q. So it would surprised you if we used your original model and ran California separately and got a 2 percent number?
A. Yes. It should be 1.2 or 1.4.
Q. Isn't it true, sur --
A. Two percent is still a low number. It is not going to change the economic analysis. My memory is you get 1.3 or 1.4.
Q. And again, sir, you have no explanation for why we've been unable to reproduce those results of yours, do you?
A. Well, it just -- it may depend on how you are doing the simulations, whether you are taking the log of the means or the means of the log. It can lead to small differences such as Professor Ashenfelter testified. No. I'd have to read your computer code. I'm not sure I could figure out exactly. Remember, we found these mistakes in Professor Ashenfelter before that there could be there are small mistakes that lead to small changes. You know, 1.4 percent, 2 percent. As I said, the economics is the same.

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Q. Let me talk briefly about your 15 or 16 or however many California stores. Those stores are dropped entirely; right?
A. Not from the analysis that -- the margin siting but the --
Q. From the price study?
A. Yes.
Q. Doesn't Chow say you should estimate separately but not drop?
A. Yes. The problem was with only 15 stores in two years of data I didn't think there was enough to be reliable. But I looked a those as well, yes. So I estimated. That's how you do Chow. That's the graph I had here up on the board before.
Q. Would you agree, sir, when you are trying to define a market in the economic sense that -- excuse me, that -- strike that. Let me try it again.
Would you agree, sir, that when you are trying to define a market in the economic sense, that competition means the ability to constrain prices?
A. Oh, yes. Sure. I always say that.
Q. So in defining a market you start with the smallest group of competitors and determine whether if they acted together as a monopoly they could raise prices five or 10 percent without being constrained by others; isn't that right?

A. That's the way the Merger Guidelines does it. I'm not sure everybody thinks that's the best way.
Q. If they are so constrained you add the next group of competitors; right?
A. Well, the problem with the Merger Guidelines is who are the next group of competitors? It doesn't tell you who they are. You often have a whole plethora of choices. So it is sort of a problem with the way the Merger Guidelines goes out and does it. I have written academic papers showing there are better ways but that is, as I said, a way.
Q. But you do agree that the mere fact a company or companies may sell the same product doesn't mean that they constrain price; isn't that right?
A. Sure. Absolutely.
Q. And again, to put this in context, let's suppose we are looking at a merger of supermarkets trying to decide whether 7-11s are in that market. You believe that supermarkets constrain the price of 7-11s, don't you?
A. What I testified to at my deposition was I believe supermarkets constrain 7-11s but I never studied the supermarket industry, and I don't know whether 7-11s constrain supermarkets.
Q. So it may well be that even if supermarkets constrain 7-11s, that 7-11s don't constrain supermarkets; isn't that right?

A. Hypothetically, yes. As I said, I never studied the supermarket industry it.
Q. IT certainly seems reasonable doesn't it, sir, to believe if supermarkets were to as a group raise prices to conclude that based on a 5 or 10 percent price increase that people wouldn't stop shopping at supermarkets and go to convenience stores and 7-11s?
A. Hypothetically, I would agree. I would need to study it though. That's why you do economic analysis, to look at things.
Q. And, again, the key issue in determining whether the market should be expanded is whether the next best substitute constrains price; right?
A. No. That's incorrect. It is not the next best substitute. That's really where the Merger Guidelines go wrong. Is you look at the whole group of substitutes. You can have a bunch of competitors each of which are fairly small and they could constrain the price taken together. So that's actually, in my view, just a fundamental analytical error in the guidelines.
Q. Let me try it differently. If two people sell the same product and the second would not constrain a price increase by the first, they are not in the same market; right?
A. That's a tautology.
Q. Okay. I'll accept that.

In your declaration, sir, in connection with market definition, you rely on some surveys; do you recall that?
A. No. If you could show it to me it would probably be better.
MR. ORLANS: May I approach, Your Honor.
THE COURT: All right.
THE WITNESS: Thank you.
BY MR. ORLANS:
Q. Pages 21 and 22, specifically. Do you see that?
A. Yes, I do.
Q. In fact, sir, isn't it your view that it is inappropriate to rely on surveys of this nature?
A. No. I have two views. Number one, if you look at paragraph 49, for instance, which says that Office Depot's business customers shop at these other stores, I think that's totally appropriate to use, because what this says is that they are already stopping, they are already shopping. So this is not asking for their opinions. I consider this to be quite strong data that they already go and shop; so long as it is not a biased survey, which I have no reason to believe. Paragraph 48 about the switching I consider to be considerably weaker evidence, because this is saying hypothetically what would you do? That's why I do econometrics. I think it's better than these type of data.
Q. Well, in fact, sir haven't you criticized the use of

such data and called it irrelevant?
A. I don't know I called it irrelevant; but I certainly don't think it is as good as econometrics. I said that numerous times.
Q. In fact, sir, haven't you stated, "In my view it really doesn't matter much at all what consumers say I just want to see what happens when their money goes through the cash register"; isn't that your view?
A. That's my view. That's why you do econometrics. The most important thing is how they spend their money. Absolutely.
Q. The survey you relied on doesn't do that, right?
A. No. Forty-nine does. It is paragraph 49 that says where are they spending their money. They are spending it at at office supply stores, they are spending it at warehouse clubs. That definitely is where the money is, as I like to say. But 48, as I said, is not as good because that's saying what would you do.
Q. In fact, sir, 48 in your view shouldn't even be relied on; isn't that right?
A. I think it gives some evidence, but it is certainly not as good as the econometrics. I would agree with that.
Q. You didn't say that in here, did you?
A. No. I still think it is evidence, but it is certainly not as good as the econometrics or the business.

Q. But you are saying -- nowhere in here do you say that this is interesting but not as important as the other evidence, do you?
A. Well, I can guarantee you not everything in these 70 pages or however many they are is as good as everything else. I'm putting down here facts. I will certainly agree that the real world data follow the money is better than this. I've always said that every time I've been asked.
Q. Market power is the ability to raise prices above competitive levels for a non-transient period of time is that right?
A. Yes. Although I usually say for a substantial period of time rather than non-transient. I assume that's what you mean.
Q. I can accept that.
A. Okay.
Q. Merger analysis is concerned with preventing the creation or enhancement of market power; is that right?
A. Yes.
Q. Now, you believe that because stores in small markets sell more computers and computers are low margin items, that there's a need in small markets to get higher margins from and charge higher prices for office supplies; isn't that right?
A. Yes. For -- if a store is going to sell both and make a

go of it, it is going to have higher margins on certain items and lower margins on others, and computers do have lower margins. I agree.
Q. So the margins on office supplies are higher in small markets because of the higher costs; is that correct?
A. Higher costs, less competition from computer superstores, Wal-Marts. There are a whole host of reasons. Costs are an element. And also the product mix, as we just agreed, is a big reason. But you know in these small markets, as I told you, there's free entry. If somebeoby were earning supernormal profits above competitive profits, which is the way that an economist looks at market power, monopoly power, somebody else can certainly enter. There are no barriers to entry in these small markets.
Q. I didn't ask that question, sir.
Isn't it true you can't increase your margins on computers? Which you stated are a low margin item because there's competition, effective competition; is that right?
A. As I told at my dep there's 1-800-GATEWAY, which you can always call and get your computer from Gateway.
Q. Okay. But you can raise your margins on office supplies; isn't that right?
A. It is not that you raise them. Competition allows you to get these, otherwise you would be able to afford to have a store there. As I said, if you could afford to have a store

there and you were earning above competitive profits, somebody else would enter. That's that economics says. There are no barriers to entry in these small markets. You can get the space. You can come in. So that's what economics says.
Q. Sir, because there's less competition in office supplies, you can get higher margins in these smaller markets isn't that right; yes or no?
A. No.
Q. I'm not asking for an explanation.
A. No. You're thinking about this the wrong way.
Q. I'm not asking for an explanation?
A. I'm not going to give you an explanation. I'm just saying your economics is wrong.
Q. That's fine.
A. Okay.
Q. But it is your testimony -- strike that.
Is it your testimony that Staples has the ability to increase its margins and profits on office supplies in small markets but not on computers; yes or no?
A. My testimony is that because there are fewer competitors, they are able to get a higher price but because -- the reason there are fewer competitors is because of the product mix. You have to look at both together.
You can't just make believe in isolation that a

Staples store came down from a spaceship and ended up in one of these small markets. You have to look at the whole thing. Where are there newer competitors. It is because of the product mix. You have to be able to make a profit.
Q. In fact, sir, in these small markets, don't these stores sell an awful lot of computers?
A. Yes. They sell a higher proportion of computers compared to Los Angeles, for instance, especially, yes.
Q. And they are very profitable stores, aren't they?
A. Some are, some aren't. Bangor, Maine, Mr. Stemberg said is. Some of the ones they lose a fair amount of money. It varies.
Q. If --
A. Excuse me. Just to show that there they are selling a lot of computers, it shows they are competitive for computers as well.
Q. Have you looked at Office Depot's margins in smaller markets?
A. I may have. I've looked at a lot of things in this case.
Q. Would you agree, sir, that Office Depot's margins on office supplies are highest in its monopoly markets?
A. Yes, but as I told you at my deposition, that's making a fundamental cross-section mistake. Many of their smaller markets are in the south and although the costs are less, you

would have to take that into account as well. Office Depot started off in the south. We all know that costs are lower in the south. Staples started off in the north.
Q. Circumstances are these small markets higher cost or lower cost? You have me confused.
A. No. They are typically lower costs. You are going to be able to do better there. We were talking about Staples before. They're the higher cost ones up in Bangor, Maine and West Lebanon, New Hampshire.
The Office Depot are often lower ones.
Q. The Staples-Office Depot are lower markets -- higher cost than the Office Depot -- monopolies are lower cost; is that your testimony?
A. I think it varies all across the country. What I'm saying if you look at the an average over all many more of the Staples single store markets, single store areas are in the Northeast where costs are higher. Many more of the Office Depot single store markets are in the south and Southeast, where apart from Miami costs are higher. That's my testimony.
Q. Sir, I'd like to read you a paragraph of Mr. Stemberg's book which is in evidence at PX-9 at page 129. Mr. Stemberg said and I quote, "Because small town stores draw customers from farther away, sales are almost as high as for big city stores. Yet rent is half as much, merchandise shrinkage is

half, and advertising costs are a fraction of what they would be in more populous areas. Not going at the small towns sooner was the dumbest thing we ever did."
Do you agree with that?
A. Well, I don't know about whether it is the dumbest thing they ever did.
(Laughter)
THE WITNESS: As I testified, if you actually look at advertising costs, there are Staples documents that show this, Bangor, Maine has considerably higher advertising costs on a per-store basis than, for instance, Boston, so I disagree with that. Certainly rent is smaller. But when you look at something like costs, if you are selling more computers, although the wages may be lower in Bangor, you have to provide more service. So that's going to lead actually to that extent to higher costs. It depends on how you look at it. You need to look at it from an economic point of view.
Q. Sir, let me direct your attention to Defendant's Exhibit 6069. I have some excerpts from it. May I approach, Your Honor?
THE COURT: Yes, sir, certainly. .
THE WITNESS: Thank you.
BY MR. ORLANS:
Q. Sir, if you look at that exhibit, the last page here

includes Bangor, does it not?
A. Yes.
Q. And doesn't that show, sir, that Bangor has far lower costs than any of the other markets? And particularly far lower costs than -- well, strike that.
Far lower costs than any of the other markets, compared to Los Angeles levels?
A. Yes. In terms of rent. I certainly agree that it does, yes.
Q. And it would include advertising here, too, wouldn't it, sir?
A. I don't think this does include advertising but I'm not absolutely sure. I don't think so. But I'm not positive of that.
Q. Do you have any basis for saying it doesn't, sir?
A. I have seen things in Bangor which show that it's higher than Boston, although Boston is not on this graph. This is on a per-store basis. So that is what leads me to believe that, as well.
Q. But according to this exhibit, sir, Bangor is lower cost than these other markets; is that correct, including Manhattan, Los Angeles, Philadelphia, is that right?
A. Yes. It certainly would have to be cheaper than Manhattan.
Q. Now, Mr. Stemberg yesterday said -- strike that.

Would it surprise you, sir, if comparing 1996 average sales in gross margin dollars per store for Los Angeles, Washington, Boston, and Bangor it turned out that on total sales, Bangor gross margin dollars per store was higher than those other markets?
A. No.
Q. Similarly on general office supplies, was higher than those other markets?
A. I'm sorry. I interrupted you. Could you repeat the question. I thought you were done.
Q. On gross margin dollars per store, reading from Plaintiff's Exhibit 408, that in 1996, average sales in gross margin dollars per store for Los Angeles, Washington, Boston, and Bangor, that Bangor actually had a higher gross margin dollars per store in total sales than the other markets and were similarly higher in general for office supplies than the other markets?
A. No. It doesn't. As I said there's less competition for computer superstores and all. In Bangor, they actually sell a fair amount. I've looked at that data before. There are less Sam's, less Wal-Marts, the computer superstores haven't come in. That's why they can do better there. No, it doesn't surprise me. There's just less overall competition. Noone disagrees with that. There are no Best Buys in Bangor, et cetera.

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Q. You don't believe that efficiencies have to be merger-specific in order to be counted; isn't that right?
A. Right. My view is do consumers get the benefits of mergers? That's the bottom line.
Q. For an efficiency to be merger-specific, it means that the efficiency could only be achieved through the merger and not in some other less anti-competitive manner; is that your understanding?
A. My view is that that is the social planning view of the world. We know better than the market. My view is the market should be allowed to speak. And if if leads to lower prices to consumers, you let the market do it. You don't let the social planners do it.
Q. And you know the Merger Guidelines require that efficiency be merger-specific to be counted.
A. Right. That's the social planner view of the world that I disagree with.
Q. A number of authoritative antitrust commentators have also recognized and accepted the requirement of merger specificity, haven't they?
A. Sure. A lot of them have worked at the DOJ and FTC. Of course, they accepted it. I disagree. I'm against social planning. But if you are a social planner, you probably like it.
Q. The possibility that certain efficiencies could be

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achieved in other ways without a possibly anti-competitive merger wasn't part of your analysis?
A. See, that's where you go wrong. You say could be. Anything hypothetically can happen in this world. Consumers don't eat hypothetical dollars. They don't spend hypothetical dollars. Consumers spend real dollars. So if prices are going down, the consumers are helped. That's what we are in business for. We are not here to say, "We are not going to let this merger go through Mrs. Consumer. We don't want to save you the money the money because hypothetically the social planners say it's not merger-specific." I think that's the wrong way to look at the world.
Q. Are you done, sir?
A. Yes, I am.
(Laughter)
Q. In terms of efficiencies, you didn't limit your assistance in this matter to assessing price effects. You also helped the company and Ms. Goodman generate some cost statements; is that right?
A. I did one regression on PSI SKUs.
Q. You did that by taking certain SKUs purchased in common by two firms and doing an analysis; is that right?
A. Yes.
Q. And the SKUs you chose was a sample of products that you referred to elsewhere as an FTC's biased and unrepresentative

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sample; isn't that right?
A. Right. I did this because I was trying to convince your staff they were looking at the -- in terms of pricing, they were looking at the wrong type of SKUs, right.
Q. Yet those very same SKUs that you call biased and unrepresentative form the basis for your efficiencies analysis of best practices; isn't that right?
A. Yes. Although I'm looking at costs here. The bias comes into -- into the FTC's staff point of view. I certainly did say that with respect to prices or bias -- excuse me. Please.
I continue to believe that, as I sit here today.
Q. So when the FTC used it it is bias, but your use was appropriate; is that correct?
A. I don't think up are listening to me.
Q. Yes or no, sir?
A. No. You are not listening to me.
Q. I'm not trying to engage in a discourse, sir. The answer is yes or no.
THE COURT: He can answer yes or no and then explain his answer, just like I did with the other experts.
THE WITNESS: The answer is no. And the reason is that in terms of using it for it is biased. I'm using this here in terms of cost. It's a totally different thing. Price and cost are two different things in economics.

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BY MR. ORLANS:.
Q. So you calculated the differences and you assumed that in all cases the merged firm would get the lower price; is that right?
A. Yes, I did because the merged firm could buy better. They would have the skill to do it, which I'm sure testimony has come in here; and they would also get some economies of scale, yes.
Q. And that was the basis for some of Ms. Goodman's projections; isn't that right?
A. No. I don't think she ever used it for any of her projections at all. All she did -- as I understand it -- was she did hers totally independently, but they said these are fairly close to some of the ones I get. That's the only she ever used this, to the best of my knowledge.
Q. So you think this shouldn't be used?
A. I think it is just a piece of data that says look Ms. Goodman went out and did this independently. She didn't even know who I was when she was doing it and was unaware of this. It gets approximately the same result. I think that's all it should be used for.
If I could do it again, I would do it on a thousand or 2,000 SKUs. You can't do the matching. I'm not really relying on this very much. But it is out there. I did the regression. As I remember, you get around 2.5 percent from

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buying better and the -- and the economies of scale, it seems reasonable to me.

Q. So to the extent Ms. Goodman relied on it, that would be a misuse of the document?

A. You'd have to ask Ms. Goodman that, sir.

Q. I think she asked us to ask you, sir?

A. Okay. I can't tell you whether Miss Goodman relied on it. What I'm saying is I went out and did the regression. It gives reasonable results. That's what it should be used for.

Q. Well, isn't it true, sir, that when you look at the actual chart, that over half the items go the wrong way? That is the company with greater scale actually paid a higher price?

A. Well, it turns out that 54 percent do. So you are correct and 46 percent; but most of those are buying very similar amounts. It is when one company is buying a good deal less or more, you do a regression. That's what regression tells you. If says there are small scale effects but if they are buying about the same amount, sometimes it is higher, sometimes it is lower. It is just -- dependss on the skill of the buyer. It is 54-46. You are correct.

Q. When you did your regression, sir, isn't it true that the regression had an R square of only .03 which means you only explain 3 percent of the variation in cost difference?

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A. Yes. You get a significant T-statistic as I remember; but there's a lot of variation. There's a lot of skill apparently. I found this very interesting in this case that some people are better buyers than others, but regression definitely says there's a scale effect.

Q. So you are telling me skill is really what is at the base of this? The bottom of this; ~~is that right~~?

A. No. I'm saying two things. Skill is important, but also there are ~~scale~~ effects. Regression says that when you buy more, you do get lower prices on averages. So both matter.

Q. You do agree that to the extent skill matters, that Staples or Office Depot could simply hire more skilled people; isn't that right?

A. No. I disagree with that. Becasue if they could do it, why haven't they done it? Everybody wants to get the lowest cost. Here is Mr. Fuente, the chairman of Office Depot. If he could just run an ad in the Washington Post, or some newspaper saying, "Wanted skilled buyers that can get me lower costs," he should have done it, because he's trying to make money for his shareholders. So it is not so easy as economic textbooks make it sound to go out and find skilled people.

Q. Sir, isn't it true that given your 3 percent R square that that means that your regression doesn't explain very

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much of what is going on? There are other factors?

A. There are a lot of other factors. Skill is very important. I certainly agree with you, sir.

Q. And isn't it also true sir if one of the 97 percent of the other factors was correlated with a units purchased that your regression would not be reliable and your T-statistic would fall below two?

A. Not for this type of regression because this is more of a predictive regression. If you did know about the other factors, you'd probably want to put them in.

Q. Isn't it true, sir, this is simply not very reliable to predict anything?

A. Well, I'm not using it to predict anything. I'm saying that it does demonstrate that there are scale effects. I'm not use, to it predict anything.

Q. Okay. And, in fact, you wouldn't suggest it should be used to predict anything?

A. I probably wouldn't. There's a lot of noise. It definitely shows -- there are documents I've have seen that are in my report that also says that Office Depot gets lower prices on average. That's what you would expect. I don't think anybody could sit here and argue with a straight face that bigger stores don't get lower costs. Economics -- I have worked in the telecommunications area for years. Every time you get bigger, every time I've been in a merger, you

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get significantly lower telecommunications costs.

So to argue there are no scale effects would be silly in my view.

Q. Sir, in your direct testimony, you talked about how all prices were going down. Do you agree that a relevant factor to consider in this case is whether prices would go down faster without the merger than with it?

A. Yes. That's what I analyzed.

Q. Okay.

A. Prices would go down 2 percent faster with the merger than without it. You do want to take into account this is a competitive industry, and with the prices falling, that helps come to that conclusion. The right standard is would prices fall faster.

Q. Isn't it true, sir, that in recent years, Staples' prices on non-price-sensitive items had gone up to the point where they were about 3 percent over Office Depot's prices?

A. They had gone up, but now they had started to come down because people in the company realized that was making them uncompetitive both with them and with the superstores. Excuse me, with the warehouse clubs as I remember. So that you know this is the whole thing. Market power. Can you rise prices for a substantial period of time? They found they couldn't. They started to get hurt in the market and had to raise prices. That's how competition works.

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Q. In fact, sir, isn't it true that that price decrease was actually put on hold pending the merger?
A. No. You asked me that in my deposition. I don't think so. As I told you, there were a lot of different plans. Staples has cut their margins before the merger got announced. Them realized they were becoming uncompetitive. This last thing as I understood it was sort of from a brainstorming. That had not been adopted even before the merger. That's my understanding. Again Mr. Stemberg is the right guy to ask.
Q. You do agree, sir, if that were drew, if a proposed price decrease of 3 percent had been put on hold pending the merger, that would be an anticonceptive effect to consider?
A. You would want to look at it, yes.
Q. Okay.
A. But I don't think those are the facts here.
Q. Office Depot's prices and margins are lower than Staples; isn't that right?
A. Yes, sir. Costs are lower and their margins are a little bit lower. That's because they get more throughput through their stores, about 50 percent more. That's how they do it. That leads to lower prices, right.
Q. Office Depot has lower costs than OfficeMax; isn't that right?
A. Yes, both -- well, I can't say OfficeMax. I don't have

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data for OfficeMax. Your staff might. I can't go look at OfficeMax. I certainly expect them to, yes, sir.
Q. Sir, at your deposition, your first deposition, page 134, did I not ask you the following question and did you not respond as follows: "Question: I thought we've agreed -- correct me if I'm wrong -- that OfficeMax had higher costs and higher prices than both Staples and Office Depot? Answer: No. I don't think we ever agreed to that. What I said was that -- I said two things: That Office Depot has lower prices than either OfficeMax or Staples. I said the merged company will have lower -- sorry, let me step back. I said that Office Depot has lower costs than either OfficeMax or Staples."
A. Yes. That's what I said.
Q. Okay.
A. That's an inference of mine. As I just testified, I can't be sure since I have never seen the OfficeMax data. Because it is bigger and has greater scale, I expect it to, yes.
Q. And you agree, sir, that Staples prices are lower in areas where it competes with Office Depot than in areas where it doesn't?
A. Yes. And Office Depot office with their lower cost and lower prices sets lower prices, and they force all the competition, Staples, Wal-Mart everybody, to come down. I

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agree.
Q. And isn't it also true that prior to considering this merger, Staples was concerned about declining margins due to increase in competitive pressures?
A. All companies are, yes. Competition is certainly increaseing in this industry. You know you have the superstores expanding, you have Wal-Marts expanding, everybody -- not everybody, you have a lot of stores expanding. So it is very competitive and, yes, they were concerned.
Q. And in the future, without this merger, there would be a growing number of three-player markets, isn't that right?
A. Well, three-player areas. I don't consider them to be markets but yes.
Q. Staples viewed this as inevitable didn't they?
A. I believe so, yes.
Q. And they predicted lower margins from that?
A. Well, my econometrics shows that. When you have three stores compared to two, that the margins are a tiny bit lower. I think it is -- I'm speaking from memory. I think it is on the order of 0.3 percent. Yes, they are lower.
Q. Isn't it true, sir, that alleviating some of these competitive pressures would address the issue of declining margins?
A. Yes, but a much better way is to get the efficiencies

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and to be able to offer lower prices; but yes, if you know they could get rid of Office Depot they would do beter. No doubt about it.
Q. Okay. Of course, getting the efficiencies might also be a more profitable way for the company to proceed; isn't that right?
A. Sure. Getting the efficiencies and lowering the prices to consumers that is a more profitable way. I presume that's why they decided to do the merger. So they are going to end up helping the shareholders. Look, they got to help the shareholders. That's what they are in business for. But they are also going to help consumers by bringing down prices. So use an old business -- hackneyed business term, it is a win-win situation.
Q. Well, that depends sir.
It depends on how much they help consumers versus how much they help their shareholders; isn't that right?
A. Sure but they are going to help consumers according to my estimates.
Q. Uh-huh. Isn't it true sir that as of today, OfficeMax imposes less of a competitive constraint on Staples than does Office Depot?
A. Yes. But OfficeMax is growing very fast. They are opening 120 stores; but as we sit here today, the answer is yes.

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Q. How do you turn this on. I'm a low tech person.
A. It is the orange button on right.
Q. That'll do it.
Sir in your direct testimony and a number of times on cross-examination you mentioned Wal-Mart. We agreed at the beginning of this cross-examination that the question was whether a competitor constrained price in order to be included in the market; is that right?
A. Yes.
Q. And in that Wal-Mart declaration, did not Mr. Long state that -- and I quote "The merged Staples and Office Depot will be able to raise prices on thousands of office supply items or SKUs. In addition, Wal-Mart cannot prevent the merged firm from raising prices on many of the same SKUs that Wal-Mart also carries."
A. He said that, but I read his deposition which is quite a bit different in that he says they do provide a lot of competition. I think Mr. Kempf calls these the amazing vanishing statements from the FTC deponents or whatever they are. In his deposition he said not only were they expanding the number of SKUs, he said he thought they provided a lot of competition. That came after he signed this. Yes, what he said he said.
Q. In fact, he said this more than once?
A. What in here?

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Q. Isn't there more than one declaration?
A. I don't know that. His deposition is the last word from Mr. Long's mouth. He said that they were expanding the number of SKUs. They were going to provide more competition, and he thought they certainly competed. That's what he said under oath.
Q. Isn't it true, sir, Wal-Mart only carries about a thousand SKUs of traditional office supplies?
A. In terms of your market definition which is general office supplies, I think the answer is closer to 3,000. Two to 3,000. Mr. Long I think testified to that. My memory could be wrong but I'm pretty sure that's right.
Q. We'll pass on it?
A. Okay. I have a pretty good memory.
Q. Well, maybe we won't pass on it then.
A. Okay. You need to look at Mr. Long's deposition. It is right towards the end.
Q. Would you agree, sir, that a merger can lead to a unilateral price increase if the merged firm can significantly raise its prices because the competitive constraint imposed by the other firm has been removed?
A. Yes. As I told you in my deposition, you usually expect to see that in branded type prices. If Budweiser were allowed to buy Miller's or Coors, I would definitely expect the price to go up just on that basis.

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Q. You do agree that Staples and Office Depot and Office Max view one another as their primary competitors; is that right?
A. Yes. They have a lot of other competitors out there, but they do view them.
Q. Those are the primary once?
A. Yes, I agree.
Q. Uh-huh.
Q. You testified in a case entitled Moore versus Wallace, sir; do you recall that?
A. Yes. Unfortunately, we did not win that case.
Q. Okay.
A. I do remember it.
Q. In your testimony in that case did you not conclude that, "Moore and Wallace often bid head-to-head and constrained each other's bidding behavior as the econometric results demonstrate; thus, the acquisition would have removed this important competitive restraint leading to bids and prices that are higher than they otherwise would be"?
A. Right. Moore and Wallace were the only two companies in the industry which had this very sophisticated computer system that allowed them to provide services that nobody else could provide. It had taken Wallace eight to 10 years to develop it. Moore had spent 70 or 80 million dollars and still didn't have as good as one. So this was a service

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nobody else could provide. Of course, in this merger Wal-Mart sells the same Post-Its that Staples and everybody else sells. But in that case, I absolutely said that. I still stand by it today. You had these incredibly sophisticated computer systems. Nobody else could provide them. They were a huge barrier to industry. In that industry as I testified, it was declining at a rate of about 5 to 10 percent a year. You don't expect any new entry. It is different from this industry where it is increasing at 10 percent a year. That's what I said. That's why I said it.
Q. Sir, if there is an office superstore market, the shares are very high of these three companies; is that right?
A. Yes. In my view there's not, as you know, but that would be true.
Q. You said in your direct examination that companies with only 10 percent of the market can't cause a competitive problem; is that correct?
A. Right.
Q. Okay. Let me for the moment accept your broad market definition and say these companies had 10 to 13 percent or a broader market. Let me try this hypothetical on you. Suppose an automobile market exists. That's a reasonable assumption isn't it?
A. I think the Courts have often decided that, yes.

