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1 UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF COLUMBIA

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4 FEDERAL TRADE COMMISSION, . . . Docket No. CA 97-0701
Plaintiff, . . . Washington, D.C.
v. . . May 23 1997
7 STAPLES, INC., et al., . . . 9:30 a.m.
8 Defendants.

9

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

11 APPEARANCES:

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

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1 PROCEEDINGS

2 THE COURT: Good morning, counsel.

3 THE DEPUTY CLERK: Civil Action 97-0701, Federal

4 Trade Commission versus Staples, Inc., et al. Counsel,

5 please identify yourselves for the record.

6 MR. CARY: Good morning, Your Honor. George Cary

7 for the plaintiff. Mel Orlans, Gary Roberts, Jonathan Baker

8 of the Bureau of Economics. Jim Fishkin, John Weber, Bill

9 Lingdorf.

10 THE COURT: Thank you, sir.

11 MR. KEMPF: Good morning, Your Honor. Don Kempf

12 for the defendants. With me are Mr. Gidley, our clients

13 Mr. Fuente and Mr. Stenberg. Mr. Gidley will be doing the

14 examination of Professor Hausman this morning and working

15 with him will be my associate Mike Becker over there, Frank

16 Vasquez from White & Case and Andy Dansicker from White &

17 Case and also Mr. Assaf is up here with us this morning.

18 THE COURT: Thank you.

19 What is your schedule for the morning if you look

20 at your time and witnesses?

21 MR. KEMPF: We have, Your Honor.

22 Let me cover that right now.

23 As you know, the defendants fought hard to get this

24 hearing, Your Honor. We appreciate the opportunity we have

25 had this week. We have tried to use our time wisely and well

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

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Data analysis
Efficiencies - how much
Can't see sense / 1/24 to - trees
Bad documents
Lawyers
Judge's reaction - nothing yet -
Analyze oral 2/29

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

2 We are the persons what fought hard to get it. We

3 know you have responsibilities next week. So we will make

4 sure that it ends today on our side.

5 To that end, I have given the government our list

6 of witnesses; and I will tell what you what that is, and then

7 I will tell you what I told them in terms of my game plan.

8 That is we are shifting things around. Last night, I

9 mentioned to you we had originally two mail-order witnesses

10 coming, the president of Viking and the CEO of Quill about

11 whom you have heard testimony from others.

12 We decided we didn't need two. We dropped

13 Mr. Helford earlier this week. Last night in view of our

14 time schedule we dropped Mr. Miller. One lives in California

15 the other in Illinois. There are lengthy declarations from

16 both of them. I will give you the cites at the next break.

17 Both have been deposed. In light of that and in light of the

18 fact there have been an abundance of competitor witnesses, we

19 have dropped both of those.

20 We also rearranged things particularly in light of

21 the Court's questioning the other day of would we call

22 economists, and if so, when.

23 We will call our economists, Professor Hausman,

24 this morning. Thereafter, I will call the following

25 witnesses: Mr. Smith will do a short presentation similar to

1 the ones we have done on competitors and suppliers and
 2 analysts. This time on consumers.

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

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

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

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

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

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

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

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

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

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

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

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

3 THE COURT: Mr. Cary?

4 MR. CARY: A couple of brief comments, Your Honor.

5 As you will recall during the course of Dr. Ashenfelter's
 6 deposition, the Court was involved on the question of
 7 Mr. Ashenfelter testifying to certain gross margin material
 8 that Professor Hausman was doing that we had gotten late, I
 9 think the night before Dr. Hausman's deposition. The outcome
 10 of that discussion was that the defendants would have an
 11 opportunity to depose Dr. Ashenfelter if he had an
 12 opportunity to complete that work. Dr. Ashenfelter was very
 13 clear on the record that given the amount of time left, it
 14 was unlikely that he would be able to complete that work and
 15 as it turns out, he was not able to complete that work and,
 16 therefore, we don't plan to bring him in on rebuttal. Given
 17 that, and the lateness of the hour last night, it didn't
 18 really make any sense to go ahead with the deposition.