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Q. And a combination of BMW, Mercedes, and Lexus would have less than a 5 percent market share; isn't that right?
A. Yes.
Q. And isn't it true, sir, that the price could well increase in the United States if those three companies merged; yes or no?
A. Yes, I said that in my paper that is being published in the Law Review.
MR. ORLANS: I have no further questions.
THE WITNESS: And the reason that that can happen is that people consider Lexus and BMWs to be close substitutes but a Post-It note from Wal-Mart is the same as a Post-It note from Staples, and that's why it is a different situation.
THE COURT: Thank you sir.
Redirect?
MR. GIDLEY: It will be brief.

REDIRECT EXAMINATION

BY MR. GIDLEY:
Q. Dr. Hausman, I'm putting up on the monitor Defendant's Exhibit 1968.
Are you able to read that?
A. Yes, I am. Thank you. It is not in color, but we can read it.
Q. Dr. Hausman, what is going on in this exhibit which

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compares the three-player, the two types of two-player and the so-called monopoly one-super-store-only markets in terms of gross margin?
A. Well, this is what Mr. Orlans was asking about. What you see is -- Your Honor, if you look at the Staples only market on the far right, it is 30.14 percent. If you compare that to Staples-Office Depot, it is actually higher, 30.89. In the three-player area, it is 30.99. This shows that Staples can't have a monopoly in a Staples-only area because if they did, they should have much higher margins. The margins are 30 percent in these other areas, 32 percent with OfficeMax. They should be probably 50 percent or higher when they "don't face any competition."
But demonstrating here how low they are, that just demonstrate how much competition you have.
Q. You may want to move your microphone.
A. I'm sorry. Professor Hausman, what effect does this have on the plaintiff's proposed office superstore-only market definition?
A. I think it demonstrate again that that can't make sense. If they were right, as Mr. Orlans just asked me, if Staples was a real monopolist in the Staples-only areas, they should have margins of 50, 60, maybe even higher. That's what we expect a monopolist to have.
Q. Economically, does it appear that people in the

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one-office superstore areas are getting some kind of raw deal from Staples?
A. No. Actually they are getting a good deal. They are getting a slightly better deal. Probably not statistically significant than a Staples-Office Depot area like Washington: so maybe Washington should move to Bangor if they are really interested in office supplies.
Q. Dr. Hausman, we talked earlier about PX-3.
A. Yes.
Q. I apologize. This doesn't quite do the job.
A. I can see it okay.
Q. You are able to basically make out the relationship there between the bars?
A. Right.
Q. And comparing this chart with the sort of prototypical PX-3 four-bar chart, what's going on in terms of product mix at Staples stores in your view?
A. Well, you can see again in the Staples-only areas which on the far right that they just get a much higher computer store. They are selling many more computers. 30 percent while in the three-player areas it is 13 percent and of course the two-player areas are in between. That's what I testified to, that they just sell a lot more computers in those areas. There's less competition, not as many Wal-Marts and Sam's and computer superstores, et cetera so people buy

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-- tend to buy more computers. You go to Los Angeles, at least when I drive around there seems to be a computer superstore on every block. And there's just a lot more competition.
Q. Let me show you Defendant's Exhibit 1972. Are you able to make that out?
A. Yes.
Q. In terms of net profit contribution, would you compare computers and office supplies, please?
A. Well, this is an accounting statement, so I'm not -- you know, I'm less confident in using this. At least according to the way they do their accounting, Staples says they are losing 10 percent on computers. Their second best is general office supplies. They get about 14 percent, which is again not high by any type of standards that I'm typically used to. For business services, it is interesting, I think that is a lot of things like coffee. That's where they do their best. They get about 25 percent. Again, nobody could argue there aren't a lot of Kinko's in this country. If you walk around downtown Washington, you see a lot of Kinko's.
Go around downtown Boston, you get a lot of Kinko's. That they are getting more profit says fundamentally how the business works. Nobody could argue they are monopolizing the Kinko's copy market.
Q. Let's direct your attention back to the colloquy you had

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on supermarkets. Can you give me any distinctions or similarities between supermarkets and office superstores in your economic view?
A. Sure. I think there is a gigantic difference. I think this whole focus on supermarkets is wrong. I don't know the exact percentage but supermarkets sell about 80 or 90 percent I think of a lot of different food items.
So we also know that the price elasticity for food is pretty low. If supermarkets drop their prices overall, they are not going to get much more business. People aren't going to eat a lot more chicken, not drink a lot more coke. Maybe eat a little more chicken. But people eat what they eat. There's not this big incentive for supermarkets overall to drop their prices.
However, if you look at office superstores, we could argue whether it is five or 10 or 20 percent, they have 80 percent of the market to gain out there. If Mr. Stemberg can go and get an extra five or 10 percent, he's going to make his shareholders very happy people and all of them make Mr. Stemberg a very happy person. So if there's so much business out to get, that's what keeps driving your prices lower. That's why the whole industry is coming down.
You can gain more and more share of the supermarkets unless they can convince people to eat more, which would not be good by and large. You are not going to

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get that much more business.
Q. I'm going to have just a handful of questions about econometrics.
Professor, all the testimony that we had about California and Pennsylvania didn't have anything to do with your gross margins work?
A. No. As I said, I included every store in the gross margins, and you end up with lower prices to consumers.
Q. And again, sir, we are dealing with a paper transcript, your gross margin analysis, your newest analysis is reflected in DX-6222; is that correct?
A. Right. That's the one based on 64,000 observations, right.
Q. We will have one more question in that area. I will come back to that in a minute.
Let me direct your attention to the monitor, Professor Hausman.
A. This I cannot read, Mr. Gidley.
Q. It is a vision test. Just one second.
A. Why don't you just read it to me.
Q. I'm going to read an excerpt from this.
MR. CARY: What is this, Mr. Gidley?
MR. GIDLEY: This is a roundtable discussion at the American Bar Association. The person being quoted is Chairman Pitofsky of the FTC.

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MR. ORLANS: I object. Is this in evidence.
MR. GIDLEY: This is a question for my economics expert. You opened the door by asking my expert what he thought about efficiencies whether they needed to be merger-specific, whether they needed to be passed through. This is redirect.
THE COURT: I will let him ask the question. This is not evidence, what Mr. Pitofsky said. You may ask if he can comment on efficiencies.
Go ahead.
MR. GIDLEY: I'm sorry, Your Honor.
BY MR. GIDLEY:
Q. Professor Hausman, would you briefly comment on the following Q&A? "Question: A showing that efficiencies be passed on in the form of lower prices. Do you think that's a central element of an efficiency showing? Answer from Mr. Pitofsky: I don't." If you skip on down, "I believe that the efficiencies are really substantial improvement and we are confident that they are there. Let's take a chance that they will be passed on. The worst thing that will happen is that the efficiencies will be pocketed but that other firms in the industry will then feel they have to duplicate their efficiencies, and that will be a pro-competitive device in itself."
Could you comment on the passage?

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MR. ORLANS: I object to the reading of that. It seems it is taken out of context where the full response is I don't and that's probably the most extreme minority position here.
MR. GIDLEY: Nonetheless, Mr. Pitofsky said it.
THE COURT Very well. Let him comment on it. I read the whole question. Go ahead.
THE WITNESS: Well, I've done a number of mergers with Mr. Pitofsky when he was in private practice and taught at Georgetown. In fact, I rode with him on the way to Richmond once. We were doing a merger three to four years ago. I was trying to convince him of this. How much I convinced him, I don't know. You can put this in context. But this is certainly my view. If Mr. Pitofsky has come around to this view I think he's getting much closer to what I consider to be the correct economic point of view. But, of course, Mr. Pitofsky can certainly speak for himself.
BY MR. GIDLEY:
Q. I would like one more question on the concept expressed in the last line. "the worst thing that will happen is that the efficiencies will be pocketed but that other firms in the industry will then feel they have to duplicate the efficiencies."
Could you comment on that in the specific context of the office products industry?

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A. Sure. That's exactly what has happened here is that Staples and Office Depot they were the -- they started this. They brought the prices down and got lower costs. They forced other people to get lower costs. I believe the gentleman from Wal-Mart said we get lower costs when they get lower costs a lot of the same times. They have contracts which force lower costs. When someone is out there that is competitive, you have to be more competitive, too.

To run to my daughter again, you are economic dead meat. This forces you to be competitive and makes the overall economy more competitive, leads to more jobs, helps people. That's my view of this.

Q. Have you heard of the term dynamic efficiencies?

A. Sure. That's the most important types of efficiencies we teach our students. Those are efficiencies that when one firm becomes more competitive, then other firms have to be -- excuse me, when one firm becomes more efficient, other firms have to become more efficient. In fact, my colleague Bob Solof won the Nobel Prize by demonstrating that dynamic efficiencies are much more important to the economy than static efficiencies, and they are the main reason of economic growth since World War II.

Q. We are going to return in the final time in my redirect to econometrics.

The topic is more forensic in nature. But the door

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was opened.

We have had a lot of discussion, Professor Hausman, with the inclusion, the exclusion of the California stores.

Can you first identify what I'm going to be asked to have marked as DX-9010. Are you able to read that?

A. Oh, sure, no problem.

Q. Could you identify that for the record?

A. Yes. Dr. Robert Levinson is an economist at the Bureau of Economics at the Federal Trade Commission.

Q. Who -- I'm sorry.

A. Excuse me. Ms. Karen Hull is a research assistant who works for me and is employed by Cambridge Economics which is a consulting company that I own. I told Dr. Levinson we would send him the California model. It would take a little bit of time to get it into shape. We did. All this says is this is a memo she sent him on February 18 that I was referring to. It says look here is the California model. There's a separate model. It said the enclosed diskette contains data for California stores which we estimated in a separate model. Then there's a bunch of computer lingo. It says this is an ASCII file that you can run this. So as I said there would be no problem running the regression. I checked with Dr. Baker who is head of the Bureau of Economics later and he said they had no trouble running it.

Q. Just so the record is clear. You sent this

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information -- you caused this information to be sent to the FTC; is that correct?

A. Yes. Federal Express.

Q. And in the first line, the reference to the separate model at the end of the sentence contains the data for California stores for which we estimated a separate model. What did that refer to?

A. That meant that on -- if you look at the next sentence, it says the files are similar in format to those sent on February 12. What that senence is saying is we sent you the previous model for the rest of the country on February 12, but here is model for California, and we estimated a separate model.

Q. The reference to the data sent on February 12, what had been sent then?

A. We sent a computer file with all the data and also with the program to run on SAS for the rest of the country.

Q. The reference in the next sentence that the file is named REG 2.SAS, what does that refer to?

A. That means there is a SAS program, as I said SAS is the most commonly used econometric software, I believe. All you have to do is stick this on a PC. It is called a self-excuting program. You don't have to do any programming yourself. You just put it on your computer, say execute SAS file reg.2.SAS and the results come printing out of your

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computer as soon as it can do the calculations.

Q. The final sentence of the first paragraph, "The regression variables are the same as those contained in the data file sent on February 12."

What does that refer to?

A. I had a phone call or meeting -- I think both actually -- with the staff in between and told them all the variable I used in the rest of the country model. This just says that this is really the same model. It is just estimated separately for California.

Q. The next line "Please feel free to call me with any questions." Do you see that?

A. Yes, I do.

Q. And did anyone call you from the Bureau of Economics with questions about the California model?

A. Well, this is from Karen Hull. I asked her. She said no one ever called her. No one called me. Of course I always encourage people to call me. As I said, I asked Dr. Baker. He said they had no problems running it.

Q. In the February time period did you have extensive discussions with the Bureau of Economics at the FTC?

A. Yes. I had a number of phone calls on Sunday afternoon, as I remember. Once at night. I went down there a number of times. I talked to Dr. Baker by himself and myself at least two or three times for probably an hour or so on the phone.

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MR. GIDLEY: Your witness.

THE COURT: Would you like to do any recross?

RECROSS EXAMINATION

BY MR. ORLANS:

Q. Just one question, sir?

A. Sure.

Q. Regarding the slide that Mr. Gidley just had up, did you say anything about stores that were excluded, the fact there were 16 stores missing?

A. I told Dr. Baker we excluded some stores. I didn't go into detail. It doesn't say that.

Q. It doesn't say anything about Pennsylvania either does it?

A. No.

THE COURT: Thank you, Dr. Hausman.

(Recess)

THE COURT: How are we doing on timing now.

MR. KEMPF: Let me ask the main controlling person. Do you have a current status there?

THE DEPUTY CLERK: Just a moment.

MR. KEMPF: Sure.

THE COURT: A few minutes ago the defendants had 12 hours and 16 minutes. The plaintiffs had about -- around 11 hours and 10 minutes or so. I am just worried about the rest of the day.

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MR. KEMPF: I understand, Your Honor. As soon as I get this exactly.

THE DEPUTY CLERK: For plaintiffs, I have 12 hours, 4 minutes. For defendants, I have 12 hours and 24 minutes.

MR. KEMPF: We are running pretty close. That means we have about split time left, Your Honor.

Here is my proposal. Going to the list I had outlined to the Court this morning, I have two that I thought would be about a quarter hour each. One is the consumer one. The two of them in total in terms of our usage of the clock would be less than half an hour. That would be the consumer presentation and Mr. Jacober. I would propose to do that and then rest. What I would like to do -- and I will gather the few declarations I referenced this morning, Your Honor, turn those in at that time.

I would then rest. What I would like to do is I would very much like to use the Stephan videotape, and I will discuss with the government over the noon hour either doing that then or if they say we could run the full day resting subject to showing that if I have more time on the clock. If not, I will trust the Court to consider looking at that videotape.

THE COURT: You are proffering to the plaintiffs if they get their rebuttal starting around 2:00, if we start at 1:30?

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MR. KEMPF: They may want to cross Mr. Jacober. As I said, his direct would be 15 minutes. Then we would turn it over to them.

THE COURT: Mr. Cary, your estimate of rebuttal time?

You have -- I forgot how much time you have left. You may have 3 hours left, or a little less. Can you get it?

MR. CARY: We have a relatively extensive examination of Mr. Painter, who is our expert on the efficiency issues. We would then anticipate a relatively short rebuttal by Dr. Warren-Boulton, and it is likely that we would have a short rebuttal by Dr. Ashenfelter.

THE COURT: Well, let's see how long they are.

I think maybe we can still get it in this afternoon. It may be later this afternoon when we finish.

MR. KEMPF: We will accommodate our cross-examination to fit the clock.

THE COURT: We will be back at 1:30 after lunch.

(Recess)

AFTERNOON SESSION

MR. ORLANS: One quick housekeeping matter. I would like to offer and mark a document I should have marked and offered before. It is the one with the .9 percent number we all thought was the overlap market. It turns out not to be

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that. We would like to mark it as Plaintiff's Exhibit 411.

MR. KEMPF: I have no objection. This is actually one of the tabs to defendant's declaration for Mr. Hausman. He has this attached as one of the attachments.

THE COURT: 411 then. Are we ready to go with the next witness, then?

MR. KEMPF: We are, Your Honor. The afternoon schedule -- first, let me make one announcement. Mr. Fuente's chair is not filled this afternoon. His daughter who is a junior in high school has her prom this evening. He promised here he would be back for that. I told him he could leave. He will be back for the oral argument.

The next thing we are going to do, Your Honor, is the presentation of consumer evidence, which will be relatively, short followed by Mr. Jacober; and my partner Tefft Smith will do both of those.

THE COURT: All right.

MR. SMITH: Good afternoon, Your Honor. Just briefly before I begin, I would like to introduce to the Court Colin Cass, my able associate who has worked very long on this case for me and Doug Jaczinski, a legal assistant from White & Case. He and his staff have done yeoman work and are here to be acknowledged.

I am here to briefly review what the consumers have to say, and then we will talk about -- in those immortal

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words -- the survey says and the FTC says, what our advertisements commit, and then we will offer the testimony of Steve Jacober of the School and Home Office Products Association.

The first consumer we want to talk about here is Kevin Hall, a consumer here in the District of Columbia.

And what he talked about in his declaration, and this is DX-1779 in the record is that, "The information and technology age is hitting my company in full force. Paper is now used only to print out final documents: it is rarely used to record information."

And as in our exhibits, we show at DX-6181 which used to be DX-3-145, technology has caused computer and office retail formats to converge as is evidenced from the various number of transitions that have taken from the place over time in the traditional office to today's office.

MR. CARY: Again, Your Honor, I hate to interrupt,, but given the time is short, if we could get to the evidence and avoid the arguments since this is the evidentiary phase.

THE COURT: I think they are just going to highlight for me these declarations and then the exhibits.

MR. SMITH: Mr. Hall goes on to say, "In my business, it is important to be cost conscious. Savings on office products is an expense that has grown over the last three years, and the question always raised is `why are we

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buying this?' Unlike many other purchasing decisions, if we reduce our costs on office products, it is a dollar-for-dollar increase in the bottom line of the company."

Other declarations make slightly different points. Lynda Smith, Port Huron, Michigan, DX-1800, "Currently I purchase most of the church's office supplies at two locations: Staples and Kerr-Albert, a local retail office supply store that sells office supplies, furniture and equipment. While I use each store for about half of my purchases, I buy most of the smaller items, such as paper clips, from Kerr-Albert. If they lower prices I would buy more from them, but if they raise prices, they would lose my business."

In context, the they they are referring to is Staples and Office Depot. Barbara Helming, Louisville, Kentucky. "The true competition for my business is between Central Office Supply and Staples. Even without the merger, if prices at the Staples store where I shopped increased, it is unlikely that I would go to the Office Depot store. Rather, I would increase my purchases at Central Office Supply. On the other hand, if prices were to decrease, I would buy significantly more from Staples and less from Central Office Supply."

I'm reminded, Your Honor, that I did have a binder

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for you as we have had with some of the other witnesses and one for your law clerk as well.

And as has been in the past, all of the references are in there as well as the exhibits that we are going to use with Mr. Jacober.

Now the FTC's e-mailers also made comments that we thought were important to bring to the attention of the court. Charles Shindler, Norman, Oklahoma, stated, "I believe that competition from outlets such as Wal-Mart, OfficeMax, CompUSA, Circuit City, et cetera, will force Staples to maintain reasonable prices for their merchandise." DX-1797.

Patrick Gannon from Incline, Nevada, "The superstores have vigorous competition in all areas, including mail-order catalogs and the developing number of electronic catalogs on the Internet, for the SOHO dollars and retail dollars."

James Sackern, from Omaha, Nebraska. "I have in the past chosen between retail stores such as Office Depot, OfficeMax, Best Buy, discount stores, such as Target, Sam's Club, and MegaMart, and have mail-order and Internet direct buying available. I truly believe that I have more options for purchasing supplies than I could ever need."

Now other consumers from the FTC e-mail say, this is Dennis Rardin from West Mart, Illinois. "Also consider

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the impact of the merged company in smaller markets which still lack an office superstore. The merged company will, I'm sure, expand more quickly into the smaller markets than either company would want or be able to on its own."

DX-1075.

Wilda Parks from Hanford, California states ,"Staples has a history of and a commitment to low prices every day. They could not stay in business without such a commitment. I believe that Staples and Office Depot will continue their history as low price leaders once they are merged. If they did raise prices, it would badly tarnish their reputation in the marketplace."

Now, the FTC's own declarants -- they offered several declarations where we went out and got declarations to amplify upon them -- clarify their earlier declarations. Ray Blank was one. "At the time of my declaration, I told a representative of the FTC that I was not aware of other stores that would have a similar stock and prices as that of Staples and Office Depot. However, since that time I have had a number of sales representatives from various mail-order office supply companies call on me. Their prices are competitive and some have offered to deliver office supplies even if I order one item, the same day."

Thomas Russ, another FTC declarant stated that, "If prices were raised to a level in the Leesburg, Florida store

D. 1769ff: Inconsistent decs

that I felt was unreasonable I would seek the lowest price source for my supplies elsewhere.

"I wrote the original letter because I am a cost conscious consumer and felt the price disparities were not justified. I shop office supplies on a continuous basis."

He then went on to say that, "In fact, my office in Leesburg is only a quarter of a mile from a Wal-Mart store and less than one-half of a mile from a Kmart. These stores simply did not have the variety of office supplies that I need for my business, including essential items such as the toner for my copy machine and packages of 100 third-cut file folders."

You may have wondered yesterday while Mr. Assaf pointed out that little spot over on the DX- number which -- I don't have the number, I can't quite read the number, but you remember the big photograph in there in the Wal-Mart planogram are 100 cut-file folders.

MR. CARY: Again, Your Honor, we objected yesterday. We asked for documentation of what this shows. None has been provided.

MR. SMITH: That's because it all was provided previously to them, Your Honor.

THE COURT: These are the blown-up pictures you are referring to?

MR. SMITH: Yes, of which they had small pictures

before. They certainly have the ability to talk to Wal-Mart and know the background on that.

THE COURT: Go ahead.

MR. SMITH: There have been a number of consumer surveys in the record. IN 1995, Office Depot conducted what they called a VIP survey of consumers. That VIP survey showed that 40 percent of the people surveyed say they purchased office products most often from somewhere other than an office supply superstore. 40 percent say they use warehouse clubs. Thirty percent say they use mail-order. Thirty-five percent use local dealers.

These are in-store customers. Forty percent say price determines where they shop.

A survey that was just completed here over the last month in April and early May by the respected firm of Shapiro & Associates which is in the record as -- concludes that it was a survey of seven city pairs, 14 markets, and 700 double blind interviews. That is to prevent any bias from being obtained, that there was anybody that was influencing the outcome as to who was doing it.

And the conclusion of that study which has been provided to counsel for some time states that when deciding where to purchase office supplies, price is by far the most important factor, 78 percent; followed by delivery, 30 percent; convenient location, 28 percent; quality, 28

percent; and having what they need in stock, 21 percent.

This is DX-1836.

Purchasers stated that they had an average of 4.7 available office supply sources in addition to Staples.

The central conclusion of this study -- quoting from the study -- is that a great deal of competition exists. Only 1 percent of Staples customers name Staples as the single source of office supply products that they buy.

Now, I know we are -- and this is the detail on the results of that study; that's the next thing. I know the Court did not give much credence to the FTC Internet web site survey; but in any event, it is here for purposes of the record. But the final -- this is the up side, downside sort of numbers we have experienced here generally.

As you can see under the FTC's own web site, unsolicited, it was 62.3 percent in favor of the merger, 38.7 opposed; and what was interesting, the FTC closed down the web site.

The FTC itself has spoken as a consumer as we saw in the opening argument. 105 different suppliers.

Your Honor, I would now like to call Mr. Jacober.

THE COURT: Thank you.

STEVEN JACOBER, DEFENDANTS' WITNESS, SWORN

MR. SMITH: Your Honor, the exhibits we are going to use with Mr. Jacober are at the very back end of this

binder. I think it is under tab C at the very, very back end.

THE COURT: All right.

DIRECT EXAMINATION

BY MR. SMITH:

MR. SMITH: If I may have a minute, Your Honor, just to give him a set of the exhibits.

Sorry, Your Honor.

Q. Could you please introduce yourself to the Court, Mr. Jacober?

A. My name is Steven Jacober.

Q. And by whom are you currently employed?

A. I am currently employed by the School & Home Office Products Association otherwise KNOWN as SHOPA, as president.

Q. And can you tell us what SHOPA is?

A. SHOPA is a trade organization, a trade association comprised of approximately 1400 corporate members, manufacturers, retailers, wholesalers, manufacturer representatives, all of whom are involved in the distribution of school and home office supplies.

Q. I'd like to direct your attention to DX-1819 which is now up on the screen and is in your book there. And ask you what that is?

A. That is a membership list of SHOPA as of December 1996.

Q. Now, are the office supply superstores members of SHOPA?

A. Yes, they are.
Q. Is Wal-Mart a member of SHOPA?
A. Yes, it is.
Q. I would like to show you an exhibit that has previously been marked in this case as Defendants' Exhibit 6027. You can see it right there on the monitor.
Are the companies that are listed here as retail sellers of office products and dealers and contract stationers and these other people, are these people who are members or attend SHOPA functions?
A. Yes. They are members.
Q. Prior to -- when did you become the president of SHOPA?
A. A little over a year ago.
Q. Prior to becoming the president of SHOPA, what did you do?
A. I was affiliated with an organization called McFadden Trade Publishing, most recently as its president and prior to that, as publisher and editor of Discount Merchandiser magazine.
Q. What subjects did Discount Merchandiser magazine cover?
A. Discount Merchandiser covered a wide variety of topics related to the retail industry from the supply, retail, distribution, marketing, merchandising, a whole host of product categories, including the office supplies category.
Q. And can you please tell us how long you have been

involved with the office products industry?
A. Including my employment with Discount Merchandiser magazine and SHOPA, probably a little over 11 years.
Q. And what have you done to familiarize yourself with that industry?
A. Through constant interaction with both retailers, suppliers regarding the industry, talking to industry experts, consultants, writing articles, and in addition to that, conducting or publishing an annual statistical overview of the marketplace.
Q. Have you done consumer interviews, any kind of consumer work on views of consumers?
A. At the annual SHOPA show, the trade event of our association, we do conduct consumer focus groups as well as having been exposed to consumer research through attending a wide variety of industry functions and also through market research firms and industry experts.
Q. As part of your responsibility to either SHOPA or while you were involved with the Discount Merchandiser, have you ever tracked office supply SKUs or counts of individual office products retailers?
A. No, we have not.
Q. Why not?
A. The SKU counts vary widely from store to store. It is an extremely unmanageable type of endeavor, so it is

something that we have never gotten involved in.
Q. And as part of your responsibilities with SHOPA or the Discount Merchandiser, did you ever track or compare with precision the actual pricing strategies of the various office products retailers?
A. Again, no, we did not. The prices varied so dramatically that a year-end summary or overview of the pricing for our purposes would not be, you know, a worthwhile endeavor.
Q. What types of information do you collect or distribute for your membership as part of the functions of SHOPA?
A. As part of SHOPA's endeavors, we publish on a yearly basis a strategic overview and distribution trends report which basically covers wholesale, manufacturer, shipments to a wide variety of channels of distribution as well as product categories. In addition to that, we also disseminate on a quarterly basis the results from some Neilsen research which is results of POS scan data.
Q. What does POS stand for?
A. Point-of-sale. In addition to that, we conduct, as I mentioned before, consumer focus groups at the show as well as conduct on a biyearly basis an educational seminar for the industry.
Q. What are those consumer focus groups designed to measure and what information are you trying to obtain?

A. Basically to obtain input from actual consumers, whether they be small business people, students, teachers on reactions to various trends in the marketplace.
Q. Now, do you personally play any role in gathering this information?
A. As president of SHOPA, I'm involved in these projects from start to finish; and really have responsibility for the integrity of the data.
Q. Now, what kind of information did you collect and distribute while you were involved at Discount Merchandising?
A. While at Discount Merchandiser as publisher and editor, I conducted a variety and a broad breadth of in-depth interviews with leading retail executives, manufacturer executives, industry consultants, experts, as well as the results of research on a wide variety of sources that influenced the development of trends within the marketplace.
Q. Did you have a title for what you called that?
A. Well, our annual true look statistical issue of the industry would comprise a wide variety of data including government statistics, research reports from other trade associations, input from retail research surveys, as well as input from leading industry experts and consultants.
Q. Based upon your experience in the industry, can you provide us your perspective on competition in the sale -- in

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the retail sale of office products?
A. Well, based on my experience, the development of the office supplies market has basically mirrored that of retailing in general. Back in the 1970s, the discount store phenomenon basically revolutionized the retail industry by concentrating on low prices, high volume sales, high turnover sales.
As this concept evolved and took root, there were many branchings and developments of similar type formats. Perhaps in the late '70s, the wholesale club format could be something that would have a similar development. Except with the wholesale clubs basically concentrated really on the fastest moving SKUs or, you know, concentrating on low prices, high volume.
Following this evolution, the development of the category dominant retail category which includes of course the office supply superstores took this to a different level, concentrating on one broad category of merchandise with the underlying themes of low prices, high volume, low margin.
Q. Now, you used the phrase "category dominant." What do you mean when you used the phrase category dominant?
A. Category dominant basically refers to a retailer who is involved in a broad line of related merchandise, whether it be office supplies, sporting goods, apparel, areas like that.