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

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1 testimony, and that would be the limited purpose for which we
 2 would call him. We do plan to call Professor Warren-Boulton.
 3 THE COURT: All right. Fine, thank you. We will
 4 try to move ahead then with the witnesses we can get to this
 5 morning on behalf of the defendants. Obviously, Dr. Hausman
 6 and maybe some of their other witnesses.
 7 The deposition, the video excerpt it seems to me
 8 could be submitted for the record and I can watch it later if
 9 that is going to take up some time.
 10 All right. We will go with the first witness,
 11 Mr. Gidley.
 12 MR. KEMPF: If I have time, I would like to see
 13 that, Your Honor. It says a lot. It is the Sergeant Schultz
 14 deposition is what I call it on our side. It is the "I know
 15 nothing" type of deposition. That's my shorthand definition
 16 for it. It says a lot in not saying anything.
 17 We would call as our next witness Professor
 18 Hausman. As I indicated, Mr. Gidley will do the
 19 examination.
 20 THE COURT: All right. Thank you.
 21 (GERRY A. HAUSMAN, DEFENDANT WITNESS, SWORN)
 22 DIRECT EXAMINATION
 23 BY MR. GIDLEY:
 24 Q. Dr. Hausman would you please introduce yourself to the
 25 Court?

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1 A. My name is Gerry A. Hausman. I am the McDonald
 2 professor of economics at MIT. That's not hamburger
 3 McDonald's, it's oil McDonald's.
 4 Q. Can you briefly describe your educational background
 5 start with college?
 6 A. Yes, I was an undergraduate at Brown and then graduated
 7 in 1968 and went into the Army. I was stationed in Anchorage
 8 for two years and then I won a Marshall scholarship to Oxford
 9 and I was at Oxford for two years, where I did a Ph.D.
 10 Q. And what have you done since graduation?
 11 A. Since graduation, I started off as an assistant
 12 professor at MIT. Then I rose through the ranks, associate
 13 professor, full professor, McDonald professor. I have taken
 14 a leave twice, taught once at Harvard and once at Harvard
 15 Business School.
 16 Q. Dr. Hausman, what courses did you teach at MIT?
 17 A. I teach two courses each year to graduate students in
 18 econometrics, and I also teach a course to graduate students
 19 and to business students and people coming from Harvard to
 20 take it as well. It is a very large course in industrial
 21 organization, applied industrial organization as applied to
 22 the telecommunications industry.
 23 Q. What economic subjects do you have expertise in?
 24 A. Well, my main one is applied microeconomics which is
 25 looking at how firms behave and how consumers behave and also

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1 industrial organization which is part of that.
 2 Q. Have you published any articles on antitrust or merger
 3 issues?
 4 A. Yes. I have published a number. In 1995, I published
 5 an article in the Antitrust Bulletin on Antitrust and
 6 Competition in Telecommunications. Last year, in 1996, I
 7 published an article in the Antitrust Law Journal which came
 8 out of the case FTC versus Donnelly, pointing out that the
 9 Merger Guidelines were incorrect with respect to price
 10 discrimination.
 11 I have an article coming out either this month or
 12 next month in the George Mason Law Review, and that looks at
 13 how mergers with differentiated products like beer or cereal
 14 should be looked at.
 15 Q. Dr. Hausman, have you published any econometric
 16 articles?
 17 A. Yes. I think I have published maybe 30, 40, maybe 50
 18 econometrics articles.
 19 Q. What journals have you served on in an editorial
 20 capacity?
 21 A. I have been an associate editor of probably five or six
 22 journals over my career. One I was longest on was
 23 Econometrica for 10 years. That's certainly the boast
 24 econometrics journal and in my view certainly the best or the
 25 most cited economics journal in the world.