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Q. Now, does dominant mean that you don't face any competition other than those firms that have a similar format?
A. No. Based on our perspective and our view of the industry, the industry is extremely competitive. You know, period.
Q. Is that competition based solely on price or are there other factors that have an effect?
A. When you take a look at what really motivates the consumer to shop for a product at a given location, there are basically three parts of the value equation. Price, of course, is exceedingly an important part of this equation but also service, convenience, translate into value for the consumer.
Q. Now, I would like to direct your attention, sir, to Defendants' Exhibit 1759. Can you tell us what that document is? Let's hold off putting that up for one second. Let's just look at DX-1759. Can you tell us what that document is?
A. This is a piece of information that was presented at the 1995 SHOPA educational seminar.
Q. Can you tell us a little bit about that educational seminar, what happens at a SHOPA educational seminar? Who the participants are?
A. Basically at the 1995 seminar, there were a little over

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200 retail manufacturer executives in attendance. The format basically took the course of, you know, having industry experts speak on given topics that impact the industry.
Q. Now, as part of that educational presentation -- and if we can put on the overhead -- this is taken from pages 19 and 20 of DX-1759, -- can you tell us what this is and what the point was that was made as part of that presentation?
A. Basically, this piece of information attempts to capsulize the development of what is going on in the retail marketplace, specifically in the school and home office supplies industry; and that as players in the industry, competitors in the industry seek to increase volume, increase sales, basically expand, grow their business, creating larger organizations which, in turn, place themselves in a position to have leverage with their manufacturer suppliers, whether it be in the terms of lower prices, greater efficiencies in the distribution process; more or less to take operating costs out of the system.
As this occurs, these retailers gain additional sales, become more profitable, reinvest in their infrastructure and their distribution processes to continue to lower costs, which, in turn, completes what we call the productivity loop in that increasing sales and volume.
Q. There are two parts to this exhibit. One talks about the opportunities; one talks about the risks.

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What is the -- what are -- the opportunities we have heard about. What are the risks of falling aside of the productivity loop?
A. As the marketplace becomes more sophisticated and players increase their efficiency, those entities which are not able to -- whether invest in their infrastructure, distribution, MIS systems, either fall by the wayside or develop new niches, new markets.
Q. Does this concept here apply to the office supply superstores?
A. In my opinion, yes, it does. Basically the office supply superstores did indeed revolutionize the distribution of office products in general in terms of creating opportunities to take advantage of greater efficiencies and, therefore, lower costs.
Q. Does this productivity loop have consequences throughout the industry?
A. Without a doubt, once again those formats or types of stores that are not able to compete, that are not able to increase their efficiencies will, unfortunately, fall by the wayside. Or will also, on the other hand, increase the efficiencies of those players who are able to compete; will try to and do indeed become better retailers for the introduction of new opportunities.
Q. Are you familiar with the allegations the Federal Trade

Commission has made in this case?
A. I'm familiar with some of the FTC --
Q. Have you read the FTC's brief and their reply brief?
A. Yes, sir.
Q. Now, the FTC asserts that consumers do not have realistic other alternatives than the office supply superstores for one-stop shopping for office product supply. Do you agree with that?
A. Based on my own perspective and my experience in the industry, one-stop shopping as a concept is basically a misnomer. Whether you are addressing individual consumers or businesses within the industry seeking to purchase product, the purchase of product is basically need-driven, focused; so for the consumer, because the consumer is hard-pressed for time and has such a plethora of alternatives available to them to make their decisions based on actual need at a specific point in time, so that their needs will be full tilled and their expectations satisfied. From a business perspective because once again the need is very focused, the -- you know, one-stop shopping concept may not even be relevant.
Q. But isn't the reason that the superstores carry such a wide selection of products is so that they can provide one-stop shopping?
A. I think that's part of the reason, but it goes well

beyond that. If one takes a look at the old retail 80-20 average where 20 percent of your merchandise mix generates approximately 80 percent of your volume, if you look at in it this respect -- and I think it is applicable -- that the broad and deep range of product offering basically provide an opportunity to gain incremental sales volume.

In addition to that, also create efficiencies for dealing with manufacturers who offer a broad range of product so that by being able to satisfy those needs and work with the supplier, again make a statement to the consumer so that when that consumer does, indeed, go to shop for a specific product, that consumer can be guaranteed that product will be in stock and on store shelves.
Q. Now, what are some of the alternatives that you would see from the work that you have done for consumers if Staples/The Office Depot, the new company, were to after the merger, the day after, ceteris paribus -- isn't that the phrase you used, Dr. Warren-Boulton, isn't that the phrase? -- all things being equal, prices would just jack up five percent the day after the merger? Are there alternatives that consumers would have to go if that were to occur?
A. In my opinion, yes, it would be based on the research we have done for the strategic overview and distribution trends report measuring wholesale shipments to a variety of channels

of distribution. Those channels include traditional discount stores, whether it be a Kmart, Target, Wal-Mart, wholesale clubs. If I am an owner of a small convenience store when I go to pick up my coffee filters and gum, pick up office supplies, whether it be drug stores and supermarkets which are also becoming very involved in the office supplies market, to the traditional dealers, contract stationers, mail-order houses; again I think that opportunities are there.
Q. Has SHOPA been tracking the Internet?
A. To some degree, yes, we have. The Internet and its potential impact on the consuming public. I have been exposed to reports that claim anywhere from five to 15 percent of total retail sales can at one point be done or could at one point be done electronically.
Q. Now, are you familiar with the concept of a profit maximizing strategy for a company?
A. That's a company's reason for being.
Q. And would it be in Staples/The Office Depot's profit maximizing self-interest to raise prices after this merger based upon your experience and knowledge in the industry?

MR. BROYLES: Objection, foundation, Your Honor.

THE COURT: Go ahead. I will allow it. He is testifying to experience after 11 years in the discount industry.

THE WITNESS: Could you repeat the question.

BY MR. SMITH:

Q. The question is whether it would be in the profit maximizing self-interest of the new entity Staples/The Office Depot to raise prices suddenly the day after the merger in office supplies without regard to any change in demand or supply or anything else?
A. Based on my experience, when prices rise consumers shop or seek to -- you know -- obtain product through different alternatives.
Q. Now have you or your organization done any specific study analyzing this proposed merger?
A. No, we have not.
Q. Are you or your organization either in favor or opposed to this merger?
A. We are neither in favor nor opposed to this merger.
Q. Now, I would like to show you what is another page from DX-1759. And ask you to describe what this is.
A. Basically again this is one of the results of -- from the 1995 educational seminar sponsored by SHOPA.
Q. What does this -- is this graphic that comes from page 15 of DX-1759 designed to show?
A. Basically, this is designed to show the types of pressures and challenges which confront basically all of our members across segments that, you know, the intensely

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competitive situation in the marketplace is truly creating challenges for the retailer and supplier to maximize their efficiencies and to satisfy the continued consumer demand for price and value.

Q. Now, within that box or however you want to call that nifty looking thing that all the arrows are pointing at are the office superstores there?

A. Yes.

Q. As well as the other entities that I think that we saw -- technology is -- we didn't get it.

I wanted to show the multitude of competitors chart.

Now, -- there we go. The consumer, you say, plays an important role in this whole industry dynamic. Why is the consumer so important?

A. Basically, in our opinion the consumer is what is driving the marketplace today unlike in times past. The consumer today is extremely sophisticated, exposed to more information, better information, is more aware of their alternatives that they have. There's not a single retailer nor manufacturer that can dictate to the consumer where they will buy at what price they will buy.

Q. Now for SHOPA's -- any of SHOPA's membership, is there a negative from this merger?

A. Yes. There is. We include as our members many

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manufacturers both large and small who given a larger retail customer will be forced to negotiate much more efficiently, whether that be, again, in the sense of lower prices, greater promotional support; again helping to take costs out of the distribution process.

Q. Is there a yin to that yang?

A. Well, basically, as people work to take costs out of the distribution process, lower operating costs, eventually it ends up being in the best interests of the consumer who again drives the marketplace.

MR. SMITH: No further questions, Your Honor.

THE COURT: Thank you, sir.

Mr. Broyles?

CROSS EXAMINATION

BY MR. BROYLES:

Q. Good afternoon, Mr. Jacober?

A. Good afternoon.

Q. You mentioned in your direct testimony that there are several retail firms that consumers could turn to if prices were to go up after the merger?

A. Yes, sir.

Q. And is it -- it is correct that you have no personal knowledge of the price practices of any of these retail firms; is that correct?

A. No specific knowledge nor have I done any specific

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studies relative to individual retailers. Just based on my experience.

Q. So you can't tell the Court today how high prices would have to go before consumers would turn to these other alternatives, can you, Mr. Jacober?

A. That's correct, sir.

Q. And when you said in your declaration that if prices rose after the merger, that consumers could also turn to contract stationers, you also did not have any specific information as to how high prices would have to go before they would turn to those alternatives, did you?

A. Yes, sir. That's true. We have not conducted any specific surveys relative to that.

Q. Nor do you know for sure how mail-order prices for office supplies compare to retail sales for office supplies; is that correct?

A. In terms of again individual specifics with regard to individual companies, no, I don't.

Q. But you think that generally mail-order prices are higher than retail prices; is that correct?

A. Yes, sir.

Q. Now, you referred to the -- I guess the yin or the yang I guess in response to Mr. Smith's question about the impact on your members. Have any of your manufacturer members come to you and told you that they will have to give lower prices

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to Staples/Office Depot after the merger?

A. We have not discussed with any of our members any of the specifics about this merger.

Q. But you do know that office supply superstore prices vary from city to city; is that correct?

A. Yes, sir.

Q. And you know that because you've observed these different prices in different cities, isn't that correct?

A. Yes, sir.

Q. And you are not in a position today, Mr. Jacober, to deny the allegation that those price differences correspond to the number of superstores in those particular cities; is that correct?

A. I'm not quite sure whether I can or I cannot. I would have to take a look at other types of information. Granted, the number of stores in a marketplace play a role in setting prices, but there are other factors such as retail costs, retail real estate costs, costs of labor, advertising efficiencies, things like that. So I couldn't say one way are the other.

Q. That's not something you have done?

A. Correct, sir.

Q. So you are not in a position to deny that allegation?

A. Correct, sir.

MR. BROYLES: Nothing further, Your Honor.

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THE COURT: Thank you, Mr. Broyles.

MR. SMITH: I have no further questions, Your Honor.

THE COURT: Thank you, Mr. Jacober. You may step down.

THE WITNESS: Thank you.

(Witness excused)

MR. KEMPF: I am handing the government two declarations, Mr. Fuente's, which we marked as DX-9015 and one from Mr. Helford, which we marked as DX-9060.

MR. CARY: We strenuously object to this. They were supposed to have their case in about three weeks ago. Nonetheless, they have continued to provide declaration after declaration after declaration even after discovery cut off. They provided even more declarations. To now provide a declaration from a witness that has signed a declaration, been deposed and another one from their client, obviously they could have gotten that declaration before the Court's ordered cutoff without giving us an opportunity to cross-examine is prejudicial.

MR. KEMPF: They have taken the depositions of both of these witnesses, Your Honor. Mr. Fuente I cut in the interest of time. I have one point that is in there. I think it is -- comes with ill grace for Mr. Cary to talk about late arriving exhibits.

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THE COURT: I am going to do this. Because Mr. Fuente was here the whole week and expected to be a witness and because of time constraints cannot be, I don't think it is unfair to attach his -- whatever relevant portion of the deposition -- of the declaration the parties defendants want to put in. There's rebuttal. If you want to put in some part of his declaration that's not included, the government can do that or put part of the deposition in that may refute that.

What is the other declaration?

MR. KEMPF: I have one from Mr. Helford, Your Honor, who was scheduled to be a witness. We cut him yesterday. The -- it is a one-pager. All it does is attach -- all it does is comment on one other document that is already an exhibit, DX-855. DX-855 was a declaration that the FTC drafted for his signature back in.

Mr. Helford reviewed it. Took a lot of time. Made line-by-line edits. Gave them a couple of riders to attach to it, including the information to the FTC he thought the merger would intensify competition for office product sales. This is a document they had since February. It is -- as I say the document is already in evidence. He just authenticates it here and says that this is indeed something I sent to them.

THE COURT: I will accept it. I think he was on

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the witness list. He was expected to testify. I don't see any prejudice to bringing in a document that was earlier filed. I had one or two others,.

MR. KEMPF: I had one or two others, Your Honor. I will get my list here.

One I mentioned this morning. This is not it. Hold it.

This is a declaration we filed yesterday. It is a one-page declaration of Mr. Becker. The question came up who made this, where did they get the numbers on that chart on the stock market prices I used in my cross-examination of Dr. Warren-Boulton.

And we put that in to show where that was made from. That was Mr. Becker, who is my associate, who is both a lawyer and a Ph.D. in economics.

That was actually provided last night.

I then said -- I see Mr. Assaf here. Do you have that?

MR. ASSAF: I do, sir.

MR. KEMPF: I said to him, I'll bet they went out and cherry-picked those eight items at McWhorter's. Why don't we send everybody to the -- why don't we send somebody out and see if we can't find eight items that go the other way. I bet we can. Sure enough, we could, Your Honor. My only purpose in that is to respond to what they put in

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evidence on cross examination. They weren't under any obligation to disclose it. Having disclosed it yesterday, I said I'll bet we can get eight items that go the other way. Sure enough we could.

I want to show that in the record, Your Honor. I'm sure McWhorter's on the average charges more in terms of its greater service to the community commitment. I just want to show the story is not as one-sided as the government would have the Court believe. Our people went out last night, got that. Here it is right now.

THE COURT: Those will be marked in as part of your case. That's McWhorter's and Becker's.

MR. KEMPF: I had one other item of information that really didn't -- I really didn't focus on until during the trial. I had someone get this information. There's been a lot of talk about the store openings planned by OfficeMax and during discovery, we did get from them highly confidential information on that score which is in the record that the Court has heard references to 120 to 150 store openings. Some of those openings are in so-called two-to-one towns, towns where the merger will change it from two-to-one.

I said in my opening, very quickly, if any of those change from ones back to twos because of store opening plans. We have that in there. It occurs to me one of the benefits of the merger is the existing and increasing store openings planned by newco. I asked the Staples people if they had a schedule of store openings, and they sent that to me. It is like about a five-line document that says here is the current schedule of our store openings, Your Honor. Five line declaration with an attached computer printout of what -- of their plan. I would ask that this be marked highly confidential.

THE COURT: Mark it highly confidential. It has the competitive business necessity for keeping it under seal at this time.

MR. KEMPF: That is -- other than that technical thing I would like to do, Your Honor, I think we have under the stipulation already moved all of our documents into evidence with objections going to weight other than specific objections.

And we would -- we will undertake to provide the Court by Monday with a list setting forth all the ones we have. I think we have two lists in already. We have two lists in already and will provide a supplemental list and a binder of the -- in case you are short on binders back there of these additional exhibits.

Mr. Orlans reminds me there is one exhibit he raised with me earlier today that the government says was an inadvertent production of a document that should not have

been produced that is on our list. I think it is DX-2204. I told him I would either withdraw it voluntarily or give them an opportunity to specifically address that one, Your Honor. I am happy to do that.

I would also -- one of the people mad over there from the company called FTI has been our principal slide maker and operator. There's a bunch of his people. On behalf of them, I would like to acknowledge their assistance to us in this trial, Your Honor.

The only thing I have left that I hadn't already said that we would discontinue was the showing of the Boris Stephan -- what I refer to as the Sergeant Schultz videotape. What I will do on that, Your Honor, I will rest provisionally. If we have time at the end of the day, we will show that. If not, we are content to let that in the record and will provide the Court with a copy of the videotape.

But subject to that, the defense rests, Your Honor.

THE COURT: Thank you. I have filed and not ruled upon -- but I will wait until the completion of the case -- on the motion to dismiss the -- I guess find an additional or an alternative market by the government.

MR. KEMPF: Your Honor, I got in court yesterday their response to that. I frankly have not read it yet. I

will try to do that and get a response -- could I have until Monday to do that, Your Honor.

THE COURT: You can have until Tuesday because I am not going to read it on Monday. You can file it on Tuesday.

MR. KEMPF: Thank you, Your Honor.

THE COURT: Mr. Cary?

MR. CARY: Thank you, Your Honor. Your Honor, at this time we are going to take our cue from the defendants and do our own rebuttal presentation from the declarations to start off and then we will call our first witness.

THE COURT: Thank you, sir.

MR. KEMPF: Your Honor, my only ---I have a question whether this is really rebuttal. It strikes me this was introduced by them in their case, all these declarations. In terms of being rebuttal, they all precede what they purport to be rebutting.

THE COURT: Let me see what the contents are.

MR. CARY: Your Honor, this is in the spirit of your permission to supplement what they have put up.

THE COURT: That's what I was referring to when I said that. This responds to the ones that the defendants had focused on.

MR. BROYLES: Yes, Your Honor.

MR. KEMPF: So the record is clear, Your Honor, and I understand the Court will let them do this, what we talked

about supplementing was supplementing things from the same declaration. I take it these are from earlier and different declarations.

MR. CARY: Same witnesses.

MR. KEMPF: It is not exactly what we talked about.

THE COURT: Looks like some are, some aren't.

Go ahead.

MR. BROYLES: There is one that is not in your binder, a declaration of Mr. Tom Russ. I will hand that up.

MR. KEMPF: Is this the one that says I can't get the hundred SKUs at Wal-Mart? If it is, I read it which is what prompted me to ask Mr. Assaf if he could get a photo of the hundred SKUs at Wal-Mart.

MR. BROYLES: You have it.

All right, Your Honor, when the defendants started their case they told you they would tell you the rest of the story. We decided we would tell you the rest of the rest of the story.

Just the last thing that was handed up to you was a declaration from Mr. Tom Russ who, as you know, provided a declaration to the defendants. And what Mr. Russ actually says or actually believes is stated in this declaration. I will read portions of it.

Paragraph 1.

"My name is Tom Russ. I am writing this affidavit to set the record straight and to clarify any confusion that may exist between the statement that I signed on May 7, 1997 and my opinion about the merger between Staples and Office Depot. I am the same Tom Russ who wrote a letter on March 17, 1997, to William Baer, the director of the Bureau of Competition at the Federal Trade Commission, in which I enclosed advertising circulars showing that the prices at the Office Depot store in Leesburg, Florida were significantly higher than the prices at the Office Depot stores in Orlando, Florida for the identical items. As the owner of a Leesburg, Florida real estate agency with seven employees, I am very concerned about this merger"."

I will skip down to paragraph 3.

"After further reflection and time to compose my thoughts, I would like to clarify my statement with the following observations and information. In Leesburg, Florida there is only one office supply superstore -- an Office Depot store. Unlike Orlando and other cities in Florida, the Office Depot store in Leesburg does not compete against Staples. The higher prices in Leesburg compared to Orlando is no secret. I observed the price differences after comparing Sunday advertising circulars for the same items at the same time earlier this year. In fact, I sent a letter to David I. Fuente, the chairman and CEO of Office Depot on

February 11, 1997 pointing out these price differences and enclosed copies of the front page of the flyers, and I requested him to personally review the pricing issue. Mr. Fuente has yet to respond to my letter or explain in any way why Office Depot charges more for the same office supply items in Leesburg than in Orlando. I believe that the lack of competition in Leesburg explains the higher prices compared to the Office Depot stores in Orlando."

Skipping down to paragraph five.

"As a result of these price differences, I am very worried that Staples and Office Depot will be able to raise prices in markets where they directly compete, such as Orlando, Florida. Although I said in my May 7, 1997 statement that I would seek the lowest price for my office supplies elsewhere if there would be a 'unreasonable' price increase in Leesburg, in reality, there is nowhere else for me to shop in the Leesburg area where I can buy all of the office supplies that I need for my business. I have looked at the office supplies sold in Wal-Mart, Kmart and other retailers. In fact, my office in Leesburg is only a quarter of a mile from a Wal-Mart store and less than one-half of a mile from a Kmart. These stores simply do not have the variety of office supplies that I need for my business, including essential items such as the toner for my copy machine and packages of 100 third-cut file folders. "

Paragraph 6: "Mail-order office supply companies send me catalogs from time to time, but I do not use them because I am usually in immediate need of office supplies."

Skipping down to the last sentence of that paragraph. "In addition, I usually do not buy enough items to meet the minimum purchases necessary to avoid shipping charges."

Paragraph 7: "In reality, a 'unreasonable' price increase that would cause me to shop elsewhere would have to be greater than 10 percent. This is why I am so concerned about the merger. If the prices for office supplies in Leesburg increase 5 to 10 percent, I effectively have nowhere else to shop for my office supplies in the Leesburg area and I would have to pay the higher prices. This is what I fear will happen in Orlando and markets across the country where Staples and Office Depot directly compete."

Finally from paragraph 9: "I remain committed to my belief that the merger between Staples and Office Depot will eliminate competition that benefits consumers like me."

And his last sentence: "Make no mistake about it, I am opposed to the merger."

I would now like to turn to the binder which is our rebuttal to the defendant's featured declarations.

THE COURT: All right.

MR. BROYLES: As you will see, declarants still say

they can't constrain Staples-Office Depot price hikes.

This is the rest of the Defendants' Exhibit 863.

Paragraph 11 states, "Through our price-checking, we have noticed that the office supply superstores have different prices in different areas of the country. These price differences appear to be related to the number of other office supply superstores in the same area and not the existence of Wal-Mart or other retailers."

Paragraph 12 and 13 of Defendants' Exhibit 863: "Based on our price-checking, in areas where Staples and Wal-Mart exist, Staples' prices are, on average, higher than in areas where Staples competes against Office Depot, even if Wal-Mart or other discounters are present. Our price-checking shows that Office Depot generally has lower average prices on consumable office supplies than either Staples or OfficeMax."

Paragraph 13 continues: "Our price-checking information shows that mail-order firms do not significantly affect the retail prices of office supplies. Mail-order firms sell office supplies at prices that are significantly higher than the office supply superstores."

Finally, paragraph 16,: "I believe that if Staples and Office Depot were to merge, the combined firm will likely raise prices in areas where there is less competition. The merged Staples and Office Depot will be able to raise prices on thousands of office supply items or SKUs. In addition, Wal-Mart cannot prevent the merged firm from raising prices on many of the same SKUs that Wal-Mart also carries."

Sam's Club cannot constrain office superstore pricing. A declaration of Mr. Mike Pratt, paragraph 6, and this is Plaintiff's Exhibit 172.

"The presence of Sam's Club stores in an area does not appear to significantly affect the average price level at an office supply superstore compared to the level of intensity of another nearby office supply superstore.

Paragraph 7: "If Staples and Office Depot were to merge, the combined firm could raise prices on many of the thousands of office supply items or SKUs that each firm carries because they no longer will be directly competing against each other. In addition, Sam's Club cannot prevent the merged Staples and Office Depot from raising prices."

Mr. Atkinson who was here and testified in front of you on Monday, it seems like a long time ago.

Paragraph 7 of his declaration which is at PX-171: "Over the past year the office supply superstores, especially Staples and OfficeMax have raised their prices on several consumable office supplies by more than 5 percent despite the presence in many markets of lower-priced club stores such as BJ's. The office supply superstores increased

their prices even as BJ's lowered its prices for some consumable office supplies."

Going down to paragraph 8: "I believe any decisions by Staples to raise prices or change prices in any way will not be affected by whether or not BJ's, or another club store, also raises its prices for consumable office supplies. As described above, I believe BJ's prices for consumable office supplies do not affect price changes by Staples for such products."

The first part of paragraph 8 reads: "It has been my experience that office supply superstore prices vary depending on how many office supply superstore firms that are in a market. Where both Office Depot and Staples compete with each other in a market, prices for consumable office supplies generally are lower than where only Staples is in a market. Based on this experience, if Staples acquires Office Depot, I would expect generally to see higher prices similar to what occurs in markets now where Staples is the only office supply superstore in the market."

Your Honor, the next two pages are from Target and they are under seal so I will pass those by.

THE COURT: All right.

MR. BROYLES: The next two tabs.

I looked at those. All right.

MR. BROYLES: Okay. The tab after that is from

Jack Miller, who was on the defendant's witness list from Quill. This is from his deposition, Your Honor. It is at PX-339, pages 16 to 17.

"Question: It is true, is it not, Mr. Miller, that you would not solicit more customers within the D category, customers with buying potential of less than $1,000 a year, if -- even if office supply superstores raised their prices by 5 percent? Answer: I would not -- that wouldn't affect my decision."

Irwin Helford, also on the defendant's witness list, Your Honor, PX-328, at his deposition, office superstores would have to increase prices by 10 percent or more before Viking sales would increase. "Question: Isn't it true that the office supply superstore prices would have to increase by 10 percent or more before a non-office supply superstore would see any significant increase in its sales volume? Answer: Well, I don't know the answer for non-superstore competitors, but in Viking's view, that is probably correct."

Mr. Helford did submit a declaration for the defendants but he also reviewed a draft and refused to sign Staples' declaration saying prices would not rise post-merger. The bottom part of it is the part I will read that he would not sign. That says in that draft, "I am certain of one thing -- the new combined company will be in

no position to raise prices, injure competition or otherwise harm consumers in any way."

The handwritten writing says "delete".

MR. KEMPF: Your Honor, I make a fairness objection at this time that goes to this designation. Mr. Helford did something in addition to that. He added substitute language that -- he eliminated what is up on the board there, beginning with the word "other sellers" which is part as you can tell from a continuation from the prior page. And when he deleted those, he substituted in for two long sentences one short one that makes essentially the same point. What he said was, "All of this should benefit consumers."

To show he deleted this without changing it basically to a simple sentence that says the same thing I think is a fairness item. I can put that on the screen.

THE COURT: In a minute. Let him finish going through these. Then you can bring that back.

MR. BROYLES: Passage from the deposition. The passage appears on page VO 660 from the same paragraph, "Why did you delete that? Answer: Because I don't know that that's the truth or a fact."

Brad Zenner from Office One, from his declaration, he says at paragraph 8, PX-170, paragraph 8. "Prices in office supply superstore markets are set by the three leaders, Staples, Office Depot and OfficeMax. Smaller office

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supply superstore chains, such as Office One, have little, if any, impact on prices where one or more of the leaders exist. Prices are higher where Staples, Office Depot, or OfficeMax face no competition from each other, even if there is another office supply superstore, such as Office One, in the market. Because Office One cannot effectively compete with the leaders on price, we follow the prices they set."

Sometimes Staples featured declarants still believe that entry is difficult.

Again, from Mr. Helford's deposition which is again PX-329, pages 27 to 28.

"You believe it would be difficult for a new office supply superstore chain to enter and compete successfully against Office Depot and Staples? Answer: I believe so, yes."

Brad Zenner, from Office One, "In the office superstore industry, Staples, Office Depot, and OfficeMax are the only firms that can realistically enter these large urban markets on a sufficient scale to be successful. I am unaware of anyone else who is considering entering these markets and, in my opinion, it is very unlikely that anyone would do so in response to a 5 percent price increase by the incumbents."

Finally, Your Honor, from Mr. Aram Rubinson of Payne Webber, "On the strategic front, the merger leaves the combined company with a dominant share of close to 40 of the

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top 50 markets and its $12 billion size gives it a wide lead over its nearest competitor."

Your Honor, I would also like to formally introduce -- never mind, Your Honor.

Thank you.

THE COURT: All right. Thank you.

Mr. Kempf, you wanted to fill in with an affidavit, you said?

MR. KEMPF: Yes, Your Honor, if I could. If I may confer with Mr. Assaf for just a second here?

This is what Mr. Helford did. I'll show you the prior page 9, next word after what you are reading here would be "other."

With other. What he did is said let's cut out the rest of that, but let's substitute in what I have highlighted which says all of this should benefit consumers.

So he didn't delete it simply. He replaced it with a shorthand version. In his final declaration, which is in evidence as DX-854, you can see looking at this sentence here where he wrote in prices down, and then it has delete and all of this to show that that was indeed what he wanted added in here, here is what his final declaration looks like. It is now paragraph 11, right after -- the whole paragraph now reads, "I predict that a combined Staples/Office Depot will move aggressively to obtain greater price concessions from

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manufacturers, and bring wholesale prices down." And then he did more than deleted it. He asked that this be put in: "All of this should benefit consumers."

So that's what he fully did.

MR. BROYLES: Your Honor, I would respond Mr. Helford was asked about this why he deleted that at his deposition. You saw his answer. He said it was not a true statement.

MR. KEMPF: It was not true as is, but as he revised it, it was.

THE COURT: We have the deposition in evidence as well as the declaration.

I think we can go to the next witness for the FTC.

MR. BROYLES: One final housekeeping matter.

THE COURT: Sure.

MR. BROYLES: I would like to offer the binder as Plaintiff's Exhibit 414, Your Honor.

THE COURT: 414. This is the binder entitled Rebuttal Defense Featured Declarations. That will be 414. Plaintiff's 414.

You are up next, Mr. Carry?

MR. CARY: I am. Back again, Your Honor.

MR. KEMPF: Your Honor, just so the court knows, the cross-examination of Mr. Painter will be handled by Mr. Chris Curran, Your Honor.

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THE COURT: All right.

MR. KEMPF: He is from White & Case.

MR. CARY: Your Honor, at this time we would like to call Mr. David Painter as our next witness.

(DAVID T. PAINTER, PLAINTIFF'S WITNESS, SWORN)

THE COURT: We will probably take a break about five after 3:00 or so. We are going to switch reporters around that time.

MR. CURRAN: Your Honor, may I make an objection right off the bat, please? We did not receive copies of these demonstrative exhibits prior to just now when I believe under the agreement between the parties and the Court those are supposed to be exchanged on the prior day.

MR. CARY: Your Honor, these exhibits are all included with the possible exception of two summary charts in PX-3-B which was produced consistent with the Court's scheduling order as part of our final submission.

MR. CURRAN: Was it an oversight we didn't get these demonstratives yesterday?

MR. CARY: As I said, we had given them to you.

THE COURT: All right. I will allow you to go ahead. It is late in the rebuttal phase of the case in any event.

Let's go ahead.

DIRECT EXAMINATION

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BY MR. CARY:
Q. Good afternoon?
A. Good afternoon.
Q. Please state your name for the record?
A. David Thomas Painter.
Q. Mr. Painter, how are you employed?
A. I'm employed by the Federal Trade Commission.
Q. And in what capacity?
A. I'm the assistant director for accounting in the Bureau of Competition.
Q. Mr. Painter, what is your educational background briefly?
A. I received a Bachelor of Sentence degree from the University of Maryland in 1967.
Q. And what was the major field of that degree?
A. Accounting.
Q. You testified that you were the assistant director for accounting at the FTC. Can you explain what the responsibilities of that position are?
A. Yes. In general, they are -- there's a staff of other accountants, and my responsibilities are to provide accounting resources, financial analysis resources to commission attorneys, to economists in the course of investigation, possible litigation of matters, on accounting and financial issues that arise in the course of an antitrust

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inquiry.
Q. What kind of accounting issues arise in the course of a merger investigation?
A. There are a variety of issues but the principal ones would be a failing company assertion. They generally are all claims made by parties to the merger offered in defense or as evidence to consider in terms of whether to bring the action or not. And one of the issues is a failing company defense.

One of the parties may assert that they are a failing company or a weakened competitor such that they are not offering a competitive impact in the marketplace such that the merger is irrelevant in terms of reducing competition.

Another major one is, in fact, the issue here. That is efficiency claims or cost savings claims. A party may offer -- may assert cost savings claims or efficiencies. There's sort of a broader -- a broader category than cost savings, as something that should be considered in recognition of whether or not to bring the case; and it is up to myself or people on my staff to assess that claim and determine the validity of the claim in terms of trying to assess what, in fact, are the cost savings that ought to be considered in the merger.

I guess the other -- sort of major category would be sort of -- many investigations lead to a consent order;

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and under a consent order, oftentimes a bundle of assets is assembled for divestiture to another party in order to restore the alleged lost competition in the marketplace because of that merger.

And it would be up to myself or people on my staff to determine whether an Applicant that is brought forward to purchase those assets is financially viable, has the means, the wherewithal to, in fact, take those assets and make them viable in the marketplace, competitively available in the marketplace. It is from a financial standpoint, however.
Q. And during the past 10 years, for example, how many mergers have you had occasion to analyze?
A. I'm sorry. How many years did you say?
Q. I said last 10 years, Mr. Painter?
A. I've heard -- myself personally?
Q. Yourself personally or people under your supervision?
A. It probably -- for myself -- probably for myself, it would be in terms of sort of substantive kinds of things, we get many, many mergers that come through many -- there's sort of just little bits and pieces of things we fill in.

Maybe 15 to 20 a year for myself. And maybe 20 to 25 a year for others on my staff. I have a staff of two people, Your Honor.
Q. Can you give me a little description of your employment history prior to assuming the position of assistant director

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for accounting?
A. Yes. I became assistant director for accounting in 1992. It was actually a title change from chief accountant in the Bureau of Competition, the accounting office of the Bureau of Competition. I held that position since 1980, and prior to that, I was a staff accountant within that same office, that was headed by somebody else, I guess from 1973 to 1980.

From 1967 to 1973, I was also employed by the Federal Trade Commission, but I was within their Bureau of Economics in a program of the division called called the division of financial statistics. It was really a program in which financial statistics, financial profit and loss statements, balance sheets and so forth were received from a cross-section of manufacturers in the country who happened to be about 10,000 and assembled, aggregated together for purposes of a quarterly publication called The Quarterly Financial Report for Manufacturing.

I started in that office as a staff accountant and when I left that office, I was head of the accounting review section of that office. The accounting review section was responsible for reviewing the financial reports that would come in and making sure they were prepared in accordance with generally accepted accounting principles, that they were prepared consistently from period-to-period so when they were

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aggregated in a publication, they would -- it would be reliable to compare across periods and to compare across industries.

MR. CURRAN: If it would speed things along, we are willing to stipulate Mr. Painter is an accountant who has been employed by the Federal Trade Commission his entire career.

THE COURT: I think they may want a little more than that.

MR. CARY: Yes, Your Honor.

THE COURT: Go ahead.

THE WITNESS: That would be easy.

BY MR. CARY:

Q. Briefly, Mr. Painter, could you describe the purposes to which this publication is put?

A. The publication, it is still being done today, actually when I left it was being expanded into retail trade. There are two publications now, one for manufacturing, one for retail trade. The title may have changed somewhat. I get, receive them each quarter. It is circulated to generally government agencies, the Council of Economic Advisers, a variety of agencies like that, the Federal Reserve Board for purposes of assessing the information and making fiscal policy. There's also a fairly long subscription list generally of libraries and those kinds of institutions.

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Q. Have you ever testified at any -- in any trial?

A. I have testified in administrative proceedings and I have also testified in Federal Court.

Q. In the administrative proceedings that you testified, were any of those merger cases?

A. Yes. Some were merger cases.

Q. In which matters have you testified either by declaration or in person in Federal Court?

A. In Federal Court, I've testified by declaration in one matter, the FTC-Himow matter; and actually that was on the same issue that I'm addressing in this matter, the efficiencies defense. I also testified in the FTC versus Abbott Labs. I think it went by. That was the infant formula case that was a conspiracy allegation. I testified on damages in that matter.

Q. That was here in the District of Columbia?

A. Yes, it was.

Q. Have you also supervised the expert testimony of others on your staff?

A. I have, yes.

Q. And consistent with Mr. Curran's stipulation, I won't ask you whether you have been with the Federal Trade Commission for 30 years now.

Can you identify the matters that you have supervised that have been in Federal Court?

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A. Two occur to me now. One is the FTC versus PPG I think -- I know it as the PPG Swedlow matter. One of the people on my staff at that time -- I think I had maybe three or four people, testified on market -- prepared market statistics, market share exhibits and testified on that.

And I believe that was -- there was live testimony on that, maybe by affidavit.

On the FTC versus Harbor Group, I believe that was in front of Your Honor, I -- one of the people in my section testified as an expert on the failing company assertion in that matter. I believe testified as an expert.

Q. As part of your responsibilities as assistant director in the Bureau of Competition, are you obligated to give expert testimony when the Commission Staff so requests?

A. Obligated to give testimony?

Q. I'm not obligated no,.

Q. Is it within your discretion whether to testify on a matter or not?

A. It is solely within my discretion.

Q. How do you make the decision as to whether or not to testify?

A. Generally, I do not on my own make the decision that I want to be an expert witness in some matter. I'm often approached and if, in fact, the facts are things that lead to an opinion that is relevant to the proceedings, I may or may

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not. I have only testified as you can see a handful of times over the course of the years.

Q. When were you first asked to look at the efficiency claims in the present matter?

A. Formally asked somewhere in early February when we received what is -- I have referred to in the declaration I prepared as the efficiency book. I think it was February 5. I have have been asked within a day or two of that to look through it and try to make an assessment of it. Informally, I don't think I was asked -- but informally, I had reviewed synergies, it was called, not -- a term called synergies as they were sort of quantified in investment and banker analyses that were prepared for the board in this merger.

Q. Now, in preparing your or in arriving at your conclusions and opinions in this matter, what did you do?

A. I'm sorry, Mr. Cary, could you repeat that?

Q. In forming your opinion in this matter, what were the steps? What did you do? How did you go about doing that?

A. Well, the first thing was to, in fact, try to understand what the claims were that were being asserted. My recollection is that sort of -- I hate to characterize it out of the blue, but I received some information that, in fact, cost savings claims were being asserted that were dramatically higher than what I had associated previously with the merger; and the very first thing I did was to try to

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take a look through the book and understand in fact what was driving cost savings that were being posited and try to understand what the rationale is behind it, supporting documentation was behind them.

It was sort of in conjunction with that very hastily, I think shortly after that there were two or three depositions taken of people that had input into preparing the cost savings; and those depositions were very helpful in terms of at least getting an initial handle on what the claims were all about.

Subsequent to that, I began looking through documents, reading testimony, participating in other depositions, and again time and time again, reading the sufficiency analysis because, to be honest, at that point I still didn't have a good handle on what this was all about; and simply over the course of time in doing all of those things, looking through documents, reading testimony, actually rereading testimony, and rereading testimony even a third time, I picked up on various things I had been seeing in some testimony that seemed to be conflicting with other testimony, I ultimately came to prepare this declaration and to testify here.

Q. Did you also review various documents that were produced by the parties in their compliance with the Pre-merger Notification Act?

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A. Yes, I did. I'm not sure if I -- we received those same identical documents as part of a response to the second question, and I'm not sure whether early on I had seen them as part of the initial filing. They were effectively the board analyses, Your Honor, which are required to be filed as part of the initial filing with the commission.

They were duplicates that were certainly submitted with respect to our second request which asked for an abundance of information. I think more than either side would like to get. Certainly, I looked through those as well as related information and so forth.

Q. Mr. Painter, how many hours roughly have you devoted to reviewing this material since February? And in preparing your report?

A. It's been about a thousand hours.

Q. A thousand hours since February of this year?

A. About a thousand hours. Actually, I'm sure I'm sort of -- maybe below average with respect to everybody else that's here and what they've done. But it has been more than I could take.

(Laughter)

BY MR. CARY:

Q. By my calculus, that's about an average of 70 hours a week. Does it sound about like that?

A. I'm sure it is. My wife often says it is 24 hours a

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day.

Q. Through this review and analysis, have you referred any opinions regarding the efficiency claims in this matter?

A. I have.

Q. And have you prepared a report?

A. Yes, I have.

MR. CARY: Your Honor, at this time I would like to hand up to the bench a copy of some demonstrative exhibits we prepared to illustrate the testimony and also a copy of the report of David Painter marked as PX-282.

MR. CARY: May I approach witness, Your Honor?

THE COURT: All right.

MR. CARY: Mr. Painter, I will hand you the same documents.

THE WITNESS: Thank you.

BY MR. CARY:

Q. Mr. Painter, referring your attention to the first slide, my question is have you reached any conclusions with respect to the efficiency claims, and if so, can you please summarize those conclusions?

A. Well, the -- I had asked that some visual graphics be prepared sort of summarizing things that were in the declaration, and they are sort of summarized here. Rather than read them, I guess --

Q. Why don't you just state them?

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A. The first point that is obviously highlighted here is that it is sort of the catalyst to my starting to look at the efficiency claims in this matter. That is that the efficiency book that is the document of defendants that reflects their current estimates when it was presented, I realized that it was many times higher than what in fact the cost savings were that had been proposed at the board analysis of the two companies.

The board analyses actually of the two companies reflected not only a conservative case presentation, or base case presentation, but they also reflected in the rest of the case presentation and even in the terms of the aggressive case the cost savings were an order of magnitude several times larger. That is in fact what is presented in this very -- sort of this first bullet point so to speak that the current claims are much higher than what was originally estimated for this.

I also -- as part of this, you see it says with respect to documents filed with the Securities and Exchange Commission, there has been a proxy statement filed with the Securities and Exchange Commission dated January 3, 1997. The efficiency book that was sort of -- again, it sort of precipitated all of this, was provided on February 5. As a result of depositions and testimony, I learned that, in fact, the efficiency book was simply a sort of -- maybe a slight

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oversimplification, but a reformatting of efficiency savings that had actually been finalized or nearly finalized on January 14 of 1997, so that was nine days earlier.

So this first bullet point relates to the fact that, in fact, they are an order of magnitude much higher than what was presented to the board and much higher than what was presented in the proxy statement.

Q. Mr. Painter, before you move on to the other bullet points, let me ask you, in your experience, when parties come in on merger transactions and argue an efficiency claim, how do the efficiency claims argued before the agencies, how do they typically compare with what is presented to the board of directors?

A. I haven't looked through files or anything as far as -- to research this out. I was astounded. I don't think I can recall an instance in which -- I may be wrong, Your Honor. I'm just not certain. Certainly, it has been far, far, far less than the general rule, that is I don't recall ever seeing an efficiency assertion made to the commission as part of a proposed merger in which the cost savings that were being asserted were higher or certainly very much higher.

I'm not sure that I can recall one where they were higher at all than what had been presented to the board in terms of trying to determine whether, in fact, there was a merger -- the merger made financial sense or strategic sense

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to pass on.

In fact, many times what is acertained to the commission are savings that are, in fact, less than what is presented to the board. The reason for that is because there is often recognition by the parties asserting it, and this may be because it dates back to some of the old guidelines or whatever, that all the commission will consider, all the antitrust authorities will consider are the merger-specific savings. The savings that are posited at a board, presented to the board are not necessarily merger-specific. They simply are cost savings that the two firms might be able to achieve; and that doesn't mean that they couldn't achieve some part of that in some other way. So oftentimes we have evaluated efficiency savings that are less than what is presented to the board; but I don't recall ever having efficiency claims -- certainly an order of magnitude anywhere close to this, exceeding the board analyses.

Q. How much higher are the efficiency claims that are being put forward here relative to the efficiency claims in the original board production?

A. In terms of dollars, they are about five times higher as a percentage of sales -- my recollection is they may be three, to three-and-a-half times higher.

Q. Do you have an understanding of where the -- do you have an understanding of where the efficiency estimates included

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and presented before the board came from?

A. The efficiency estimates, the cost savings estimates that were presented to the board, they call them synergies, they were -- they were based upon management's estimates at that point. That is -- that actually is contained in the board analyses. They were prepared, I believe, by the investment bankers. They were certainly incorporated and made part of the investment banker analyses. They specifically say on their face they represent management's estimates of what the cost savings would be with respect to the merger.

Q. You recited the history of the compilation of the book that eventually became the efficiency book in January, and the subsequent filing with the Securities and Exchange Commission.

Let me show you a document that we have blown up. Is this the proxy statement filed with the Securities and Exchange Commission that you referred to?

A. It is.

Q. And what information did you glean from the proxy statement?

A. Two bits of information at least that hit me right now. One is that in fact the savings that were posited in the proxy statement are identical to the savings that were presented to the board in terms of the dollars. Actually

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maybe there's three things that sort of hit me now. The second thing is that the proxy statement says -- again it was prepared nine days after the finalization of essentially the cost savings that are now currently being presented.

The proxy statement said that those reflected -- and I can read the exact language -- but essentially it is that they reflected the best estimates of management; and I think the third point would be that the proxy statement -- did present projected earnings per share for the merged entity afterward, and they were premised upon those savings that were in the proxy statement. So those would be sort of the three bits of information that struck out at me in the proxy statement.

Q. Okay. Now what was your reaction when you learned that the efficiency claims that were being presented to you in defense of the merger were five times larger than the efficiency claims presented to the board of directors?

A. I wanted to understand why they were that; and to be perfectly honest, I was skeptical. I'm skeptical when any -- when any claim is put forth to the agency. I think that's part of my job. Skepticism doesn't mean that I -- that I lead to a doubt of the claim or anything. It is a matter of trying to assess the claim and trying to validate whether the claim is completely 100 percent accurate; whether it is understated; whether it is -- half-stated.

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To try to bottom line it, to try to get an assessment that allows the decision-makers to make an assessment and factor it into their overall decision.

Q. Did you have a view of whether a report filed with the Securities and Exchange Commission should accurately reflect proposed cost savings?

MR. CURRAN: Objection, Your Honor. Goes beyond the witness' expertise. Purported expertise.

THE COURT: He's talking about an opinion, ethical, proper?

MR. CARY: I'm actually getting to a financial opinion about what the implications for the bottom line financial statements for the company are, making certain representations in their SEC filing.

MR. CURRAN: Same objection, Your Honor.

THE COURT: Try to reword the question. It is asking whether or not they are accurately reflecting -- any filing to the SEC be accurate. That's a general question.

BY MR. CARY:

Q. Mr. Painter, in your experience, should the filings with the SEC be accurate statements of the financial condition of the company?

MR. CURRAN: Objection, Your Honor.

THE COURT: I will overrule the objection.

THE WITNESS: I actually don't have an opinion on

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that. I have an opinion on other aspects of the proxy statement; and maybe opinion is, in fact, too strong a word on this.

Let me explain.

It certainly raises questions in my mind when the language -- the actual language in the proxy statement is what raises questions in my mind. Actually the two points within -- it says that those are the very best estimates of management. I'm not sure if the word "very" is in there. But they are the very best estimates of management. At the same time that seems inconsistent with the language being used to describe the current efficiency claims that were prepared earlier. Essentially the language there is they are based upon known facts and realistic estimates to date. Words to that effect. That seems inconsistent to me.

I don't know how both can be true. I also -- it also raises some questions in my mind with respect to the financial implications, if, in fact, the current cost savings are the valid cost savings.

The current cost savings because of -- an order of magnitude are so much higher than what is reflected in the proxy statement, that if any of those savings are retained by the company, if they actually could lead to profits, then the projected earnings per share for the newco entity, this merged entity that is posited in the proxy statement, that's

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what the proxy statement is all about, could be dramatically higher; and it seems to me that if those are the best estimates, these much higher savings, and if they could lead to these higher profits, that seems relevant to me in terms of, again, incorporating that into the proxy statement.

I don't have an opinion with respect to the legal or financial requirements under the SEC regulations or the securities law on it.

THE COURT: We are going to take our afternoon recess and be back at 3:30 and set up our other reporter at that time.

(Recess)

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(Brief recess)

THE COURT: Mr. Cary, I was looking at what the plans were this afternoon and perhaps part of this evening. I would like to move it along, so since Mr. Painter is the expert in efficiencies and cost savings, I expect we can have him do some of that now in his testimony and move things along quickly, if we could.

MR. CARY: Yes, Your Honor.

BY MR. CARY:

Q. Now, Mr. Painter, let's go to this one. Mr. Painter, let me set forth a plan for you, a proposal for you in terms of complying with the Judge's request that we try to do this efficiently. You have a very thick report and you have a lot of detail in there, but we obviously can't cover it all. Why don't we attempt to illustrate various observations you've made about the efficiency report in the context of the particular types of cost savings with a few examples, touching on the various categories and the various criticisms in an overview sort of way. Let's start with this chart.

Does this chart represent the breakdown of the efficiencies that the parties have claimed as a result of this transaction?

A. This is premised upon a single year, 1988, and it does then provide a breakdown of the five major categories of savings that they assert.

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Q. 1998?

A. 1998.

Q. And the biggest category is product cost savings?

A. Yes, it is.

Q. Let's talk about product cost savings with reference to the slide we had up originally of your overall observations about the efficiency claims. There are three criticisms with regard to product costs that are highlighted here. Can you describe each of those criticisms for me?

A. Yes. The first bullet point is that Staples claims ignore the substantial efficiencies the firms can achieve on their own. That, I have estimated to be approximately 40 percent, a little more than 40 percent of the total savings that are attributed to lower vendor prices; to be savings that would occur without the merger, simply on their stand-alone basis.

Q. All right. Let's go to a slide here and I will ask you to explain what you mean when you say that the parties have ignored certain efficiencies they might be able to achieve on their own?

A. Yes. I think I have to back up a little bit from this chart and just give you some background, Your Honor. When the -- as I understand it, when the efficiency savings were put into motion; that is, when they were determined to start making some estimates of what the savings would be. In the

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product cost area, one of the major categories is lower vendor prices. And actually that -- there is two captions to that. There is lower vendor prices, and then also some imputed interest that they have calculated based upon extended payment terms. That is, after the merger they would presumably have a longer time to pay their bills. I am focusing only on the lower vendor prices right now.

The merchants, the five merchants for Staples, for the five major categories -- product categories, were asked to estimate what the post-NEWCO, the merged entity, would receive in terms of improved terms after the merger. Each -- four of the five did it this way. They took the 1996 Staples' terms. Staples was being used as a proxy for Office Depot as well. And they then estimated what the 1997 Staples terms would be without the merger. They called that pre-NEWCO.

And they then, from that step, estimated what the merged entity would receive in improved terms over and above what the 1997 Staples terms were.

Q. Let me interrupt just for a minute. What do you mean by a "Staples merchant"? What is a merchant?

A. A Staples merchant is the merchandising manager, the person that's responsible for the buying of the SKU items within each of the five departments they have. The five departments being furniture; computers; accessories; business

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machines; and paper, housewares and office supplies.

Q. Okay. Please continue with the description of what they did.

A. They then provided that information, as I understand it, to the finance department, who was then to take the terms and then apply the -- determine what the purchases were from each of the vendors and figure out what the savings were based on those improved discount terms.

And the first cut that was actually made to do that estimate took the difference, the amount attributable to the merger, as the difference between what the 1997 terms were going to be for Staples -- again, Office Depot is also sort of embodied in that in that Staples was a proxy for them -- and what the post-NEWCO terms would be. And that difference was then called the incremental benefit from the merger.

They actually assigned the terms premerger/post-merger to that calculation. There came a point at which they -- a decision was made, as I understand it by Mr. Rich Gentry, to --

Q. Who is Mr. Gentry?

A. Mr. Gentry is -- I'm not sure of his exact title, but he heads the merchandising effort, the merchandising group for Staples -- to in fact do it in a different way. And that is to eliminate what the 1997 stand-alone improvements would be and to measure the difference as the difference between the

1996 terms and what the post-NEWCO or the merged entity would get.

There is a rationale that has been given for that and I can get into that if you would like. But in any event, as a result of doing that, about 43 percent of the savings were effectively the stand-alone savings that would have been realized. So of their total savings that were captured as a result of doing that, 43 percent of them would have been -- approximately 43 percent would have been related to the stand-alone improvement from 1997 -- six, I am sorry, to the 1997 terms on a stand-alone basis.

Q. Okay. Using this chart here, could you illustrate your testimony?

A. Yes. This is actually an example of one of the vendors. This happens to be 3M. They are all different; that is, they are not exactly the same. Some vary, some are given higher stand-alone improvement and lesser post-NEWCO improvement, and so forth.

This one, using 3M as an example, assuming that they were paying an invoice price of $100,000 here, for example, because of the discounts they were getting in 1996 they would have only paid 86.5. I'm not sure -- somewhere a little above that, perhaps, in the line. I don't have the exact figures. The merchant responsible for 3M estimated an improvement they would have gotten on the stand-alone basis,

an additional discount that would have brought them down to an 86.2 level. And after the merger, they would have gone down to an 86 level.

In my opinion, what ought to be attributed to the merger is the difference between 86.2 and the 86. What effectively got attributed to the merger is the 86.5, not reading the chart exactly, and the 86. That is what got attributed to the merger and called savings from this merger.

Q. And why in your opinion should the higher amount not have been attributed to the merger?

A. For a variety of reasons. Maybe it requires me to get into what the rationale was.

Q. Why don't you go ahead and do that.

A. The rationale, as I understand it, was that, according to testimony, some vendors -- and I am using -- the word "some" is the actual term in the testimony. Some vendors were believed to be anticipating the merger, and as a result they were providing what Mr. Gentry deemed to be better discounts on a stand-alone basis than they really would have given them. They called this, I think, the "merger effect" in some documents. And there are other terms that escape me right now, but it is a levelling of the field.

I think what was meant by that, although there is not testimony directly on point on it, is that essentially

what they were anticipating is that if the merger went through they would discover that Staples was getting a different price than Office Depot, and that one of the other of them would be upset. And they wanted to close that gap before it actually happened, perhaps to minimize the impact if in fact the merger went through. And because of that they -- the determination was made to reject all of the estimates of improved vendor terms in 1997 on a stand-alone basis.

Again, I emphasize again, the testimony is that some vendors were believed to be doing that. There were 93 vendors for which they estimated improvements, and that was actually used as the basis then for estimating improvements for all other vendors. All 93, the improvements were eliminated, and the decision was made to fall back on the '96 terms.

That does not seem fair to me, certainly, and particularly in light of the fact from 1994 to 1995 there were substantial improvements in virtually all of the vendors and certainly all of the product categories. And from '95 to '96 there was substantial improvements, and one would expect at least the trend to continue, if not the order of magnitude to continue.

Again, that was all effectively -- whatever that order of magnitude would be. And it was estimated by the

merchants at roughly 43 percent of the total was ultimately attributed to the merger ought to be, in my opinion, savings that should be considered to occur without the merger. Even if I accept the notion that there was a levelling of the field, there is a levelling of the prices in anticipation of this merger, I don't find that to be persuasive, certainly not to eliminate it all. And I don't believe that it really is persuasive to me to eliminate any of it, of what the merchants, the experts, actually had estimated.

And as an aside, Your Honor, even in the latest deposition of Ms. Goodman, she did testify that the merchants, who were the ones who did these estimates, were capable of estimating the 1997 pre-NEWCO, the Staples stand-alone improvement. There is testimony on that. And I certainly hope I am recalling properly. I am certain I am. I don't have the cite.

The reason that I don't believe that, even if there was a levelling of the -- sort of the prices, why that should serve as a basis for the rejection of any of it, really, is because, as I understand it, in a prior acquisition that Staples had had, two years earlier -- it happened to be of National Office Supply. There was a discovery that indeed Staples was paying a higher price than a much smaller entity. And they went back to the vendors, I think rightfully so, upset by that.

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And subsequent to that, the testimony from Ms. Clark, Laurie Clark -- who was, again, one of the merchandising managers, I believe, for one of the departments. Actually, I think she is in charge now of merchandising integration. She said on that, in fact, subsequent to that they started to enter into best -- what's called best prices, often known as most-favorite-nations kind of clauses with their vendors to prevent just this happening from occurring.

And that doesn't -- I think they would not have entered into those clauses if they didn't believe they had some protection under those clauses; if it wasn't going to alleviate some of the problems, if not remedy it. There may well be differences in prices between Office Depot and Staples that they are legally entitled to, under these clauses. But in my view, in terms of assessing a cost savings claim in this area for the purposes of an antitrust inquiry, a merger analysis on the antitrust laws, I believe there are alternative ways of remedying that and capturing those savings.

And one of the ways is in fact to simply negotiate another clause, if they are not already there. And they may be there, I don't know. That simply says, We will have a third party review of the prices. We will simply put into the vendor agreement a periodic view to ensure that we are

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getting the best price. And that is not uncommon, at least in my experience. I mean, the last case I worked on was Time-Warner, Turner Broadcasting, and they had -- the industry was prevalent with those, and with review provisions.

Q. Mr. Painter, let me ask you another question along those same lines. Is it the case they eliminated all of the 1997 pre-NEWCO improvements in discounts, even among vendors that had not gone through any kind of renegotiation through that period?

MR. KEMPF: Objection, leading.

THE COURT: I will allow it to move it along. He has already essentially said that.

It is all right. Go ahead.

THE WITNESS: I don't know to what extent they had commenced or were in the process of negotiations with their vendors in terms of the numbers. I know there were some that they had not begun negotiations with.

BY MR. CARY:

Q. Let me refer you to the slide on the board. You testified that historically Staples had received improvements in their discounts over the years, and these are -- what do these slides represent?

A. These slides represent the actual, I think, 10 vendors in the office supplies category that were selected as the

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basis for trying to assess what the improvements would be after the merger. And this shows the historical improvement that each of those vendors has provided to Staples in the last three-year period.

Q. And you said 10, that was the first four. Here is the second four.

A. Using Duo-Tang as an example, in 1994 they were giving a discount of -- an overall discount. It is called program terms, and it consists of a variety of things, but essentially it represents an overall discount off the invoice price. 23.89 percent. In 1995 they raised that to 30.06 percent. In 1996 it had gone up to 32.52 percent. Again, one would expect that in 1997, on a stand-alone basis, it also would go up.

And each one would be different. The pattern was different for various vendors.

Q. Here are the final three.

A. Well, actually there were 10, and the "all others" category is the 11th catchall for vendors that were not selected.

Q. So the "all others" also got increased discounts?

A. On the basis of the historical presentation by Staples merchants, that is correct. That's actually part of the -- in the documents, the worksheets that the merchants used to estimate the cost savings that are in this efficiency book

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that Staples now presents.

Q. In the documents you reviewed, did you also find evidence that in fact the promotional allowances were higher in 1997 than they were in 1996, even without the merger?

A. Yes. Actually in two ways. This is one way. There was a document in their files that showed within each of the product groups the various individuals that were responsible for particular vendors, what they were anticipating to be the improvement from 1996 to 1997 for the various vendors they were responsible for. And it shows improvement virtually across the board for everybody.

There is also a budget that has been prepared for 1997 that also says that we will have approximately 70 basis points of improvement on a stand-alone basis. I will try to give some sense of what that means, 70 basis points. The total improvement attributed to the merger was 161 basis points in this area. 70 basis points were effectively expected to be achieved on a stand-alone basis. That actually -- by coincidence or whatever, that is actually very close to what the merchants themselves estimated on a stand-alone basis as sort of an aggregate form. It was roughly the same amount of basis points they were estimating to be achieved on a stand-alone basis as well.

Q. All right. Let's go back to the summary chart. And again in order to move through this, on the product cost side

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we have talked about the first point, about the differences in the original estimate. And we have talked about the second point, ignoring efficiencies that they could achieve on their own.

Your third statement is that the facts contrary to assumptions are ignored. Can you give us an illustration of that point or that criticism?

A. Yes. I recognize, in having analyzed other efficiency assertions and claims, that you -- you can't all be perfect. There are methodologies and various things that are done in order to arrive at an overall estimate of what the savings are. And one of the things I have done is try to evaluate over the years in a case-by-case basis, whether the methodology is sound and whether it is likely to lead to at least reasonably reliable results.

In this instance, one of the varied assumptions that Staples made in terms of estimating the improvement for non-selected vendors, all other vendors that were not among the 93 that were picked, was -- there were savings that were attributed to that group, even though there was one very significant vendor in that group that they knew or certainly believe -- I think the actual language is that the merchant was not that confident there would be any improvement from.

Q. Mr. Painter, let me back up just a little bit and make sure we have the sequence here. They took 93 vendors and

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estimated certain cost savings; is that correct?

A. Yes.

Q. And from that estimate they applied that to all other vendors that they did not look at directly; is that right?

A. Yes. For each department a simple average of the improvement. If one was 2 percent improvement, one was 4 percent improvement, one was 3 percent improvement, regardless of whether one was buying a lot more volume than the other. The average of 3 percent was used to determine what the basis would be for all other vendors in that category.

Q. So they didn't use a weighted average, they used a numerical average?

A. They use a simple average. I don't have a problem with selection of simple average versus a weighted average, because I am unable to determine which is the most appropriate; other than the fact that if you had used the weighted average you would get less savings.

Q. You started to describe a particular vendor, a large vendor that was excluded from the 93 that they were using as the basis for their estimation. Which vendor was that?

A. It was Hewlett-Packard. The testimony was that the merchant, when asked why Hewlett-Packard, the largest vendor Staples has -- and it's so large that it's three times larger than any other vendor. And in fact, after the merger,

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having reviewed a lot of documents, I find that it is -- I think it is over four times, I believe, larger than the next-largest vendor, which in that case would be Packard-Bell. Four times larger. 775 million dollars worth of purchases, by my recollection, after the merger, compared to 175, or something like that, million for Packard-Bell.

The testimony was that, well, because that particular merchant didn't feel confident that that particular vendor was going to provide improvement, they didn't select him. In other testimony there is -- the basis of selection was said to be, We picked the top vendors in each category.

The problem that is created by not selecting Hewlett-Packard is sort of a dual problem. One is that it is automatically shoved into the "all other" category. And by being shoved into the "all other" category, it is getting the savings, actually. It is being attributed savings on the average for selected vendors.

Second, if it had been selected, then the average that would be computed for the remaining vendors would be obviously lower if it was not getting any improvement. It actually creates even a third problem in my mind, again; and that is that if the selection process is in fact premised upon who is going to give you savings -- we didn't pick Hewlett-Packard because we were not that comfortable they

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would give us savings -- then that suggests certainly the possibility that the vendors that have been selected to measure the improvement are not representative of the non-selected vendors, if you are only going to pick the ones that you expect the improvement from.

Let me just finish that thought. That created, again, particular concerns for me. Because, as I looked through every single vendor, knowing Hewlett-Packard was not expected to give improvement, every vendor -- every vendor, with the exception of a few in business machines, showed improvement. The ones that were in business machines that did not show improvement were effectively eliminated from computing the average in trying to assess what the improvement would be for all the others. So even there, they simply -- they were ignored in determining the average to be assigned to the "all other" category.

I hope I am not going too fast.

Q. Going to the slide on the board, could you explain what the implications are in terms of the total amount of imputed savings to Hewlett-Packard of their inclusion in the "all other" category, and can you talk about the source -- why don't I stop there, and let you answer that question.

A. It is the quote. Actually, in the testimony, the quote is actually at the very bottom of this exhibit. Direct estimate is meant to be, This is what we think would really

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happen; no savings. However, because they were put into the "all other" category; and again, I am assuming that the "all other" category they would have been put into, certainly the bulk of it would have been in this computers-accessories area, because I think that is where most of the purchases would fall. I have seen documents that suggest that it falls in three of the five products areas.

There is other testimony in which Ms. Goodman assumed that it was all in computers-accessories, or she certainly used that as the proxy for where Hewlett-Packard would be. What happens is that when you put them in the "all other" category and you compute the savings for them, because they are part of "all other," you effectively calculate a savings of about 27, 28 million dollars for 1997.

Q. Now, this chart shows 10 million. Why does it show 10 instead of 28?

A. In this instance it is 10 million because in 1997 the efficiency study assumed only a third of the year. The merger is only in effect for a third of the year, so it is a third of that amount.

What happens is, because sales go up in 1998 and because the savings have been calculated or converted to a percentage of sales, when you apply that percentage of sales to 1998, 1998 sales, the savings go up to 36 million. When you apply it to 1999 sales, it goes up to 44 million, and so

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on, such that over the course of the five-year period Hewlett-Packard is being attributed savings of about 207 million dollars. And the starting point is there is testimony that says the merchant doesn't feel that confident they will get any savings from Hewlett-Packard.

That is just Hewlett-Packard. There are other vendors that I don't know in the "all other" categories that would not give improvement or would give less improvement than the average. They pose similar, similar problems; I don't believe in anything close to the order of magnitude that this single vendor does, because of its size.

Q. Are you aware of -- strike that. Is there another example that we can walk through of a situation where an assumption was made that was contrary to known facts in calculating the efficiency method?

A. There may be several. Let me jump to one that comes to mind. It is another category of cost savings, Your Honor. There were two major categories. One was improved prices from vendors. That had a subpart to it; that is, these longer payment terms would allow us to sort of -- imputed interest was assigned to that. And that created about 17 percent of the overall savings, as I recall, of the improvements from vendors. That is one category.

There was then a second category of product cost savings that are related to something that you have heard

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testimony about, the Global Product Sourcing program of Staples and the fact that that Global Product Sourcing program would be implemented into the Office Depot stores and they would benefit by that program in such a way as to attain a lot of savings. Over the course of five years, 743 million dollars of additional product cost savings.

The vendor term savings I think quantify to about 1.2 billion, just lower prices. And I could have this wrong, but another couple of hundred million, I believe, improved vendor terms -- I mean, I'm sorry, for the longer payment terms. And this, to about 743 million over the five years from Global Product Sourcing.

Q. Can you explain how they went about calculating the 743 million dollars' worth of total savings from global products sourcing?

A. Yes.

Q. What was the methodology they used?

A. The methodology was to take a sample of about 51 SKUs that were out of the roughly 600 that had been asserted to be the total SKUs in this Global Product Sourcing program, and to calculate savings for those 51 SKUs.

Q. Now, how did they pick those 51 SKUs?

A. I'm not certain. Underlying information to the book indicates that the SKUs that were selected were the opportune SKUs. My initial interpretation of what that meant by

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opportune SKUs were that these were the ones that were going to provide the greatest savings.

In my deposition, a document was presented me in which it was said to be at the opportune SKUs were the ones that were the easiest and quickest ones to implement into the Office Depot program. Others would follow. I don't find that distinction, in light of other evidence that I have seen, to be a significant difference, certainly, if I fall back on the other evidence.

What happens then is 51 of the SKUs are said to be about 15 percent of the total purchases of all SKUs, the total of -- within the Global Product Sourcing. And so if you calculated 8 million dollars, which is what they did, calculated 8 million dollars on savings on those SKUs; then by using a divider of 15 percent calculates to, as my recollection, 54 million dollars of savings for Staples. In 1996 based on the methodology that was employed. Staples saves 54 million dollars on its Global Product Sourcing.

There are other documents that relate to the Global Product Sourcing program. And one of those documents, which is actually entitled "Global Product Sourcing," budgets savings for Staples for 1996 of 22 million dollars in Global Product Sourcing. Not 54 million. At best, as I read that document, it does contain a term, a line above this budgeted figure of 22 million called "reach."

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I have been unable -- I don't know what reach means, but I have assumed for the purposes of assessing this, that reach maybe means that this is what we actually got. We reached a little higher level than we budgeted. But even that quantifies only to 27 million dollars, not 54 million dollars. It is half of that amount.

I think maybe even more persuasive than that, although that is fairly persuasive to me that these savings have been overstated with respect to Global Product Sourcing, is the fact that in underlying documents, this efficiency book, they are not contained in the binder, the efficiency book binder.

But the underlying documents actually talk about a different SKU sample. They talk about a 52-SKU sample. And they calculate, based upon that, 66 basis points of improvement. This actually calculated I believe 100 -- the methodology here, 143 basis points of improvement. I am sure I will be corrected if my memory is wrong, during cross.

Q. Now, when we talk about --

A. If I can just finish. I'm sorry, Mr. Cary. If I can finish that thought process.

The 66 basis points in these underlying documents was recognized, because they were opportune SKUs, as being an overstatement of what in fact would be the proper basis points that ought to be applied to the merger.

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Actually, let me back up. The 66 basis points -- forgive me, Your Honor. I have just forgotten.

The 66 basis points, by my recollection, was expected what they expected to be the basis points translation for the post-merger entity. The 133 basis points I just referred to was actually reduced to 85 basis points when it was applied to a greater sales volume for Office Depot. The proper comparison is that the estimate that was done by Staples for the purposes of this efficiency book is 85 basis points of improvements for the combined sales of the post-merger entity. Underlying document says that it ought to be 66 basis points based on opportune SKUs, and reduces the 66 basis points to 45 basis points in recognition they were opportune and they are not necessarily representative of what the remaining SKUs would be.

So the underlying sum, the underlying documents, quantified at 45 basis points. The efficiency book says it is 85 basis points. The budget effectively said that it was about -- this budgeted figure or this reach figure said it was about 50 percent of what Staples says it is now. They sort of all play out to about 50 percent of what is really being asserted for the purposes of cost savings due to this merger.

Q. Okay. Let me break you down a little bit. The GPS program you are talking about is the private label program that Ms. Goodman talked about, sourcing things overseas?

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A. It is essentially that. It is more than that, but it's -- I am sure Staples can describe it better. But it consists of products that are imported by Staples or arranged under a contract manufacturer by Staples to avoid a middle person.

Q. And when you talked about the opportune SKUs, did you assess what the averages of those opportune SKUs were in terms of product cost savings? I will refer your attention to the slide on the board.

A. Yes. Again, this goes back to my initial interpretation of "opportune." My initial interpretation of opportune is that it in fact was the SKUs that would provide the greatest savings. The averages that were computed for purposes of determining what the total savings were from GPS by Staples are on your left side. The actual lowest-saving SKU within that sample, for each of those product groupings, is the lowest of the opportune, as shown on the right side. So there are SKUs in there much lower than the average.

Q. If you assume that the most profitable or the most opportune SKUs are the ones that have already been put out for Global Product Sourcing, would that imply to you that the appropriate number to use or a more appropriate number to use would be one closer to the lowest opportune rather than the average?

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MR. GIDLEY: Objection, leading.

THE COURT: That was very leading. Not just a little bit.

Why don't you rephrase it.

BY MR. CARY:

Q. What in your opinion is the appropriate percentage savings to use in calculating future savings from the Global Product Sourcing program?

A. Again, during my deposition there was a document presented to me that suggested on its face that "opportune" might not mean the SKUs with the greatest savings, but rather the SKUs that can be rolled out the quickest. So while we have this visual graphic in front of me, certainly if you use the lowest of what has been characterized as the SKU in the sample, we have an overstatement of 70 percent.

I think -- at this point I think a fair assessment is it is 50 percent, based on other documents, and not 70 percent overstatement. Again, I don't have a good handle on what was opportune, but there is a much better piece of evidence, much better evidence in the record with respect to overstatement to the documents.

Q. Since your deposition, you considered the Defendants' definition of opportune and reevaluated?

A. Accepting the definition of opportune as it was shown in a single document that didn't contain attachments to it,

although it referenced attachments to it; accepting that, then I no longer think this is perhaps an appropriate way of trying to assess what the true savings are.
Q. Did you also review some testimony of Georgia Pacific Corporation and compare that against the claims of the efficiencies?
A. Yes. Again, that is another example of sort of a factor that is contrary to the assumption they used.
As I understand Ms. Goodman's testimony, and as I read the efficiency book and I read the executive summary and the efficiency book, the guiding rationale -- an example of the guiding rationale as to why there would be cost savings here, was a reference to paper companies and avoiding the upcharge that you now have to pay paper companies because paper is distributed through a paper merchant to the companies.
And actually -- it is on the screen, but the actual quote in the executive summary, and I know that you heard a lot of this already, Your Honor, but is that NEWCO scale will enable it to require all paper companies to eliminate the non-value-added costs of the merchants. Now, I understand Ms. Goodman's testimony is that only a part of the savings that would relate to paper, at least as presented in the overview, I think it was -- I think it was 18 million dollars was actually incorporated into the ultimate product cost

savings.
My feeling is that none of it should be. Again, from the standpoint of whether it is something that will occur with -- only with the merger, and not without the merger, I have reviewed some internal documents of Staples.
And I have reviewed an affidavit submitted by Georgia Pacific, by Michael Houghton, who says in the documents -- and the underlying documents support this. That this ability to deal with paper companies direct, at least certain paper companies direct, was going to occur without this merger. And so whatever savings would result from that ought not be attributed to the merger.
Also, it is my understanding from a document that once one company -- and Georgia Pacific clearly has said in its declaration it is ready, willing, and able to deal on a direct basis. When one paper company is able to do that, we can leverage that -- on a stand-alone basis, we can leverage that into having them all do it.
So again, I think that is an example where savings are being attributed to the merger that are improper to attribute to the merger, that shouldn't be attributed to the merger. It's going to occur without the merger anyway.
Q. Do you have any information Office Depot already has such an arrangement?
A. I believe Office Depot has an arrangement with Union

Camp. Again, I could be wrong about the paper company, bu that is my recollection, is Union Camp is one that deals with them direct already.
Q. Let me refer you to product cost savings claims with respect to business machines. If you will hold on a minute until we catch up with you here.
Would you describe what the efficiency report does with respect to business machines?
A. Yes. Essentially it does this. As I mentioned earlier there was -- there were certain vendors selected, and based on the average improvement of those vendors, an average improvement for other vendors that were not selected calculated. In business machines there were 39 vendors that were selected. And actually out of the 39, I believe there were six that didn't even have purchases associated with them. They were simply listed. But of -- but 19 -- I'm sorry, 20 vendors showed improvement. 19 did not show improvement, at least by my recollection.
Q. Now, when you say "show improvement," where did these improvements -- where were these improvements shown?
A. They were improvements that are shown in terms of the improved discount terms from the vendors.
Q. That would be received as part of the merger?
A. Yes.
Q. Okay. So they estimated for 20 of them, savings?

A. What happened is that in computing the average for that particular product group -- unlike the other ones, because there were some that were not showing improvement. The ones that did not show improvement were simply not included in the calculation. So the improvement for those that did show improvement was the sole basis for determining what the average improvement should be for the "all other." In my view, if you are going to compute the average, then you ought to be computing the average for all of the vendors that are selected.
Q. So in this case there were a total of 39 vendors. According to the chart, 19 of them had zero savings. 20 of them had savings. What did they do in calculating the savings for the entire group?
A. Again, maybe I am misunderstanding your question. I thought I answered that. But that is, to determine the savings for the "all other," they computed an average of 1.63. My recollection is that if you computed an average based on all 39, it would be half that amount. Roughly half that amount. But -- the 0.83, I think. 1.63 is the figure that is then used, however, to determine what the savings are from the all other vendors.
Q. Are the 19 that are excluded in the "all other" category?
A. No. Those are selected vendors.

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Q. And once the 1.63 is applied to the "all other" vendors, what did they then do?
A. They determined an estimated improvement for the "all other" vendors. And as a consequence of using the 1.63 average rather than a 0.83 average, they determined there was 5 million dollars worth of savings from those "all other" vendors. It was an overstatement of the savings from the "all other" vendors:
Again, Your Honor, the amount is not nearly so significant as Hewlett-Packard. What is -- what is concerning to me about this is that it is a methodology that seems clearly inappropriate. And even in this instance where I don't believe it sort of creates a lot of additional cost savings, it -- there are lots of methodologies that I have not been able to figure out or uncover. There are lots of things that are unsupported. And it creates, at least in my mind, reliability concerns about estimates that have not been substantiated or which are unexplainable in terms of underlying documentation. So I think that is the emphasis that I think this merits.
Q. All right. And once these savings are estimated, are they then projected out over a period of time?
A. Yes, they are.
Q. And do they make any -- do they make any assumptions in the efficiency report as to how those savings ought to be

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projected?
A. I'm sorry. Could you repeat that, Mr. Cary?
Q. Yes. In the efficiency report, is there an assumption made how the projected savings ought to be projected over the next five years?
A. Yes. Essentially the cost savings are determined for a particular point in time, 1997. They -- the savings, the discount terms that Staples was receiving before the merger -- and this is since 1996, are converted to a percentage of sales. They call it -- it is called basis points. The savings that are then -- the discount terms that are then estimated by the merchants for the post-NEWCO merged entity are then taken as a percentage of the sales, the combined sales volume after the merger. And that is converted to basis points.
The difference between the basis points before the merger and the basis points after the merger is considered to be the savings. That is the percentage of sales that each vendor and each product group would provide throughout the five-year time frame. So that as projected sales increase, that fixed -- that fixed percentage is applied to those sales, and it generates a cost savings for that particular year.
So what that means is, if you have made a mistake, if you have overstated the savings for the base period that

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you are using to calculate the basis points, that overstatement gets carried through to each and every year and in fact increases, at least in terms of the dollars, because the sales dollars are increasing. The Hewlett-Packard example was a good example of that.
Q. Now, were there some claims that you were not able to verify in doing your review of the efficiencies as well?
A. There were.
Q. Was one of those claims the distribution claim?
A. Yes, it was.
Q. Would you explain what the distribution claim is?
A. The distribution claim as I understand it is essentially this: That this merger will allow three things to occur. This merger will allow the two companies together known as Staples, the Office Depot, to go to the vendors and take over the responsibility from those vendors for the freight function; that is, right now vendors deliver products to Staples and Office Depot. And 95 to 99 percent of the products that are delivered have the freight cost imbedded in the price. The responsibility for that freight management; that is, for going out and arranging for shipment, and so forth, is in the hands of the vendors.
After the merger it was determined that they would take that function over. They could take it over only because of the merger, and that would allow them to reap the

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benefits because they could do it cheaper. And so there is a freight management component of the overall distribution savings.
While we are on that, let me mention one of the concerns that I have, at least that hits me right now. They were -- they actually -- Staples, prior to this merger, had had recommended to it by its -- by one of its consultants, A.T. Kearney, that it could take over that function on its own. And it was presented to management of Staples just prior to the merger, and there were savings that were quantified as a result of doing that if they had been able to do that. And the savings ranged from a low of 12 million to a high of about 25 million dollars if they could take that function over.
As I understand it, it was rejected by either the board or the committee, the management committee responsible for making that decision. And it was rejected because the testimony -- according to testimony it was theoretical, it was too theoretical. That is the testimony.
And essentially I think it was this: That the merchants who are negotiating with vendors, who the principal contacts with vendors, were unable to -- at least had not been acquainted enough with this freight function to be able to negotiate the extraction of that responsibility from the vendors. So, it was rejected as something they would do.

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Mr. Watts, who is head of logistics for Staples, did testify that it was his belief that it could be done. He actually talked to Kearney and said, Come up with some better ideas, something that is more persuasive, so we can convince management. In fact, he wanted to do it immediately. What immediately is, there is no date to that. There was a consensus, apparently, that it would happen in time, clearly. I think that is generally the testimony, the verbatim testimony. It was a matter of time.

However, it was sort of tabled with respect to the merger, his efforts. Well, the merger allowed for a much better analysis of that particular aspect, and obviously it creates also some additional scale which could be used to sort of leverage into requiring the vendors to turn that function over. And so savings were attributed to the takeover of that function. They were attributed to the merger.

Now, my concern is that whether there is a likelihood, whether there is a reasonable likelihood that in fact they could have done that prior to the merger and achieved at least some of the savings. As I understood the testimony, about 12 million of the savings could be achieved, potentially out of 25 million. But the 25 million could not be totally achieved because they didn't have enough clout, buying clout to take over all 25 million. They, to share

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that with the vendors, they would only get 12 of the 25 million.

There is testimony that the freight savings that are attributed to this merger in the efficiency book are incremental to any freight savings, any freight management savings that were being posited or could be obtained without this merger. I have been unable to find documentation other than the absolute testimony of that. And I have looked through a lot of documents.

And I have recently looked through 21 boxes of documents submitted by Kearney on response to a subpoena. And if there is a document in there that suggests that it is the way it is, I am sure I will be confronted with that on cross-examination. But at this point I am unable to determine whether the entire freight management savings being attributed to this merger include freight management savings that Staples could realize on its own and freight management savings that perhaps Office Depot could realize on its own. Office Depot is larger and so if Staples could presumably do it, Office Depot would presumably have a better shot at it.

That is one category of distribution.

Q. Okay. Were you provided with any documentation of the methodology employed to arrive at the final figure that was estimated from distribution savings?

A. You jumped ahead, Mr. Cary. I am sorry, but are you

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talking about only the freight management aspect?

Q. Right, the freight management.

A. I have found no documentation either in the efficiency book, or in underlying documents that have been uncovered, or in the Kearney uncovered boxes of documents that have allowed me to come to some sort of conclusion that it is or it isn't included. And I am left with that.

There is a -- there are two other aspects of distribution savings, and there has been some testimony on those as well. One of them is that the merged entity would rationalize -- the merged entity would rationalize two different distribution systems of the two companies, one in the retail end and one in the contract and commercial end, the business services end. And there are significant savings attributed to that rationalization, the optimum distribution savings that would be in place by NEWCO, the merged entity, over and above what the two companies could do on their own.

I find evidence in that area, for both of those areas to be some evidence that in fact stand-alone savings have been attributed to the merger, for a couple of reasons. One -- and I don't know if this is more for than the other. I think it is not.

But, one, as I understand it, NEWCO -- Kearney was asked as part of its engagement to design the optimum system, distribution system in each of those two areas for the

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post-merger entity. And I also remember the testimony it was being done, not for litigation, but for actually the merged entity.

And this is one of the ironies. Typically we don't want something to be done for litigation, creates some concerns. This is an instance in which I would have preferred it to be -- the engagement letter to have been, Do it for litigation. Because what we are trying to get here is the savings that the post-merger entity could get, over and above what either of the two companies could achieve on their own. Now, both of these companies on their own have the ability to optimize their own distribution systems.

And in fact, they have talked about that. They -- Staples is putting into place lots of new facilities in the retail end. Office Depot is, as I understand it, is -- from their -- I believe it was the proxy statement, or one of their annual reports. Has gone through some rationalization of its own in the retail end.

In the contract and commercial end, there are an abundance of facilities that each of them has, because they have been buying up -- apparently they're either buying up or constructing. I think it's been mostly through acquisition, lots of facilities. They each had individual plans to in fact optimize, at least to the extent they could do it on a stand-alone basis, these facilities. That creates cost

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savings.

And the concern that I would have -- if you did it for litigation purposes you might be able to say, do it from the -- optimize the two stand-alones first. And then measure your savings attributed to the merger from what the base costs would be for those two optimal systems.

And that is fair. I think that is fair to attribute that to the merger. That doesn't mean it is merger specific, but that is a different issue which I haven't addressed. Because if you can buy other companies that allow you to do some optimization over and above what you can do on your own, obviously that should be the base that you start from.

But with that said, the underlying documents that I have uncovered with respect to measuring this cost savings in these two areas focuses on 1996 costs. It takes Office Depot 1996 costs and it takes Staples 1996 costs, and some of the underlying documents then say these are the savings you can get from taking those costs and post-merger then we would have savings from that.

Well, that suggests in my mind, certainly, a possibility. I think a strong possibility, actually, that the measurement of savings attributable to this merger have been started from the 1996 costs of Staples and Office Depot. That actually creates a twofold problem. First,

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clearly it certainly doesn't suggest that it has been measured -- the savings to the merged entity has been measured from the optimal distribution system and what those costs would be for the optimal distribution system. And in fact, in this instance, it doesn't even measure it from the 1997 stand-alone savings or costs that either of the two companies would have. And both companies, to the best of my recollection, were projecting cost savings from 1996 to 1997 in the distribution systems.

So, bottom line, in sum, I have not been able to absolutely identify whether or not the savings being attributed to this merger are truly incremental over and above what could be achieved at the merger. I believe there is evidence to suggest to the contrary, and I certainly believe that there is -- despite 21 boxes of documents and despite a lot of extra documents we got separate from the Kearney submission, that there has not been adequate substantiation to allow people to -- myself, and I have actually had others looking for documents to validate the savings attributable to the merger.

Q. Mr. Painter, did you also evaluate claimed savings in the marketing area?

A. I tried to validate savings in the marketing area. It posed a couple of problems, I think more of a substantiation problem than anything.

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With one exception, actually. Maybe I will jump to the exception. Some of the savings in the marketing area relate to changing the catalog format of Office Depot. A cheaper -- they would change it to a format that Staples uses. And as a result of changing it to the format Staples uses, I think they would achieve 15 million dollars in savings. A small amount of the overall marketing savings, but nonetheless savings.

In my view, unless there is something I am missing, based on the information I have seen, Office Depot can change its own catalog. It doesn't need this merger to allow it to change its catalog. And it could achieve on a stand-alone basis presumably the same 15 million dollars worth of savings if it changed its catalog.

Q. Let me ask you about marketing best practices and leveraging scale, which is one of the claims made in the efficiency study.

Did you review the Kincannon report?

A. I did.

Q. What is the Kincannon report?

A. It is a consultant that advised Staples what the potential marketing savings would be from this merger. Consists of -- and it is in the efficiency book. It consists of three or four pages, and in it it talks about these are the savings that you can get from going to best practices of

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the two companies and employing some scale. And then add a scale of economics merger.

Q. What is meant by the term "best practices"? What do you understand that to mean?

A. Best practices is where somebody is doing it better than you are. And you can piggyback on that, simply employ it in your own business.

Q. How is that related to this merger?

A. It is an element. It is one of the drivers, I think, throughout all of the five categories of savings, is a driver of some of the savings. Best practices.

If I could deviate for a minute. A good part of the best of the cost savings as I see them from vendors was premised upon best practices. And let me expand that term, because best practices under the Staples definition was intended to include best prices as well. So a good part of the savings are intended to be, We will get -- whichever one of us, again, is getting a lower price, that price we will get. And that contributes to savings. I have already addressed that. I don't find that to be a merger specific savings, and I don't know how much of the overall product cost savings from vendors relates to that.

Q. Have you seen evidence in this proceeding that hiring people from competitors is a way to get best practices and a way to implement best practices?

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A. Yes.
Q. Referring you back to the Kincannon market analysis report, did you find that that report substantiated the claims that were asserted with respect to best practices and leveraging scale in the marketing?
A. It did not substantiate the claims, in the sense that it was simply a document that talked about best practices and scale. And when it started to quantify dollars, it simply had X's, or add signs inserted into it. And actually, on the face of the document it says, we have not been able to precisely -- we are not quantifying this in terms of precision, but it serves in terms of direction. I mean, there would be savings.
And so again, it didn't allow me to validate or not validate. I mean, you know, the marketing savings that were being posited. There are other aspects of marketing that I can get into that also, I think, are relevant to these cost savings, but --
Q. Given the shortness of time, there is a section in your report that goes into those in some greater detail?
A. Yes, there is.
Q. Okay. Let's talk a minute about other goods and services claims. Were there savings claimed in the other goods and services category?
A. Yes there were.

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Q. Do you have any criticisms or observations about those claims?
A. Again, I find that they are -- they don't provide significant substantiation of what the savings would be for the merger. There were several examples of other goods of -- they are called indirect goods and services. And actually, in underlying documents they are captured as -- at least in part -- as part of general administrative expenses, GNA expenses.
And the total category -- there were, I think, six different area of goods and services that were sort of -- they looked -- Staples looked to its historical savings in those areas and sort of extrapolated those savings into what the overall savings for all goods and services would be from this merger. Goods and services represent about 4 percent of the overall -- 4 percent of sales for the combined entities.
The items that were quantified, these six items or areas that were quantified and used as a basis for estimating the overall goods and services saving, represented when you quantify them about 15 percent of the overall savings that were being attributed to goods and services. Not a real well -- again, it was 15 percent of the 100 percent. There were -- within those categories it was clear to me that at least some of those savings were things that could be realized -- savings that could be realized without the merger. And that

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is not to say there won't be some savings with the merger, but there were -- again, I think it is unfair to attribute savings that would occur without the merger to the merger.
I mean -- and I think we got into a little bit of that the other day with Ms. Goodman. And that is that I think about one-fourth of the overall savings in employee health care and employee benefits related to changes in the actual plan design; that is, there were going to be changes such that the employees, the dropout rates or the non-participation rates would be less with the merger, because they would be forced to pay more. Or they would be paying higher co-ops, or whatever. But all of it effectively resulted in some savings.
I have concerns about those kinds of savings, I guess for two reasons. I think the corporation fairly can do what it chooses to do, and I think they make sound business decisions when they make changes in plan design. My guess is the cost savings that you would achieve by reducing the benefits to employees more than offsets what negative aspects might flow from that. My concern would be if there are negative aspects that flow from that -- productivity declines, for example -- then that is an offset. That should be taken away from the savings.
I think more importantly, though, in this instance, it is the merger specificity part of it. If Office Depot on

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its own, without this merger, wants to in fact change its plan design, it can do so. And again, for that reason, I don't believe it is fair to say that, hey, if Staples will -- once we acquire them, we will change the plan design and call that savings attributable to the merger.
Q. Going back to the board, listed up there are six categories. Are those the only specifics that are given with respect to the total claimed savings of 553 million dollars in the other goods and services category?
A. Again, I don't recall. I believe so. I'm not sure about the telecommunications. That may have quantified out something. But at one time I reviewed these exhibits and they were -- they effectively were drawing from my declaration. As I sit here today and go through this declaration, I believe that is an accurate portrayal of exactly what was quantified out. I know that the employee benefits were quantified at 8 to 11 million, and I am virtually certain the American Express was quantified at 2.7 million. And I can't recall if there was a zero quantification or some quantification in one or two of the other categories.
American Express actually is an example that I would like to point to, perhaps, as some indicator of, again, a concern that I have here. American Express is clearly one of the -- one of the companies that they have charges with,

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but so are Visa and Mastercard. And those companies are -- with respect to the total volume of Staples, are three times -- I believe it was three times than American Express was. I think American Express provided a letter saying, Yeah, with this merger we will reduce our savings -- we're going to reduce our rates and you will save a certain amount of money. I think it was 2.7 million.

I would like to have seen, given that Visa and Mastercard were so significantly larger, the same kind of documentation from Visa and Mastercard to fall back on to see if they also believe the higher volume would lend themselves to comparable savings.

Q. How were these examples extrapolated to the full 553 million in total claimed savings in the category?

A. Well, these savings were effectively the basis for estimating what the total savings were in all goods and services. Again, the quantification that is shown there is about 15 percent of the total. And there is no -- there is no documentation, at least to my memory, that shows -- that makes that leap. It gets from the 15 percent that is shown as these examples to the ultimate total shown in the efficiency report.

And obviously those are then expanded. There is savings that increase each year because they are a percentage of projected sales.

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Q. Mr. Painter, do you have an estimate of how much of the efficiency claim is subject to these criticisms?

A. I have prepared an estimate. I broke down my estimate of the overall savings and I did it as a percentage of sales, which is effectively, I think, the more relevant thing to look at, since that sort of is what is applied to the projected sales each year. And I have tried to take out what either is erroneously attributed, in my opinion, to the merger, or what is not substantiated, at least in my opinion, in a way that allows for me to perform informed judgments about the accuracy or reliability of the cost savings.

And in the product cost area, I have taken out of their 2.46 percent or 246 basis points, 23 basis points that would relate to the Hewlett-Packard situation. I have also taken out 47 basis points for savings that related to the 97 stand-alone improvements that, as I explained earlier, I felt there was evidence to suggest that went without the merger.

I also have taken out 28 basis points, and that is all of the basis points that actually relate to getting longer payment terms from vendors. I did that because I have reviewed about 48 -- 40 declarations from vendors; and I have interviewed, participated in some interviews of vendors; and I don't see anything to substantiate that those savings would be realized. And not a single vendor, given the opportunity to comment -- I assume given the opportunity to comment about

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whether there would be lower prices -- and they did comment about the likelihood of lower prices -- ever mentioned longer payment terms. And the ones that I talked to said, "We are not giving longer payment terms. If we do, it is coming out from somewhere else. That is not a cost savings for us to give them longer savings terms." I don't see where there is any basis, at least in my opinion, for concluding these 28 basis points in savings from longer payment terms are appropriate.

I would like to add something to it. The imputed interest rate that was used to determine what the savings would be was 10 percent imputed interest rate. It was obtained from the Treasury Department, according to Mr. Patriarca, who testified in this matter in deposition. And there are underlying documents when you get to these other goods and services that seem to suggest an internal imputed interest rate of 5.8 percent being used to assess accounts receivable.

Again, you know, it makes a huge difference as to what the interest rate is. If the interest rate is fairly 5.8 percent instead of 10 percent, you are cutting your savings from longer payment terms -- even accepting that you get them -- by almost half. So again, I don't -- you know, I am -- in sum, I am taking away 28 basis points, all of the savings for longer payment terms.

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With respect to the GPS savings, I am taking away 42 basis points.

Q. That is the global products sourcing?

A. Global Product Sourcing, Your Honor. Again, that is half of -- essentially half of what was estimated by Staples to be the gross in global product sources savings.

In the area of distribution, because there was some testimony that they could achieve some freight savings on their own, freight management savings on their own, I have assumed that is consumed, it's attributed to the merger as well. And to that extent I am taking it out of the distribution savings. That is 15 basis points.

We get to our unsubstantiated category, which is effectively all of the rationalization of the distribution systems. I find no substantiation for the full amount. Now, I will say this, that I believe that there will be some savings. And I -- it may be small or medium or large. I don't know. There will be some savings, I believe, from rationalization of even the optimal systems that each of the two companies have, by the post-NEWCO entity. I have taken it all away because it is not substantiated. I think, clearly, there is something there that would probably result from this merger.

In the marketing area I mentioned the example of the catalog. That is the only thing that I am taking away in

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terms of erroneous, that I think is unfairly attributable to the merger. But there is a portion that is not substantiated. It is the remainder.

In the general administrative area, there has been 51 basis points. We didn't touch on this area. But Staples looked to some historical experience of its own, and it looked at two or three other companies to get a snapshot. How does general administrative expense decline as volume increases. They determined that 51 basis points is what would be saved as a result of meshing these two companies. But I have looked at their own GNA reductions over volume changes. And, one, they were -- and again, my recollection may be slightly off. But as Staples was going from a billion-dollar company to a five-billion-dollar company, its GNA was only declining by 20 or 30 basis points, not 51. In fact, if you look at their budget from 1997 to the year 2000, when it is doubling in size from a 5 billion to a 10-billion-dollar company, its GNA is only declining by 19 basis points.

And the third thing is Office Depot. If you look at Office Depot, its historical experience, you could extrapolate out the same kind of thing. As they have grown in orders of magnitude, very significant orders of magnitude, their GNA has not been declining by the 51 basis points shown. So I believe there is an overstatement in the GNA as

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well, and I have taken 21 basis points away from that, and given credit for the rest.

And the other goods and services, I have taken away for the medical insurance that is the -- what Office Depot can do on its own. And for the employee benefits, there are two captions there. My recollection is I thought they were together, but apparently there were two captions.

Bottom line, Staples claim -- this is all premised on 1988 I believe. 1998, rather, I am sorry. They are claiming 5.3 percent of savings from this merger. I find that at least in terms of erroneous or improperly attributed savings to this merger, 1.94 percentage points of that 5.03 to be improper.

Unsubstantiated, 1.66 percent. But I will say that I think a part of that -- and it is probably going to result -- there will probably be savings. It is just not substantiated. There will be some savings that come out of that category.

And the remaining, I think it is called possible efficiencies. I think that -- let me correct that right now. I think "possible" is too strong. The remaining efficiencies, if you take away all of the erroneous stuff and unsubstantiated stuff, comes to 1.43. The actual savings from the merger are probably about 1.43. It will be between 1.43 and if you add 1.66, which gives you about a 3

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percentage point savings. It will be somewhere in between there.

Q. Were you in the courtroom yesterday when a gentleman from Ampad testified?

A. Mr. Stoudt. Yes, I was.

Q. And did you hear Mr. Stoudt's testimony with regard to savings based on 1996 items?

A. Yes, I did.

Q. And what relevance was that testimony to your analysis?

A. I think there were a couple of points that were relevant. One is in fact, as I understood Mr. Stoudt -- and as I understood his testimony, the savings that he was estimating to -- that he would realize, the cost savings he would realize, which he would share in -- largely, he said, with Staples and Office Depot after the merger -- were premised upon the combined volumes that he estimated he could get and that they were higher than what he was presently achieving from Staples and Office Depot. And largely, on the Office Depot side, were premised on 1996.

Again, to the extent there would be additional cost savings from volume increases that would occur on a stand-alone basis, I think that that is improperly counted, at least in terms of, I think, what was intended by that testimony to the merger.

Second, I think there may well be -- again, I don't

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have the evidence, but here -- the savings that are being attributed by Ampad, the cost savings from Ampad -- let me back up.

They also indicated that he would bid aggressively, even if the merger doesn't go through, for the Office Depot volume. To the extent that he can get the Office Depot volume without the merger, that is part of the savings that ought not be attributed to the merger. He did say that there was a higher likelihood of getting it with the merger. But he did say that he would bid aggressively for it without the merger.

To the extent that there are cost savings from the combined volumes on a stand-alone basis without this merger, it would make sense to me if he were bidding at the mark to frame that bid at the margin, to bid the lowest price he can that reflects the cost savings he would have if he had the combined volume. So he may or may not get the volume without the merger.

But I think there may be even a third problem too. Office Depot has, for whatever reasons, determined it doesn't want to buy all four product categories from Ampad. It is buying two of four, I believe. It is buying another two from another vendor. There may be reasons that ought to be taken into account in terms of assessing the cost savings for why Office Depot is buying from those other two.

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It may be buying from the other two because it wants to provide a different choice to the consumer. I am not -- I can't sit here and tell you from an economic standpoint I know how that plays out, but it is clearly a different choice to the consumer. If they are buying lower volumes from Ampad, and then buying additional volume of the same products from another supplier, they may be doing that because they want to, again, provide another choice to the consumer.

They may also be doing it because they want to have dual supply. A good example is in case there is a disruption of the delivery. At least you are getting it from one of the two. There may be reasons why in fact it is doing it. The most obvious reason is that for the two products that they are not buying from Ampad right now they may not be buying them because they are getting a better price from whoever it is providing it to them.

The savings that should be attributed to the merger should start from the better price, if there is indeed a better price, of the vendor presently providing it to him. Not from what the Staples price is, or however that was computed.

And so, again, I don't think that tells the whole story as it was spelled out in the testimony.

MR. CARY: Thank you very much.

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THE COURT: I will take a short break. That was a pretty long witness this afternoon. And we will come back and see if we can finish up this evening or not. I will take about a 10-minute break.

(Brief recess).

MR. CURRAN: Given the restraints of time, I will attempt a point-by-point addressing of the issues. We believe many of those issues can be addressed in our post-hearing brief, so I will try to make it a focused cross-examination.

CROSS-EXAMINATION

BY MR. CURRAN:

Q. Mr. Painter, at the beginning of your direct testimony you -- Mr. Cary asked you if were being compelled to testify here today. And your answer was that you were not; is that correct?
A. That is correct.
Q. And you are appearing as an expert witness?
A. Yes, as I understand it. Certainly an expert at trying to assess efficiency claims.
Q. And Mr. Cary also, I think, elicited from you the statement that you make up your own mind as to whether you will be testifying as an expert on the behalf of the FTC; is that correct?
A. That is correct.

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Q. You are an employee of the FTC and you have been for a number of decades; is that correct?
A. For 30 years.
Q. And in that 30 years, have you ever been compelled to testify as an expert?
A. Never.
Q. It has always been at your own volition?
A. Yes, it has.
Q. And you have always given careful consideration to the issues you've been asked to opine about, before you testify?
A. The best I could.
Q. Now, when Mr. Cary asked you about your prior testimony, first he asked if you had ever testified by affidavit or live testimony in any administrative proceeding or court proceeding. Do you remember that?
A. I remember him asking about that, about my testimony, yes.
Q. And you said, "yes;" right?
A. Yes.
Q. Including in merger cases; right?
A. Yes.
Q. And then Mr. Cary asked you to identify the Federal Court cases in which that applied; right?
A. I believe he did.
Q. And you identified the Imo case and the Abbott Labs case; correct? Imo is I-m-o. FTC v. Imo; correct, Mr. Painter?
A. Yes.

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Q. Both of those cases were in this court?
A. They were in Washington. One of them was in front of Judge Sporkin, the Abbott Labs. And I can't recall the other one.
Q. But it was in this courthouse?
A. Yes.
Q. All right. Now, one thing that was not elicited by Mr. Cary in his preliminary questioning regarding your prior testimony was another merger case in which you served as an expert witness by affidavit; correct? At least one?
A. I don't recall.
Q. You don't recall. Mr. Painter, do you still have up there the report you submitted to Judge Hogan in this case?
A. Yes, I do.
Q. Can you take a look at the first page, please? The first page of text?
A. I got it here.
Q. On number -- page 1, do you see that?
A. Yes.
Q. I direct your attention to paragraph 4 there.
A. All right.
Q. Let's start with the third sentence. I have appeared as

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a witness in several administrative hearings "before the Commission, two of which involved a merger challenged under Section 7 of the Clayton Act. I have testified by affidavit in Federal Court in the matter of FTC v. Imo Industries" -- and there's a cite. "And appeared as an expert witness in Federal Court in the matter of FTC v. Abbott Labs". And then there is a cite, period. Do you see that?
A. Yes.
Q. There again, you are acknowledging that you testified in the administrative proceedings as well as in Federal Court proceedings, but you only identified by name the Federal Court proceedings; correct?
A. That is correct.
Q. Just like you did under Mr. Cary's testimony; right? Under Mr. Cary's questioning?
A. I don't believe he asked for the administrative proceedings. That is correct.
Q. He didn't ask you to identify those by name?
A. Right.
Q. So the information conveyed in the report you submitted to Judge Hogan is basically the same information that Mr. Cary elicited in his preliminary questioning; right?
A. I'm not sure I understand what you are saying, but it is what it is in paragraph 4.
Q. Do you remember testifying in the B.A.T. case, don't

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you?
A. The potential entry case?
Q. Do you recall submitting an expert report in that case?
A. No, I didn't. I did not submit an expert report in that case. Actually, this is something that came up in discussions with counsel. I can get into it if you would like.
Q. Well, I am going to get into it.
Do you recall the Federal Trade Commission proceeding entitled In the Matter of B.A.T. Industries, Limited, and Appleton Papers, Inc.?
A. I sure do.
Q. That was a merger case, wasn't it?
A. It was a potential entry case. It was a merger case, yes.
Q. That is Section 7 of the Clayton Act as well?
A. Yes.
Q. That is one of the statutes that's at issue in this case; right?
A. Yes.
Q. And that case was tried in the Federal -- in the FTC administrative proceeding?
A. Yes. In front of Judge Morton Needleman, I think it is.
Q. You don't forget his name, do you?
A. I don't.

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Q. In that case, as you mentioned, the FTC was challenging an acquisition after it had occurred; right?
A. I think so. You are testing my memory about that. I think so.
Q. And in that case the FTC argued the acquiror, Wiggins Teap, a subsidiary of B.A.T., could have properly entered the market on its own without having to acquire Appleton Paper, Inc.
A. That is correct.
Q. Technically, as you suggested, the issue is whether Wiggins Teap was an actual potential entrant; is that right?
A. Yes.
Q. Now, you submitted an expert analysis as an accountant in that proceeding, didn't you?
A. There were two -- there may have been more than two exhibits, but there were at least two exhibits that occur to me that were received into evidence without testimony, without being sponsored through testimony. Stipulated to.
Q. You prepared a model analyzing the expenses connected to possible entry by Wiggins Teap; right?
A. Yes, I did. I think it was more than one model, but yes.
Q. And you were opposing analyses prepared by people on behalf of Wiggins Teap and B.A.T.; correct?
A. That is correct.

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Q. And those people had sufficiently more experience and day-to-day dealings in their business than you do or than you had as an FTC employee; correct?
A. Yes.
Q. Do you remember what the product involved in that case was?
A. I think it was carbonless paper.
Q. That is a consumable office supply, isn't it?
A. I think it is.
Q. And so the people who were opposing your model, your analysis, were people in the consumable office supply industry; isn't that right?
A. In that sense, yes.
Q. So, Judge Morton Needleman in that case was faced with testimony, expert testimony presented by people within the office -- the consumable office supply industry, if I can use that, and yourself; correct? And he had to resolve a conflict of expert opinions?
A. There were more witnesses than myself. There was -- but maybe you could ask the question again, because I got lost in terms of number of witnesses. But tell me again now. I am sorry, sir.
Q. You were an expert on behalf of the FTC; right?
A. Again, you know, this is maybe it is a technicality, because, again, I didn't know if that is something I should

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list. But during the course of that trial I prepared some models, financial models. "What if" scenarios on what the likelihood of profitability would be on entry. They were received in evidence on stipulation of both counsel.

And you know, I was never offered -- to my knowledge, I was never offered as an expert. I didn't testify in that.

Q. Whose side were you supporting?

A. I was representing Federal Trade Commission in that.

Q. And there were people, there were other people who were serving as expert witnesses by affidavit or by testimony?

A. On both side.

Q. Who had opposite views from you; right?

A. Oh, yes. Yes.

Q. And your analysis didn't fare too well in that case, did it?

A. No, it didn't. In a sense that the case was -- judge Needleman found against the Commission. Actually, I think he did. I'm not even sure if on appeal -- I think it went to appeal and the Commission voted it 5/0 against the case, as well.

Q. So you lost both at the ALJ stage and the Commission stage?

A. I believe so, yes.

Q. Let's take a look at what Mr. Needleman thought of your

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analysis as opposed to the analysis presented by the people who were in the consumable office supply business on a day-in and day-out basis, on a real-world basis for many years. Okay?

A. Correct.

MR. CURRAN: John Early, Your Honor, is assisting me with the Elmo machine, and Matt Lewis is over here if we need the overhead projector.

THE COURT: All right.

BY MR. CURRAN:

Q. Mr. Painter, can you see the text that has been put up from page 91 of the decision of Morton Needleman?

A. Yes, I can.

Q. I have highlighted in yellow. The language I think is most pertinent here. I will read it, you can read along.

"However, when Painter inserted a base paper penalty into the Horowitz model, he took a 3 percent reduction, from 12.5 percent in model 1 of table 5 to 9.5 percent in model 3, on grounds that the change from Appleton's integrated operation to the new entrance non-integrated mode might result in savings in the 'other expenses' category."

"The savings were to flow, for example, from the prospect that the WT finance department officials would not have to check pulp prices. The chief executive of WT" -- as

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we mentioned, that is the B.A.T. subsidiary -- "would not have to develop long-range plans related to paper making. The WT engineering department would not have to plan the proper loading of paper" -- over to the next page -- "machines, and warehousing expense attributable to paper making would be eliminated."

"Whether any of these predicted savings would approach 3 percent of net revenue is sheer conjecture. An equally plausible line of speculation might lead to the conclusion that WT as a new entrant may have a different set of other expenses which could conceivably exceed 3 percent. What the record shows on this point is that other expenses, other distribution costs and department expenses in Appleton's financial statements comprise freight, shipping, finished goods warehousing, operation services, marketing, R&D, and the expense of the president's office.

"The last three; marketing, financing and the president's office, clearly relate to Appleton's total business, not to specifics such as the manufacture of paper, and these expenses are not likely to be reduced by merely substituting the purchase of paper for in-house production.

"Insofar as freight and warehousing are concerned, these charges, and at least the bulk of them, relate to the finished CCP product."

CCP, again, is "carbonless" --

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A. I think it might be just carbonless --

Q. Copy paper?

A. That's it.

Q. "Whether a roll of CCP is made with internally produced or purchased base, it still must be coated. And after it is coated, it must still be shipped. Thus it incurs a freight charge, and would do so for WT's plant just as it does for Appleton's. And whether coating of CCP takes place on a paper machine, as in the case of Appleton, or off the paper machine, as in the case of the hypothesized unintegrated new entrant, the category called operations services; that is, industrial relations, fringe benefits, freight planning and distribution planning is not likely to change."

Have I read that correctly?

A. Yes, you have.

Q. I would like to turn your attention to the following page, page 94. On that page do you see paragraph 111?

A. Yes, I do.

Q. It says, "Several other components of the Horowitz model, all largely adopted in the Painter models, involve various degrees of still additional controversy."

Did I read that part right?

A. Yes. Well, there is a finish on it, findings, 112 to 117.

MR. CURRAN: Thank you, Mr. Painter.

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Your Honor, I will pass up to you, if I may, the copy of this, if you would like to read along.
BY MR. CURRAN:
Q. The next excerpt I would like to read, Mr. Painter, is over on page 123. At the top of that page, see where it says, "Since the burden rests with Complaint counsel, this means that their entire case depends on the validity of the Horowitz-Painter models."
Did I read take part right?
A. Yes, you did.
Q. Now, let's look over to the final page. Page 128, paragraph eight. "Although WT had an interest and an incentive in evaluating the feasibility of US entry, the model of entry advanced by Complaint counsel does not constitute reliable, probative and substantial evidence that it would have been in WT's economic self-interest to enter into by means of a non-integrated greenfield coating operation."
Did I read that correct?
A. Yes, you did.
Q. "Complaint counsel" is counsel for FTC in these proceedings; is that right?
A. Yes.
Q. And the model of entry advanced by Complaint counsel, they are talking about your model there, aren't they?

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A. Yes. They are talking about, I guess, a Horowitz-Painter model. I mean, there were dozens of models that ultimately that came out of all of this very lengthy case. And some of those models were entitled Horowitz-Painter, some of those models were entitled Hippus-Painter, some of those were titled Horowitz models. Some, I think, were Elliott models. Some were called Hippus models, and they just went on and on and on.
Q. And you remember this?
A. I am sure these relate to the combination of Horowitz and Horowitz-Painter models, because we were the only two that were addressing the financial modelling.
Q. So it's your understanding and recollection that the model of entry advanced by Complaint counsel in paragraph 8 on the last page, that is talking about your model, isn't it?
A. I am sure it is. It's certainly encompassed.
Q. And Judge Needleman found that that model did not constitute reliable and probative and substantive evidence; is that right?
A. Yes, he did.
Q. Now, you recall that that case went up on appeal to the full Commission; right?
A. That is my recollection. It was a 5/0 vote, I think, to dismiss.
Q. Do you remember what they said about your models there?

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A. No, I don't.
Q. Why don't we take a look at that.
Mr. Painter, I have now put on the screen -- my colleague has put on the screen some of the language out of the Commission's consideration of this case.
MR. CURRAN: Your Honor, may I hand around this decision as well.
BY MR. CURRAN:
Q. Can you read that?
A. I believe so. I think so, yes.
Q. I will read where I highlighted. "Complaint counsel relied upon modifications in the Horowitz models prepared by David Painter, chief supervising accountant in the Commission's Bureau of Competition. Painter relied upon Appleton's actual 1977 costs, $902 per ton, and added to that a $72.34 per ton base paper penalty, and subtracted three percentage points from the other expenses category to account for Appleton's base paper production expenses. Note 104."
Did I read that part right?
A. You did. I didn't pick up on the last. Something 104.
Q. That is a footnote. Why don't we take a look at what they said in the footnote. Footnote 104.
"The ALJ criticized Painter's reduction in the other expenses percentage from 12.5 percent to 9.5 percent, characterizing the view that the predicted savings would

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approach 3 percent of net revenue as sheer conjecture. The 'other expenses' category included, in Appleton's case, freight, shipping, finished goods, warehousing, operations services, marketing, research and development, finance, and the expense of the president's office."
Did I read that part right?
A. Yes, you did.
Q. I would like to flip over to the conclusion. Following page, page 32 of this Lexis printout.
"Complaint counsel have failed to demonstrate that B.A.T. was an actual potential entrant into the United States CCP market. The Commission has therefore determined to dismiss the Complaint in this matter in all respects."
That was the end of the B.A.T. case, wasn't it, Mr. Painter?
A. Yes, it was.
Q. You were sitting in this courtroom yesterday when Shira Goodman was in that chair, weren't you?
A. If it was yesterday, yes. I was in the courtroom. I have been losing track of days.
Q. You have been here just about every day, haven't you?
A. Yes, I believe so.
Q. Because you are an expert witness, not a fact witness; right?
The fact witnesses were excluded from the courtroom

prior to their testimony. Are you aware of that?
A. I wasn't.
Q. You heard Ms. Goodman testify about the process that they followed at Staples and Office Depot in identifying and quantifying the efficiencies?
A. Yes, I did.
Q. You don't dispute that within days of the announcement of the proposed merger in September, the two companies began devoting personnel resources and money to identify and quantify their efficiencies to be gained from the merger?
A. That is my understanding. I believe she referred to charts and task forces and so forth that have been set up.
Q. You don't dispute the facts of her testimony in that regard, do you?
A. No.
Q. This is one of the charts that you recall from Ms. Goodman's testimony?
A. I believe so.
Q. And that identifies the 15 integration task forces they have set up, doesn't it?
A. Yes, it does.
Q. Do you see there are task forces for marketing up there, and distribution, financial processes, merchandising? Do you see those various categories?
A. Yes.

Q. You don't dispute there were task forces formed for all of those various issues, do you?
A. No, I don't.
Q. And you don't dispute that the function and the purpose of these task forces was for people that spend day-in and day-out in the business to try to identify the efficiencies to be gained from the potential merger; right?
A. To identify -- they probably had a variety of tasks, and I am sure some of them had to do with identifying the cost savings that would be realized by the merged entity. Again, I distinguish that from merger specific. I think they obviously had other functions in terms of planning for the integration of the two companies.
Q. Let's talk about the people on these task forces, okay. They included senior executives from Staples and Office Depot?
A. As I understand, yes.
Q. You have heard a lot of documents in this case, haven't you?
A. I have.
Q. And so you have more than just some understanding as to who was on these task forces, don't you?
A. I don't. I can't tell you who was on the specific task forces. I know there were a variety of high ranking officials, probably outside people. I know Kearney, for

example, was part of distribution; as was Mr. Watts. In that sense I agree, yes, there was a number of senior people involved, and outside experts.
Q. And you went to a number of depositions in the FTC investigation and this litigation?
A. Yes, I did.
Q. And you sat there while people from Staples and Office Depot testified about their participation in these task forces; right?
A. Yes.
Q. So, with respect to at least some of these people, you have seen them testify about their role in these task forces; right?
A. Yes.
Q. You are not disputing their credibility or their truthfulness, are you?
A. No. To be honest, I can't recall the specific people and the specific task forces, but I am certainly not disputing it.
Q. And you acknowledged, did you not, senior executives participated in those task forces; is that right?
A. Yes.
Q. Those senior executives have spent years and years of their lives in this industry; right?
A. I'm sure.

Q. Do you recall reading documents or hearing testimony to the effect that there were more than 200 people involved in these task forces?
A. I don't recall that. I don't recall that.
Q. You mentioned a moment ago that you recalled there were some consulting firms --
A. Yes.
Q. -- that participated in these task forces; right?
A. Yes, there were.
Q. What type of consulting firms?
A. I think A.T. Kearney was involved. EDS was involved. Bain Associates was involved. Those were our people that worked with the firms.
Q. Take a look at this chart. Do you recognize this chart from Ms. Goodman's testimony yesterday?
A. Yes, I do.
Q. I think you mentioned Bain. BCG, do you know who that is?
A. Yes, Boston Consulting Group.
Q. Alexander Group?
A. Yes.
Q. Direct Tech, A.T. Kearney, Brand Equity, Management Horizon. Do you see those consultants listed there?
A. Yes, I do.
Q. That is a pretty top-flight list of management

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consulting firms, isn't it?
A. I certainly heard of Bain, BCG and A.T. Kearney, as a result of this case. I've heard of the others beforehand. Alexander Group. They all sound very impressive to me.
Q. They get a lot of MBAs coming right out of the best schools, don't they, those firms?
A. I think so.
Q. You see the totals of the numbers of people that were involved in these task forces?
A. I do now, yes.
Q. And do you see 43 full-time people on the task force? Do you see that in the left column?
A. I do see that.
Q. 124 part-time people?
A. I see that.
Q. And 94 advisory personnel, do you see that?
A. Yes, I do.
Q. Do you see there are 20 from A.T. Kearney in the distribution task force?
A. Yes.
Q. Do you see there are 15 advisory people in the merchandising task force?
A. Yes.
Q. You don't dispute that these people, these 200-plus people, devoted substantial time, effort, energy and

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commitment to try to identify the efficiencies to be achieved through the merger of these two companies, do you? You don't dispute that?
A. I don't dispute it. I know that a large part of the integration task forces was aimed at identifying cost savings from the merger, and I am sure that the bulk of it was also aimed at non-quantifiable kinds of things that sort of -- trying to come up with plans for integrating the companies and so forth. And -- but I think I understand the gist of your question, and I certainly don't dispute it.
What -- I just, I only say that I don't know that all of these people were working on cost savings, but there is no question in my mind but that a substantial number was -- were in that area.
Q. You have heard people testify from in your presence that over 200 people committed themselves to these task forces; is that right?
A. I believe so, yes.
Q. Do you have any reason to doubt their testimony?
A. No, I don't. Well.
Q. Do you have a reason to doubt their testimony?
A. Only in the sense, Mr. Curran, that-- I mean, one of the people that presented testimony here was Ms. Goodman. And obviously she is sponsoring an efficiency book that has calculated in it the cost savings that Staples is asserting

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as part of this proceeding would occur from the merger. And obviously I have disputed that.
I mean, in that sense, anything that relates to things that are contained in my efficiency report that disputes things that are contained in the efficiency book, those would be things that I dispute. I can't hand-pick which, you know, people are involved and which task forces are involved, but those are the things I dispute.
Q. You are testifying as an accountant expert; is that right, an expert in accounting?
A. I don't know. I am certainly testifying as an expert in analyzing efficiency defences. I believe I am an expert in accounting.
Q. You are not sure about that?
A. If you could -- if there was something drafted showing what I am being offered as -- I may have seen it. I don't recall.
Q. Mr. Painter, take a look at your monitor for a moment, will you, please.
(Videotape played)
Q. Do you recall that from your deposition in this case, Mr. Painter?
A. I recall it now. Yes. Again, you know, Mr. Curran, I don't mean to -- you asked if I was considered being offered as an expert in accounting. I mean, I am clearly here to

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offer opinions with respect to the claimed cost savings. Clearly I -- my profession, I am an accountant. And clearly a lot of what the analysis was does involve accounting. Lots of accounting records, certainly.
I mean -- and again, I don't mean to play semantics. The question had to do with whether I was being offered as an expert in accounting, and I don't have the answer to that.
Q. Does your expertise in accounting enable you to have superior judgment of the credibility of other people who are testifying under oath?
A. That is a very broad question.
Q. I think it is a yes-or-no question.
A. I believe that with respect to analyzing the efficiency claims in a merger context, in the antitrust context, that have been asserted to this Court, I believe that I have -- that I have expertise.
Q. You got your accounting degree at the University of Maryland?
A. Yes, I did.
Q. Did you take any special courses in assessing the credibility of other people?
A. No, I didn't.
Q. It wasn't part of the standard curriculum in that area?
A. No, it wasn't. Still isn't, I would have to assume. I

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think they do that in law school. (Laughter)
Q. Well, they teach us how to make an assessment of credibility, that's true.
Now, when you say -- I want to make sure I understand your testimony here. Do you dispute Shira Goodman's testimony as to the effort and commitment and energy and time and expense that went into these task forces?
A. Absolutely not.
Q. Over 200 people participated on these task forces; right?
A. Yes.
Q. You don't dispute that?
A. No.
Q. You spent about a thousand hours by yourself; is that right?
A. About a thousand hours.
Q. Without any prior work experience in the office products business; right?
A. That is correct.
Q. Now, since that B.A.T. case where Judge Needleman made his findings and today, you have not developed any expertise in the office supplies area or consumable office supplies area, have you?
A. No, I have not.
Q. Mr. Painter, do you recall the various categories of

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efficiencies that were identified at Staples and Office Depot?
A. Yes, I do.
Q. Do you see that chart there on the screen on the overhead?
A. Yes.
Q. Does that identify the various categories?
A. Yes, it does.
Q. Let's start at the bottom and go up on these six categories, Mr. Painter. You take an issue with certain savings identified in the traditional vendor savings category; is that right?
A. Yes, I have.
Q. And that relates to purchasing goods; right? From vendors?
A. Yes, it does.
Q. Do you ever work as a purchaser of goods from vendors?
A. No, I haven't.
Q. Have you ever negotiated large volume purchases for a company?
A. No, I haven't. I think this will be a whole series of nos, at least if it is the same list of questions asked at my deposition. (Laughter)
Q. Well, I could pretty much go through all of those categories. I could talk about Global Product Sourcing,

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where people arrange for items to be manufactured or purchased overseas, and I could ask you a series of questions about your personal work experience in that area. You would answer no to all of those questions, wouldn't you?
A. Yes, I would.
Q. If I asked you about distribution costs?
A. I would answer no. I have no experience in distribution costs, in terms of being part of a private company that is involved in understanding the distribution system in the company.
Q. And the same with marketing; right?
A. Right. These are -- yes. With the exception of these are categories of savings that are -- often make up a cost savings claim or cost savings assertion in a merger context. Beyond that, absolutely not.
Q. Now, what I want to know is whether you have personal work experience since you got out of college, working in any of these areas. Okay, we have covered the vendor savings. We have covered Global Product Sourcing. We have covered marketing and distribution. And I don't know if we covered about marketing, but it applies to marketing as well?
A. Yes.
Q. And goods and services savings and GNA?
A. That is correct.
Q. No work experience whatsoever in those areas?

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A. No.
Q. Thank you for your cooperation. I think that will help to speed things along. In fact, Mr. Painter, since you graduated from the University of Maryland with your -- is it a BS in Accounting?
A. I think so.
Q. You have not worked anywhere full-time other than the FTC; right?
A. I worked full-time for about three or four months for Woodward & Lothrop. I mean full-time in the sense of 40 hours a week. (Laughter) I work a lot more full time here at the Commission.
Q. But not for much longer; right? You are retiring?
A. In four months. I will be retiring in September.
Q. Tell me what you did over at Woodward & Lothrop.
A. I was part of -- it was actually -- I dropped out of college and I took a job. I was working at Woodward & Lothrop and then working another job. And I was in the management training program, and I went through a variety of week-here, week-there, working in various departments with Woodward & Lothrop.
Ultimately worked the final phase of that period with the buyer for electronics. I think it was actually called radios and televisions and electronics. And they offered me a position as assistant buyer and I declined, and

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they put me in the stock room for my last two weeks.
Q. You lasted in the management training program about three months there?
A. I think it was about three months.
Q. Mr. Painter, you are not a CPA?
A. No, I'm not.
Q. You have not completed any post-graduate work?
A. No, I haven't.
Q. You are not published in any professional journals or anything?
A. No, I haven't.
MR. CURRAN: Your Honor, if it would please you, I would be happy to address the specific points in Mr. Painter --
THE COURT: You can ask him whatever you would like. You have your time and you can use your 15 hours as you want. It is up to you.
BY MR. CURRAN:
Q. Mr. Painter, I would like to direct your attention to your report again.
A. All right.
Q. Mr. Painter, I would like to direct your attention specifically to paragraph 15 on page 8 of your report.
A. I have it here in front of me now.
Q. It's Plaintiff's Exhibit 282. Page 8, paragraph 15.

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And we also have highlighted a sentence in that paragraph.
"The aggressive case cost savings appear to be totally unsubstantiated."
That is what it says in your report?
A. That is what it says, yes.
Q. That is not right, is it?
A. This came up at the deposition, and I indicated that with the exception of the Hausman analysis that it was totally unsubstantiated. After a series of questions that brought that out.
Q. But you hadn't even read the Hausman analysis; is that right?
A. No, I haven't.
Q. And you are not qualified to read or review or to scrutinize the Hausman analysis, are you?
A. I am not. I am glad I'm not. (Laughter)
Q. So, when you say the aggressive case cost savings appear to be totally unsubstantiated, you are comfortable making that statement, having not read underlying analyses performed by MIT professors?
A. The analysis itself, as I understood it at that point, is that the analysis did not distinguish between -- it distinguished between best prices and scale. Best prices being about 1.2 percent of the 1.8 percent.
Now, I have to tell you that I have learned that

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since this was written. I had some -- I will leave it at that. I had -- I'm sorry Mr. Curran. Maybe I didn't answer that question. Was the question had I looked at the -- had I analyzed the Hausman analysis in forming that statement?
Q. You are not capable of analyzing the Hausman analysis, are you?
A. No, I am not.
Q. But you are comfortable making that statement?
A. I'm comfortable --
Q. It is a yes-or-no statement. Are you comfortable making that statement, not having read the Hausman analysis?
A. If I could explain. As I sit here today, I am somewhat comfortable with it, but I need to explain why.
Q. Today, do you have an understanding of the Hausman analysis?
A. I have more of an understanding of the Hausman analysis than I had before.
Q. Mr. Painter, all of your knowledge about the achievable efficiencies in this case comes straight out of your review of documents that have been provided to you from this case; right?
A. They come out of my analysis of documents that have been submitted by both parties. They come out of my analysis of vendor declarations. They come out of my analysis of testimony. They come out of my analysis of documents

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submitted by third parties, and so forth. Yes.
Q. If I recall correctly on your direct examination, you stated -- I tried to keep a little list of things where you acknowledged you didn't know what the words meant. And at least there are a couple that I would like to confirm with you.
At the time that you wrote your report and appeared for your deposition in this case, you didn't know what the word "opportune" meant in connection with these; is that right?
A. No. I did not. I had to review documents related to the Global Product Sourcing program. I had reviewed underlying documents that were either identified or I uncovered with respect to the Global Product Sourcing program. I believe it actually -- I think they were contained -- they were contained in the actual underlying analysis, the January the 14th analysis that was the basis for the efficiency book. That is, it took those savings and then reformatted them into basis points and so on.
And in the underlying documents in there, the word "opportune" appeared. It was used. And I had no understanding of the word "opportune." I believe Ms. Goodman was asked about the word "opportune." And my recollection, and you correct me if I am wrong, is that she didn't know what the word "opportune" meant either.

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And I made an assumption which I spelled out very clearly in my report that, assuming that it meant those SKUs with the greatest savings, then I reached some conclusions. And again, I don't want to point to that paragraph in isolation, because that paragraph was part of a whole series of paragraphs that sort of discussed GPS, and they are very much integrated with one another. One supports the other, and so forth.
Q. At the time that you prepared your report and the time of the deposition, you didn't know what "opportune" meant in this context; is that right?
A. That is correct.
Q. You didn't know what the word "reach" meant either, did you?
A. I still don't know what the word "reach" means. I thought I indicated in my report, assuming "reach" means something that -- a cost savings that was obtained that was greater than the budgeted savings. The budgeted savings appearing to be 22 million and the reach being something like 27 million, then this would mean that the savings were 27 million of the 55 million that were being derived as a result of the sample.
Q. You were -- you were adding some words or some new meanings to your vocabulary in this process; right?
A. Yes. I was making judgments on what they might mean

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with respect to trying to draw conclusions about the analysis.
Q. Because you did not have a background in the industry and with these companies; right?
A. That is correct. But again, I point you to testimony from Ms. Goodman, who didn't know what the word "opportune" meant either. At least that is my recollection.
Q. Can you give me a cite for that?
A. I can't.
Q. You testified on direct, I believe, that you first became suspicious or cynical or --
A. Skeptical.
Q. -- skeptical. Thank you. About the level of efficiencies, because the company's estimate was higher than the Goldman Sachs estimate. Right?
A. Because the estimates that were presented in the efficiency book premised on a January 14th study were represented to be the -- based on known facts and the most realistic projections. And they were, in order of magnitude, much, much higher than what I had seen in the board analysis.
And actually, even if they had not been described as the best estimates or the most realistic estimates, I would have been skeptical, given the order of magnitude and difference in comparison.

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Q. What was the purpose of the efficiencies analysis at Goldman Sachs for the board and for the prospectus?
A. The efficiencies, as I understand them in Goldman Sachs, was to determine what the benefits -- financial benefits or the strategic benefits were of recommending this merger to the shareholders. Of determining whether or not to recommend the merger to the shareholders.
Q. So the purpose of the analysis was to support a fairness opinion; right?
A. No, that's not my understanding. The fairness opinion is something that would effectively try to assess the consideration being given for the transaction. In this instance, the exchange ratio, for example, I think was 1.14 shares of Staples stock for Office Depot stock. And whether that represented, based on current market values of the companies, that represented a fair consideration as part of the fairness opinion. It doesn't mean that it was the best -- the best offer that the shareholders could get or the worst offer. It was within a range of reasonable offers, of reasonable consideration for the shareholders.
Q. Do you know what a fairness opinion is?
A. I know it in the context that it is a generally sort of a short letter that is prepared by the investment bankers to assess the consideration that is being given to the individuals -- to the shareholders to companies, and to draw

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some conclusions with respect to whether that is a fair consideration being given.
Q. Do you know what an accretion analysis is?
A. It is an analysis of what the added benefits are to the earnings per share; generally in terms of earnings per share to the shareholders as a result of the merger, over what was anticipated without the merger.
Q. What exactly was Goldman Sachs project? Was it to project total synergies, or was it to project earning per share accretion that would result from the synergies?
A. Well, they probably go hand and hand. Goldman Sachs prepared two assessments of cost savings. They determined a base case set of cost savings and then they prepared an aggressive set of cost savings. And from that the projected earnings per share were -- actually, they were -- they ultimately, in the proxy statement, they resorted to the base case set of cost savings.
And based on those cost savings, they determined what the accretive effect was on the earnings per share of the post-NEWCO companies relative to the projected earnings per share of the two companies. That is, Merrill Lynch did it. I mean, Goldman Sachs did it for Staples. Merrill Lynch did it for -- I think it was Merrill Lynch did it for Office Depot.
Q. I would like to direct your attention to the excerpts

that are up on the wall here --
A. All right.
Q. -- from the proxy statement. Do you see the first one?
The following is a summary of certain of the financial analyses used by Goldman Sachs in connection with providing its oral opinion to the Staples board of directors on September 3, 1996?
A. That is correct. I see it.
Q. This is from the proxy statement of several months later; right?
A. Yes. I am assuming it is from the -- I don't recall the proxy, and I am sure it is the January 23rd proxy statement. I'm not aware of any other one.
Q. The second bullet point, "Goldman Sachs opinion necessarily was based on the economic, market and other conditions as an effect on, and the information made available to it as of the date of its opinion."
Do you see that?
A. Yes.
Q. The third bullet point, "The analyses were prepared solely for the purposes of Goldman Sachs providing its opinion to the Staples board of directors as to the fairness of the exchange ratio to Staples, and do not purport to be appraisals or to necessarily reflect prices at which businesses or securities actually may be sold or may track in

the future."
Do you see that?
A. Yes, I do.
Q. And the fourth one, "The preparation of a fairness opinion is a complex process. Selecting portions of the analysis or of the summary set forth above, without considering Goldman Sachs analyses as a whole, would create an incomplete view of the processes underlying Goldman Sachs' opinion."
Do you see that?
A. Yes, I do.
Q. Now, one of the slides that you reviewed on your direct examination quoted an excerpt from the prospectus -- from the proxy statement; right?
A. The proxy statement/prospectus. It is a combination.
Q. I would like to put on the Elmo a paragraph beginning on the same page of the excerpt that you read from before. Let me read that.
"Projected earnings per share and accretion analysis. Goldman Sachs analyzed the projected earnings per share EPS and projected EPS accretion of the combined company following the merger, using the synergies for the combined company projected by Staples management, of 91 million in fiscal 1997, 146 million in fiscal 1998, and 211 million in fiscal 1999.

"The projections of EPS for Staples was provided by Staples management, and projections of EPS for Office Depot were provided by Office Depot management and modified by Staples management. Such analysis indicated that the merger is projected to be accreteive to Staples' stand-alone EPS by 6.4 percent in fiscal 1997, 7.9 percent in fiscal 1998, and 10.3 percent in fiscal 1999."
Did I read that right?
A. Yes, you did.
Q. Mr. Painter, isn't the purpose of an accretion analysis to determine what is going to shareholders and necessarily what is -- not what is going to consumers?
A. It certainly doesn't assess what is going to consumers. You are absolutely right.
Q. I am putting on the monitor another visual that I pulled out of the notebook that Mr. Cary gave me before you testified. Can you read it on the screen?
A. Yes, I can see it here.
Q. Up top, it says, "An entire distribution claim of 883 million cannot be verified."
Can you see that?
A. Yes.
Q. On direct examination you were describing the inquiry you made to determine, or in order to conclude that the entire distribution claim of 883 million cannot be verified.

Do you remember that?
A. Pretty much.
Q. You did it twice, didn't you? You talked about all the A.T. Kearney documents you looked at?
A. Yes. I looked -- I did it twice. Did I say it twice?
Q. Tell me what documents you looked at and what inquiry you undertook in order to reach this conclusion?
A. I looked at the documents that were provided in the efficiency book. I believe there were underlying documents -- there were documents that we had received that were Kearney documents from the parties -- from Staples themselves. And there were 21 boxes of documents that were submitted to a copy center as a result of a subpoena from the Commission. Actually, I wanted to make this 21 boxes. And I went through all of the boxes, to the best of my ability. And that's the basis.
Q. And you concluded, based on your review of those documents, that the entire distribution claim cannot be verified?
A. I should have added "by me." I could certainly not verify them. I tried to explain some of the documents that in fact suggested to the contrary of what is being asserted and these are specific to this merger. By mentioning that, I saw documents used as the base from which to measure savings, at least on their face, 1996. And one actually for retail

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was 1996, August actual, one month. Or that -- and the other was budgeted 1996 figure for the BSD. I might have it flip-flopped.
Q. The fact that you can't verify these distribution claims, these savings, it doesn't mean that other people can verify them, does it?
A. You are absolutely right. We have asked, but you are right. That I can't verify them, doesn't mean that there isn't somebody out there, probably with Kearney.
Q. I think I stuttered in making the question. Let me say it again.
The fact that you cannot verify these savings doesn't mean that someone else cannot; right?
A. No, it doesn't.
Q. And in fact, given that you do not have experience in this industry and have not worked at these companies, you are at a significant handicap in verifying these distribution savings; is that right?
A. I am certainly at a significant handicap in understanding a lot of the documents that I went through, and I have a significant handicap with respect to the people that were literally compiling the savings. Again, with respect to being at a handicap, if the documentation was all there as to determining what was the merger's specific portion or what was not, I may not be at a handicap. I don't know.

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Q. You're not disputing there are in fact distribution claims, are you? That there are in fact distribution savings to be achieved here?
A. No. I believe that there probably are some distribution savings. I believe that if you took -- even companies the size of Staples and Office Depot that have fairly elaborate distribution systems in place, that even after they would rationalize or optimize the distribution systems, I believe that you could take those two systems stand-alone, optimize those, and achieve savings.
And I do believe that in fact there would be savings in that respect attributable to the merger, from distribution. I just don't know how much.
Q. One final document, Mr. Painter, from what Mr. Cary showed you before. Do you recognize that one?
A. I do.
Q. I believe it was the last document Mr. Cary showed you?
A. I think so, yes.
Q. And down at the bottom you have broken out the 5.03 percent into three separate categories; is that right?
A. Yes.
Q. And the first category you call erroneous; right?
A. That is the terminology attached to it, yes.
Q. And the second category you call unsubstantiated?
A. That's right.

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Q. And the third you call remaining possible efficiencies?
A. Yes.
Q. You are an accountant. What is the 1.66 percent, plus the 1.43 percent? What does that total up to?
A. 3.09 percent. 3.09 percent.
Q. And that is a percent of what?
A. That is a percent of sales.
Q. In the year 1998?
A. Yes.
Q. Do you know what the estimated sales are for the combined company in 1998?
A. Give me just a minute. (Pause, referring) I really think I might have it. Close, anyway. For some reason, 15,629 -- 15,629,000,000 is standing out in my mind. Correct me if I am wrong.
Q. Let's take that figure and multiply it by 3.09 percent. What does that come to? (Laughter)
A. Tell me again. I may need a calculator.
Q. I just want to you multiply the percentage that you calculated times the sales volume that you calculated, that you recall?
A. Okay. Assuming it is 15.629 billion and the percentage is 3.09 percent -- you won't help me out with a calculator?
Q. Mr. Smith will.
A. Thanks.

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Q. May I, Your Honor?
THE COURT: Yes, sir.
A. Is this a Staples product? Is this a GPS product?
Q. It is a Staples product, but I have no idea if it is a consumable office supply.
A. I get 483 million dollars, rounded. 483 million dollars, when I do the calculation.
MR. CURRAN: No further questions, Your Honor.
THE COURT: Thank you, sir. Let's see if there is any redirect.

REDIRECT EXAMINATION

BY MR. CARY:
Q. Mr. Painter, is there a relationship between accretion to shareholders and possible cost savings from a merger?
A. There is.
Q. What is that?
A. There is potential. There is certainly a potential relationship.
Q. What is that relationship?
A. I mean, to the extent that you have cost savings that are -- effectively translate to the bottom line; that they are not passed through, for example, to consumers in the form of lower prices, they have the potential for -- to the extent they are realized, they would improve the projected earnings per share.

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Q. Why would a company pass through cost savings to consumers?
A. To -- it would be a profit maximizing objective to in fact increase in terms of dollars the bottom-line dollar profits.
Q. So, efficiencies that are passed through to consumers should also result in an accretion to shareholder value; is that right?
MR. CURRAN: Objection, Your Honor, leading.
THE COURT: Why don't you just reask it to him.
BY MR. CARY:
Q. Would savings that are passed on consumers in the form of lower prices potentially have an impact on shareholder value?
A. To the extent that savings passed through to the consumer in the form of lower prices create great -- for example, create greater sales, that then create greater gross profit dollars, that then create greater bottom-line dollars for the company, then it would have an accreteive effect. It would improve earnings per share.
MR. CARY: No further questions, Your Honor.
THE COURT: Thank you, sir. Thank you very much, sir.
MR. KEMPF: Mr. Cary said he was going to call someone else, and I said that I would concede my time so he

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can finish today. There may be some dispute as to the time. My only question, Mr. Cary, I don't want to raise this, but I think you have about half an hour left, 20 minutes or so.
MR. CARY: I can finish in half an hour, Mr. Kempf.
MR. KEMPF: I can name that tune in four notes.
MR. CARY: Plus I think that means that you have no time left which means there is no cross-exam; right?
MR. KEMPF: No, I have a little time left.
MR. CARY: Your Honor, the Government calls Professor Warren-Boulton.
THE COURT: Good.
FREDERICK WARREN-BOULTON, GOVERNMENT'S WITNESS, SWORN
THE COURT: Good afternoon, or evening.
DIRECT EXAMINATION
BY MR. CARY:
Q. Professor Warren-Boulton, welcome back. As you have heard, we are extremely limited in time, so I would request that you answer my questions as concisely as possible so we can get through this very quickly.
A. Yes.
Q. You have been sitting in the courtroom during the defense case, have you not?
A. Yes.
Q. You have heard testimony alleging that there are efficiencies that arise from this transaction; correct?

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A. Yes.
Q. And have you also heard testimony about the possible price impact, anti-competitive price impact as a result of this transaction?
A. Yes.
Q. Could you please explain how, as an economist, you woul[d] evaluate those two forces arising out of this transaction?
A. It would be -- would it be possible for me to use the board?
THE COURT: Certainly.
THE WITNESS: In looking at the effect of both of these influences together on prices, there are really two things going on here that have been talked about continuousl[y] over the last two days.
One is the competition effect, and the second is the cost effects. Cost or efficiencies almost always are scaled effects. And the combined effect of these two gives you the price effect.
THE COURT: Let me give you a mike, if you don't mind. I don't think a lot of people here can hear you, and they need to hear you. There should be 40 feet of cord there.
If you would hold that with your other hand when you talk. Thank you, sir. That's on.
THE WITNESS: Now, the competition effect is the

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effect of the merger if there were no efficiencies at all. We've estimated this from a number of different sources, including documents and elsewhere. But what I would like to do in going through here is really go through almost like a numerical example with reasonable numbers, so we can get a feel as to how we combine these things and some idea of the sensitivity, shall we say, of the results. The kind of assumptions, or whatever numbers you decide are the right numbers, how one would go about combining them to get to the answer.
And the answers which I want to get, or at least I am assuming we want to get to, is what will be the effect of the merger on prices. And my particular concern is the -- on the price of office supplies in the regions where Staples and Office Depot compete. So that is where I am going.
In doing that, we would start with an estimation of what would be the effect of the merger, absent efficiencies, at least at the national level. I will make that point later. Because this is the only question that we can truly answer using the experience of the past. We have an enormous amount of data which has been put together in admittedly very complex econometric models, but in trying to learn what it is that we can tell from the past that would help us in the future, the one question we can answer there is, what would be the effect of the merger before looking at nationwide

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efficiencies.

And to begin with, there is no dispute amongst anybody that this is positive. We -- absent efficiencies, it is my understanding from listening to everybody here, that everybody agrees the prices would go up in these markets after the merger. The FTC certainly believes it. Professor Hausman believes it. Mr. Sternberg believes it. So it is not a question of whether this is positive or not, it is a question of how big it is.

The best estimate from Professor Ashenfelter is something in the order of 7 and a half percent. He is a statistician, and so he won't tell me exactly what the right number is to 12 significant digits, which is what I would like. But what he will say to me is, Look, it is somewhere between 5 and 10. I mean, I am confident that it is somewhere between 5 and 10.

So from my point of view, as a matter of fact, I will start with my own number. I know of course that perhaps Staples would like to start with different numbers, but let me just start with what I think is, for example, what Professor Ashenfelter would argue and which I find consistent with the documents, by the way, as the right number for the percentage price increase if we had no efficiencies.

And the second question is then to ask how large efficiencies are we going to have. And as we have been

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listening to here for some time, that too is under a great deal of dispute. The parties appear to be alleging efficiencies something in the order of 6 percent. I have listened for the last hour, two hours, two and a half hours to Mr. Painter on the cross, and I have read his report. And anybody can decide whatever number they want to decide. My feeling about what you should do or one should do is one should err on the conservative side. You want to make sure you don't let a merger through unless it will be efficient.

I am going to put up a number that I think is a big number. I would probably, if pressed, say it was much smaller, but I am sure the other parties would disagree. And it would be something like the order of one and a half percent, if I take Mr. Painter's results out of the 6 percent. And I asked, what is left after we look at substantiated efficiencies that are specific to this merger, that would not happen otherwise. Because if they would happen otherwise they are not really relevant, because we are looking at a price effect that would have happened otherwise.

So we have about a one and a half percent. But that unfortunately is not the end of the story. Because the next question is, how much of this will be passed on to consumers, and that is the pass-through rate.

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Now, in this particular case, while this will be disputed, I would argue that virtually all of these efficiencies are specific to the firm. Certainly all of the non-procurement ones, and as an economist I would also argue even the procurement ones are specific to the firm.

We have -- or rather Dr. Ashenfelter has been able to look to the question of how and what percentage of efficiencies get passed through, depending on whether they are specific to the firm or whether they are across the industry. And the answer is, as economic theory would lead you to expect, the percentage is much smaller if it is specific to the firm. If I get a cost increase and it is only to me, I am under no pressure to pass that on. But if that cost increase also goes to my competitors and he cuts his prices I will find that I am cutting my prices, not just because my costs have gone down, but because my competitors have cut their price.

THE COURT: You said cost decrease; right?

THE WITNESS: We get a cost decrease.

So what kind of pass-through rate would be reasonable? Professor Ashenfelter's estimate is 17 percent. I am not nearly as good with numbers as Mr. Painter, so I would like to round that up to 20 percent so I can multiply, you know, in my head. So I have 20 percent of 1 and a half percentage points that are going through, and so what I have

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is the equation here, is I have a 7 and a half percent price increase, absent efficiencies. I have one and a half percent of revenue which are cost efficiencies; which, by the way, is in dollar terms a very, very large number. That is a big amount. 20 percent of which are passed on. Okay.

And what I have is, since this is .3, I have an estimate of what is the price effect of the merger in those markets where Staples and Office Depot compete for office supplies. At this point that would be my best estimate if I had to look into a crystal ball and see what was going to happen.

Faster?

Q. No. I was going to ask you a question. I was going to slow you down a little bit. Can you walk through the calculation that got you to 7.4? You went too fast for me.

A. Went too fast for me too. Is that better?

Q. It is the .2 times 1.5. I got it.

A. Minus .3 should be 7.2. Sorry. That is why we have calculators.

Now, the question next is, how sensitive is this to any kind of reasonable change?

Q. On this scale then, if you still have a positive price effect, the merger would be anti-competitive?

A. The merger would be anti-competitive. I will put a plus 7.2 there. We now have 7.2 percent price. And the next

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question is, how sensitive is this to the kind of things that could happen. I mean, you know, what are the numbers alternatively that you might want to plug in?

The first thing you could say is, how sensitive is it to the amount of efficiencies? You could ask, suppose we simply doubled the amount of efficiency above what Mr. Painter would give them. At that point we have 7.5 minus our 20 percent pass-through, times 3 percent efficiencies. Okay.

And so what we would get here, if I am good at this, is I now have a plus 6.9 percent. So if I doubled the amount of efficiencies that are involved, holding the pass-through rate the same, I still get 6.9 percent price increase, which is a very large price increase.

Now, I could say well, maybe I am not just wrong about the efficiencies. Maybe I am wrong about the pass-through rate. Perhaps Professor Ashenfelter has missed and we should double his pass-through rate.

Now we go 7.5 and double this pass-through rate as well, we get 40 percent of the 3 percent efficiency rate, and I have now got a plus 6.2. So, the thing is that no matter how large the efficiencies are -- not no matter how large, but any reasonable range of efficiencies and pass-through, even when they are twice what the data appear to be the pattern in the past. What we are getting is very large price

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increases.

THE COURT: How did you get the 6.2? And the .2 part of that 6?

THE WITNESS: Yes. And again. All right.

So however one does it, one basically has to go through this same little formula. And you know, without sort of prejudging which number should be where, it just is an easy way to sort of say, what are the reasonable numbers that I find for this price increase. This happens to be Professor Ashenfelter's number, but anybody can plug in relative numbers and come to a result.

And the point essentially that I see here is that these results in terms of the bottom line you, if you like; which is, do you expect to see a large price increase after this merger for office supplies in overlap areas, the answer is yes, and it is not very sensitive to the kinds of assumptions that you need to make here.

BY MR. CARY:

Q. Very good. Do you mind pressing the Xerox button before you return to the witness stand.

A. It wasn't on.

Q. It wasn't on? I am sorry, I thought I turned it on.

(Pause, diagram copy made)

Q. Professor Warren-Boulton, one other thing I would like you to address. We have heard a lot in the defense case

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about Wal-Mart, and I would like you to address the extent to which Wal-Mart can be expected to significantly constrain or even eliminate the price increase after the merger?

A. Okay. Once again, I would like to approach it in terms of what I have heard is the facts of the case, but also mainly in terms of how you put it in perspective. I guess, if I can, I have to get back over here again.

Q. All right.

A. Can I erase this? Let's erase the productivity loop. I think I just reduced your productivity.

So it is a scenario with respect to how you might look at the role of Wal-Mart in this process. And let me just start with what seems to be consistent with what I have heard the Wal-Mart people saying to me when I listen to them and when I read the depositions.

And let me begin with here, let me just draw something that would be what is essentially sort of a picture how the FTC sees the relationship between exception and prices in -- for Staples. And essentially the way the FTC has thought of this and the way I have thought of this is the price of Staples.

We can think of that being in several competitive zones. The lowest price zone is the one where all three are. Staples and Office Depot and OfficeMax. Okay.

And then there is second group in which there are

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two competitors. Two competitors, Staples, plus OfficeMax.

And there is a third group in which there is another group of two, which is Staples plus Office Depot.

And finally there is a final group, which is the Staples only. The one competitive superstore.

I think what the data says, and what everybody agrees, is that the highest price is in the Staples-only zone. The next is in a Staples plus OfficeMax, since OfficeMax clearly seems to be much less forceful competitor here than Office Depot. The next lowest is Staples plus Office Depot. And very close behind it, not far away, is all three firms.

Now, if we think about what Wal-Mart said in the depositions -- or at least what I hear them saying. Wal-Mart says -- and let me draw a sort of a run underneath there -- they have basically nationwide prices. National pricing. Everyday low pricing. So if we have the price of Wal-Mart here, and we look across these zones, what they say is they begin with a single set of nationwide pricing. So we'd expect it to look something like that.

The only thing is, they then go on to say, where they face competition in particular areas, particularly low prices, either from Kmart or Target or from category killers, in those particular products where they face particularly intense competition, where prices are lower, they will lower

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their prices. They will discount off their already low everyday national prices.

So if I kind of like draw these little zones down here, unfortunately I don't have a data set that consists of Wal-Mart prices to test this, because that would clearly be the next step. As I understand what Mr. Glass and Mr. Long said, what they have said is when they see particularly strong competition from category killers, what they do is they discount. A little bit. Some, I don't know how much, off the price.

Now, since what we find is that there is particularly strong competition when Office Depot is present, I would expect to see that in markets where Wal-Mart competes with Staples, Office Depot and OfficeMax, what they will tend to do is they will tend to discount off the national price. And in markets of here and here, they will tend to get a relatively large discount, and here they won't discount at all. Okay. And there maybe, you know, maybe not at all.

So now we ask the question, what happens when there is a merger here? Now, one story we will get to in a moment is a story that says Wal-Mart will stop this merger from being profitable, at least in terms of its increased price and increased monopoly profits story. Another story is what I hear here. That is, if we have a merger, what will happen?

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What the FTC is alleging, and what I believe, is that what we are going to see if this merger goes through is a perhaps gradual, may take days or months or a year, but what will happen is that these -- this price level will begin to approach this price. They will probably move down and converge, so that over a period of time what they will see is -- by the way, all of these prices are drifting down. Prices are constantly declining in this industry, and they will probably continue to decline no matter what we do here today, the same way as prices decline in the computer industry even if there were a monopoly.

But looking at it, as somebody says, caeteris paribus -- all else being equal -- what we expect to see is that -- what the FTC would expect to see, and I would too, over time this will drift up. So the price effect that we will see is here, that these three-firm markets, Staples, Office Depot and OfficeMax will begin to look like Staples and OfficeMax markets. These markets that are Staples/Office Depot markets, will begin over time to look like Staples markets.

Now, when you estimate this in the past and you ask the question, looking at the past, the last 20 months, in the data and saying, how big a price increase, how big a difference is there a year, holding constant for everything we can think of holding constant. Holding constant for costs

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at individual stores, holding constant of time, holding constant for presence of competitors, holding constant -- I am sorry, for the number of competitors, holding constant for everything we are physically capable of holding constant for, what happens is you get numbers in the order of maybe a 5 percent price increase here; maybe a 9 percent price increase there. And overall, across the board, it is somewhere like 7 to 7 and a half percent. Professor Ashenfelter said somewhere between 5 and 7 percent is what we expect.

So now what is the relationship between this and Wal-Mart? Well, as I understand the story that I am hearing, what Wal-Mart does is they would say after this merger, We have seen an increase in prices here. Competition from the categories is less intense. That does not say they will turn around and say whoopie, I will raise my prices today. But in the same way as these prices drift up, we expect to see those discounts drifting up too.

So what I would expect to see in terms of the relationship between Wal-Mart's prices and the office superstores prices over time is not one story. It is not that the presence of Wal-Mart makes the merger unprofitable or it doesn't result in price increase, but that there are ripple effects that go outside. That we expect to see perhaps a little lessening of the discounts there in terms of Wal-Mart.

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And I think, you know, whenever you define markets, markets are not watertight. The idea is to define a market so you have a market that is at least one worth monopolizing.

It is like you take a rock and you throw it in a pond, and here is Staples and Office Depot. That is where the biggest impact is. And then the ripples head out from there. And you say, where is the next? Where are you going to be anchored to get the next biggest sort of bump? I think it is OfficeMax sitting out here. That sort of goes out. And when we look at the data in terms of the ripple effect of the merger, you know, maybe you get into Best Buys. At the moment, at any rate, Wal-Mart is really out here.

Now, why don't we think -- you know, could it go both ways? The answer is yes. Wal-Mart could be constraining the office superstore pricing and the office superstores could also be constraining to some extent Wal-Mart's pricing. And we have been able to test for that: that at least looking in the past for the past 20 months, saying, how much of a difference has Wal-Mart made? We can answer the question, what would happen if Wal-Mart disappeared? What would happen to the prices here? And the answer is, it is a very small number for the Wal-Mart of the past 20 months.

Q. How small?

year or so would be enough so as to drive that number down to a relatively low point? Because you have to get it down to a relatively low point if you are going to -- I guess we have left it, but if you are going to get a number for the price effect absent efficiencies which is sufficiently low so it can be offset by the cost effects times their pass-through.

And all I can say is, looking at the past, it doesn't -- you know, I can't see any way I could reliably feel any sense of confidence that Wal-Mart is going to change in such a way as to make this a credible alternative.

MR. CARY: Thank you. No further questions, Your Honor.

MR. KEMPF: My count, they are over 15. And I won't use my full 15, but I do have a little bit of cross. I will try to be very brief.

THE COURT: That's fine.

(Pause, diagram copy made)

MR. CARY: Just for the ease of the record, I will take the Xerox of this and have it prepared in an exhibit form that is a little more manageable than the printout that comes out of the machine.

THE COURT: All right. Just take exactly that as it looks.

MR. CARY: Exactly how that looks and put it on a real piece of paper instead of the shiny stuff.

THE COURT: All right.

CROSS-EXAMINATION

BY MR. KEMPF:

Q. Professor Warren-Boulton, let me hand you up something I have identified as 9012. And I will give the Court a couple of copies.

MR. CARY: Your Honor, I will object to the ground this subject was not touched upon in the rebuttal case, and therefore it is beyond the scope of direct.

MR. KEMPF: It is be beyond the scope of direct. You asked me the first day we were together if we would be sticky about holding people to direct, and I assured you I wouldn't. I thought we had a sauce rule.

And what this is is something that I picked up from Mr. -- or Dr. Warren-Boulton the other day at the end of his examination, when I said, Let me take a peek at your notes. If I can cover this.

THE COURT: I will let him do it for a couple of minutes in this area. Go ahead.

BY MR. KEMPF:

Q. These are some notes I saw you making on the witness stand the other day when you were testifying. Do you recall these?

A. I certainly recall this piece of paper, yes.

Q. And if I take a look at the first page and I go over to

where you had, where you had testified about 6.68 expected price increase -- do you see that on the bottom column, the last number? I am sorry, middle column, last number?

A. Yes. I see 6.68, yes.

Q. And then when you were recalculating up there you came up with something less than 5 percent. It looked like 4.45 percent to me; is that correct?

A. No. Actually, that is not even my handwriting.

Q. Whose is that?

A. Sergar Delkar.

Q. Who is he?

A. He is an economist at Micra.

Q. And he came up with the 4.45?

A. No. He was looking to see what result you would get if you assumed a 10 percent discount rate.

Q. If you're assuming a 10 percent discount rate, you get 4.45?

A. That is correct. As I said, between 10 and 20.

Q. Let's go over to the chart over there. See the first column?

A. Yes.

Q. I believe that you testified --

MR. CARY: Your Honor, I would object to the introduction into evidence of this document, with a cover sheet prepared by Mr. Kempf that doesn't look like

Dr. Warren-Boulton's handwriting.

MR. KEMPF: I am happy to change that sticker and put it on the second page.

THE COURT: Thank you.

BY MR. CARY:

Q. The first column, competition effect?

A. Yes.

Q. That is in the overlap markets, I believe you said?

A. That is correct.

Q. Now, the second column, the efficiencies, those are in all markets; isn't that correct?

A. That is correct. I tried to make that very clear.

Q. So that if you were to redo that chart and say, let's look at the overlap markets -- excuse me, the non-overlap markets, what you would have is you would have no Column 1; is that correct?

A. That is correct. But I think Column 2 would be different as well.

Q. Well, my point is there would not be a Column 1; is that correct?

A. That is correct.

Q. All right.

A. At least not now.

Q. I understand.

A. I mean, next year -- as I think we sort of pointed out,

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these markets --
Q. The answer is no, I take it?
A. I am sorry. Was the answer tomorrow no? The answer is no, tomorrow. That is correct.
Q. I take it the commercial you are trying to give is if there is more overlap stores in the future, there would be more Column 1s. Is that the gist of what you are trying to sneak in?
A. I am trying to give you an accurate answer, sir.
Q. Mr. Cary will pick those things out.
You said during your direct testimony that everyone said that prices would go up. Why, even Mr. Sternberg said that. Do you recall that?
A. That is my recollection.
Q. He didn't say anything like that, did he?
A. I think he said that --
Q. No. No. Answer my question first. He didn't say anything like that, did he?
A. I don't have a quote from him, no.
Q. Were you here when he testified?
A. Yes.
Q. Do you remember the last thing I asked him is what would happen to prices, and he said they would go down?
A. But you are not talking about the number.
Q. No. I am talking about what you said he said. Don't

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you remember my last question is what would happen to prices, and he said they would go down, and they would go down in every single market in the country?
A. Yes.
Q. All right. When you are talking about the pass-through analysis, that was on the 30 SKU out of 7,000 analysis, wasn't it?
A. That is correct.
Q. Now, let's take your column over here and let me sort of -- do you see that? Look at the top line there. This is one that we don't have a 7.5 on it. But I think what your testimony is, is that there were -- you know, late-changing news from Dr. Ashenfelter said that the final column ought to be about 7 and a half. Do you remember that?
A. Again, my previous exhibit said 7.6. But we could make it 7.5.
Q. It is changing all the time. All I am saying is the chart doesn't have a 7.5, so I will work with these numbers.
And I gather what your testimony is, what you show over there, is if you took any of the other columns and applied the second column to it, why, the price change would be even lower than the small price change shown on here. Isn't that the implication of what you drew up there?
A. I am sorry. You lost me there.
Q. In other words, if we took Column 6, which is now --

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A. I am sorry. I was looking at.
Q. If you look at Column 6 on the monitor, 3.7?
A. Yes.
Q. And what I gather your testimony is, if you took this column of Dr. Ashenfelter's and applied the efficiencies analysis, you would come up with 3.4 instead of 3.7. It would be lower; right?
A. It would certainly be lower.
Q. That would be true of every column on here, wouldn't it?
A. That's true.
Q. Now, there was a comment here -- I think it was by Dr. Ashenfelter -- that a number like 11 that Mr. Hausman had on the first column or 14 like he had on the final column, that is a pretty good T square. If you will back up a little bit, you will see that that is a T square number.
Can you un-zoom me a little bit? Keep going. We are getting there.
A. T statistic.
Q. See, it is a T square?
A. Yes.
Q. And he said that you know, 14 number -- anything over two means that it is statistically significant. Do you recall that testimony?
A. At the 5 percent level, yes.
Q. And when you get these high numbers like 14 or 11, those

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are like million and one shots. Do you remember that testimony?
A. That is correct.
Q. Okay. Let's go to column 3. You can zoom in a little closer Mr. Gidley.
I take it what the implication of that is, if these numbers like the 3.7 figure in Dr. Ashenfelter's sixth column, or the 3.6 in his fifth column, or the 3.3 in the fourth column, or all -- or the 2.5 in the third column, those all have pretty hefty T square numbers, don't they?
A. They are T statistics. But what that is saying is that they --
Q. Do they have large T statistics, is my question?
A. They have very large T statistics.
Q. That is the only question I am asking you. Thank you.
Now, the other thing is you had said that everybody said that this competition effect would occur, but for efficiencies. They testified a little more than that. Didn't Dr. Hausman say actually there were two things?
A. Can you refresh my memory?
Q. Well, I'm asking you. Don't you remember he said there were two things?
A. Two things?
Q. You said there were two things that would impact that, one being efficiency. Didn't Mr. Hausman say there would be

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two things that would impact it, one being efficiency and the other being --
A. Pass-through?
Q. No. How about try "entry"?
A. Yes.
Q. Didn't he say that?
A. And that is what I have tried to deal with in the Wal-Mart issue.
Q. When you put that up there, you said everything except efficiencies. And the actual testimony is everything except efficiency and entry. Isn't that correct?
A. I'm sorry. I was trying to be very clear. When I was talking about the Wal-Mart, what I was saying is that the one thing not taken into account there is an issue such as Wal-Mart changing the nature of what it is doing. That is why I discussed Wal-Mart.
Q. But entry by anyone is important, isn't it?
A. Entry is always important.
Q. And it doesn't matter who it's by, does it?
A. It could matter who it was by.
Q. Well?
A. For example, if I entered the office super supply business, I don't think it would --
Q. You're correct on that.
A. Thank you. Once again we reached agreement.

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Q. But entry that is real by someone that knows what they are doing is significant as long as there -- it may be more significant if General Motors or IBM decides to enter it, but entry that is real and provides pressure is always a welcome thing and always has an impact, doesn't it?
A. In general, yes.
Q. You talked about the competition effect. Didn't Dr. Ashenfelter testify that he didn't know whether that was sustainable; that it might be a one-shot event under his analysis?
A. That would seem reasonable.
Q. All right. Now the efficiencies. You know there is evidence that the efficiencies will go on year after year after year, and indeed increase over time, even under Mr. Painter's analysis?
A. I am sorry. When you meant a one-shot on the prices, you meant they would go up and come back down again?
Q. I said that he said that he didn't know beyond that. There would be an immediate one-shot one, and he didn't know if it would be sustainable or not.
A. I think in terms of -- it seems reasonable to me they would -- in fact, my testimony has been.
Q. I am asking you -- I have moved beyond that. You already testified to that.
I am now asking you on efficiencies. Those go on

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year after year. And not only that, they increase over time, as Mr. Painter's analysis has shown?
A. The question is whether the price effects would --
Q. No. The question is whether the efficiencies are one shot or continue on over time, and indeed get bigger over time?
A. I really don't have any particular view as to whether or not those efficiencies are likely to grow or not.
Q. Let me carry you back. Let me put this up here. This is the last thing we looked at this part right here. This is Mr. Painter's exhibit, do you recall? I think you were in the courtroom?
A. Yes.
Q. And it talks about a percentage as against sales. Do you remember Mr. Curran walked him through 3 percent times 15 billion dollars as 483 million, I think was his number?
A. Yes.
Q. Sort of a robust number?
A. Large.
Q. And the sales won't be 15 billion. This year they are up from 10 billion to 15. Isn't it anticipated, and don't you expect that the combined company sales will be, instead of 15 next year, maybe 17, maybe 20. And then maybe 25. So that we apply 3 percent efficiencies against the number over time, the amount of the efficiencies in terms of -- may stay

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the same percentage year to year, but in terms of dollars it increases year to year. Is that fair?
A. These are all in percentage terms.
Q. But the efficiencies are not only what they are, but they increase over time?
A. I think that --
Q. Is that correct?
A. I have no idea if the increase --
Q. Is that the implication of Mr. Painter's chart here?
A. I think you would have to ask Mr. Painter.
Q. When you look at it, let me ask you this, is 3 percent of 200 higher than 3 percent of 100?
A. Yes.
Q. And if the 3 percent figure is correct and the sales increase, won't the amount of the efficiencies increase from year to year?
A. The dollar value would, necessarily. Yes.
Q. All right. Now, let's go back to this for a minute. In looking at a merger you care about all consumers and the impact on them, don't you?
A. Personally?
Q. Yes.
A. Yes.
Q. Now, let me jump forward to the next one. Let me see if I have any questions on this, and then I will jump forward to

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the next one and we will be done.
Now, you see your first three charts there? I mean, your first three bars there; the three and then the two two-firm markets?
A. Yes.
Q. And you see how you have the two two-firm markets above the three-firm market?
A. Yes.
Q. And in fact, if you look and compare the first bar with the third bar, you see how you have the Staples, Office Depot bar higher than the markets where there is Staples, Office Depot and OfficeMax, according to your drawing?
A. Yes.
Q. Actually you concluded at one point in your work on this case that that bar is actually in the wrong place, didn't you?
A. I think you will have to explain.
Q. Didn't you conclude that the average prices appear to be somewhat higher in markets where Staples and Office Depot and OfficeMax are present, than markets where only Staples and Office Depot are present?
A. I think those are the simple averages, yes.
Q. Based on your conclusion that you reached, that chart is drawn wrong, isn't it?
A. No. As I tried to be careful when I explained this,

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that that chart is an attempt to ask all -- holding all else constant: Holding constant local cost conditions, holding constant the level of competition from the other firms, it is the caeteris paribus. It is holding all else constant. What you do with an econometric model, you know, what are the price differences between three-firm, two-firm and one-firm zones? If you look at the simple averages, not holding constant for those, you can get variation there.
Q. You have the Staples/Office Depot line. In fact, you can see it above the red line here; right?
A. That's right.
Q. And that is way above the blue line over in the three-firm market; right?
A. Yeah. The econometric results are that it is above. Not a great deal above, but yes.
Q. And the conclusion you reached is that the average prices appear to be somewhat higher in the markets where Staples, Office Depot and OfficeMax are present than in markets where only Staples and Office Depot are present?
A. Those conclusions are based on, as I stressed, simple -- just simply comparing zone averages from the documents. But that is what you criticized. That is why we wanted to do an econometric model was to handle that sort of problem.
Q. Let me turn to the efficiencies, and that is the last thing I want to cover.

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Now, the reason that Wal-Mart checks Staples and Office Depot and OfficeMax is because Wal-Mart views Staples and Depot and OfficeMax as competitors in the sale of office products. Isn't that right?
A. That is correct.
Q. Now, wouldn't you agree that where companies monitor the prices of each other and react to changes in each other's prices, that that is an indication they are significant competitors?
A. It certainly would be consistent with their being competitors. How significant is an empirical question.
Q. Now, in comparing SKUs, and in comparing companies that are selling office products, if you want to compare the number of SKUs each are carrying so you can say how many SKUs does this one have than the other one, you want to do an apples-to apples comparison, don't you?
A. I assume, yes.
Q. And if one person has some of the things that the other one counts as office products, parked over somewhere else, whether it is in the electronics department, a battery department or computer department, whatever, if you were doing a company-to-company comparison, you would want to move those over and add them to the tote, so you get an apples-to-apples comparison, wouldn't you?
A. Not necessarily, but you can do that.

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Q. Why would you not necessarily want to do that?
A. I think, as I have said in my direct testimony, trying to mine a great deal of information by looking at SKU counts, it is difficult and not all that rewarding process. We can all think of examples in which you can count SKUs, in your term, to apples to apples, and come up with all kinds of strange SKU counts. I think the purpose of counting SKUs or identifying things like what people consider to be their competitors is to establish a provisional market. Who is likely to be -- who should you look at? Who should you expect that are good candidates for being in a provisional market if you want to expand to arrive at your market definition.
And the more different firms look, the more different the products look, you know. The less likely you are to say those are firms that are similar.
Q. Let me just ask you in terms of three simple things.
A. Yes.
Q. Suppose over at Office Depot and Staples, they count as office supply, consumable office supply SKUs, toner, batteries, and disks. Okay?
A. Yes.
Q. Now, if you are comparing them to somebody else in terms of their SKU count of consumable office supplies, and that other person has those three other, those same three products

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but in a different department, you want to move those over and count them in their SKU count to get a fair comparison, don't you?
A. You can do that.
Q. No, no. Don't you want to do that to get a fair comparison?
A. I don't think that would be unreasonable.
Q. I didn't ask you whether it would be unreasonable. I said if you want to do it fair, isn't that the way you do it?
A. Fairness is not an economics concept. (Laughter)
MR. KEMPF: Your Honor, I will take that answer and move on. Three last questions.
BY MR. KEMPF:
Q. Evidence that larger firms have lower unit costs would help corroborate specific efficiency claims, wouldn't it?
A. Yes.
Q. All right. Second, the past merger experience of the merging firms or other firms in the industry can be a source of evidence indicating the validity of claimed efficiencies, can't they?
A. The past measure of experiences with respect to efficiencies? It could be. If you believe that you were in a similar position to where you had been in the past, yes.
Q. And evidence the past mergers reduced unit cost would support a claim of efficiencies; isn't that correct?

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A. Yes.
MR. KEMPF: I have no further questions, Your Honor.
THE COURT: Redirect, Mr. Cary.
REDIRECT EXAMINATION
BY MR. CARY:
Q. Mr. Kempf characterized some testimony by Professor Ashenfelter. You didn't take Professor Ashenfelter to be saying the price effects on this transaction would go up and then back down, did you?
A. No.
Q. Would you expect the price effects to be sustained for some period of time?
A. In fact, as I think I have testified, I would expect them to be intensified. That 7 and a half percent or whatever number would come out of this model basically assumes that the future is -- can be predicted by the past.
And as I think I said on my direct, there are a couple of things copying up on the horizon which would seem to me to indicate that the effects of this merger are likely to be more severe if you compare the world with merger and the world without the merger, and you say that difference will be 7 and a half percent based on the experience over the past 20 months. If you project what you think is happening in this industry and where it is going, and you ask how big a

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difference will the merger have made in two to three years, I would say that the difference is likely to be greater than 7 and a half percent for the reasons that I outlined. Which is, first of all, facility overlap amongst these stores is increasing. Indeed, there is some evidence that impact is the impetus of this merger.
And secondly is the finding both in the documents, in the financial reports; and most interesting, even has been confirmed in the econometics analysis. As markets approach saturation, that competition amongst the office superstores intensifies. So that at the moment, you know, there is a 7 and a half percent difference depending on the level of competition. Once they eat all of the little fish in the pool and turn on each other, that 7 and a half percent is likely to be -- you know, competition among the superstores is likely to become more important.
If I am asked the question if I am looking forward into some sort of "but for" world, what is the effect of merger and no merger in terms of the price of office supplies, I would say that while the immediate estimate might be 7 and a half percent increase, if we look forward into the year 2000 and comparing those two rules, that number is likely to grow rather than shrink. But then there is the possibility of Wal-Mart, and these are balancing factors that you have to take into account.

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Q. Mr. Kempf also asked you about the expected growth in the efficiencies over time. Were you in the courtroom when Ms. Shira Goodman testified?
A. Yes.
Q. And Ms. Shira Goodman was the Defendants' witness on behalf of efficiencies; is that right?
A. Yes.
Q. Isn't it true that Ms. Shira Goodman has written that the relevant advantage of NEWCO's sale versus Staples or Office Depot would only decrease rather than increase over time? Do you see that on the diagram for defendants?
A. That is what is on this document, yes. In other words, in a sense that's what you expect to see. Most industries have scale economies up to a certain level. As you increase the scale of output, your average costs fall for a host of reasons. For most industries they then flatten out. And indeed, in the vast majority of industries you start getting disecomomies of scale. In other words, costs first fall with output, and they remain constant with output for a while, and then they start to increase with output. And that is why we have businesses of all sizes.
There is only one situation that I know of that is described in economics that is a situation in which scale economies continue indefinitely, and those are called natural monopolies. They are industries in which scale economics are

that don't deserve it. So we thank you all for the work.

We will be back for the closing arguments on June 5th, I believe. Thursday at 9:30. Two hours apiece. If you want to reduce that or add to that, you give me a call and we will talk that over. Right now we will leave it at that. Thank you.

THE DEPUTY CLERK: All rise.

(Which were all proceedings had at this time.)

CERTIFICATE

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

PATRICIA YERKES, RMR-CRR

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