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1 Q. Professor Hausman, have you ever testified before
 2 Congress about antitrust or competition issues?
 3 A. Yes. When asked, if I'm not teaching, I usually try to
 4 do so. Last year, for instance, I testified with respect to
 5 competition in the cellular and telecommunications industry
 6 and also about competition for things like cable TV and
 7 high-definition TV and satellite TV.
 8 Q. Professor Hausman, could you briefly describe your
 9 experience testifying as an expert witness in antitrust
 10 cases?
 11 A. Yes. Well, as I said, I testified for R. Donnelly in
 12 FTC versus Donnelly which was tried here about seven years
 13 ago before Judge Harris. I testified for the Chicago Bulls
 14 in -- the Chicago Bulls versus NBA. The NBA tried to keep
 15 Michael Jordan off TV, off WGN. I'm a big Michael Jordan
 16 fan, so I did that.
 17 I testified in United States v. Kodak about getting
 18 rid of the consent decrees a couple of years ago. I
 19 testified in the State of New York versus Anheuser-Busch; I
 20 testified in Continental Airlines versus United Airlines,
 21 which was about computerized reservation systems. And then I
 22 testified also in a case called Moore versus Wallace in
 23 Delaware last year.
 24 Q. Have you ever worked as an impartial expert for a
 25 Federal judge?

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

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

1 A. Twice. Yes. Once the night before last; and then about
 2 10 days ago.
 3 Q. Let's turn to the office products marketplace.
 4 Professor Hausman, what are your criteria for reviewing a
 5 merger?
 6 A. Well, my overall criterion is whether consumers are
 7 going to be made better off by the merger. If consumers are
 8 made better off, either because they get lower prices or they
 9 have higher quality goods, then I think a merger should take
 10 place. Because the antitrust laws, in my view, are mainly
 11 here to help consumers.
 12 Q. What should be the role, in your view, of efficiency
 13 claims?
 14 A. Well, efficiencies have two aspects to them. The first
 15 is efficiencies, to the extent they bring down costs in the
 16 United States economy, make us a more productive economy, get
 17 better jobs for people, help people. Then the other things,
 18 efficiencies also are typically passed through in part by
 19 companies. When companies become more efficient, they keep
 20 some of it for their shareholders and have to help pay back
 21 their shareholders. But they often pass the majority of it
 22 on to consumers. And those lower prices help consumers.
 23 Q. Two days before this action was filed the FTC amended
 24 their Merger Guidelines. Have you reviewed those Merger
 25 Guidelines on efficiency, the new ones?

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

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

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

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

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

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

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

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

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

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

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

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

24 A. Yes, I have.

25 Q. How does Staples and Office Depot's market shares affect

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

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

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

1 your views?

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

10 Q. Another excerpt from DX-3, yes.

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

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

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

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

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

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

1 on Staples sales so that's a pretty good sign that they are
 2 competing.
 3 Q. Just so I have this clear, this is sort of a
 4 before-and-after study that determines whether before and
 5 after the opening of a Best Buy or a Sam's or a Computer
 6 U.S.A., whether those have an effect on Staples sales; is
 7 that correct?
 8 A. Yes. It is before and after. You see how well a
 9 Staples store is doing. You need a regression to control for
 10 other factors such as seasonal effects. It might be the
 11 back-to-school season when the new store opens. But you
 12 basically see how the Staples store is doing before, how much
 13 it is selling, and how much it sells, let's say, after the
 14 Best Buy opens. What you notice is that I even wait a while
 15 to make sure it is not just a grand opening sale. That could
 16 be an affect of the grand opening sale. I wait and look.
 17 And after about 6 months later, the Staples store sales
 18 usually are down by about 7 percent which definitely shows
 19 these other people are competing and competing hard. Seven
 20 percent is a really big hit for a store.
 21 Q. Let's talk about entry. You have talked about the large
 22 number of competitors in the office products industry. How
 23 would you characterize the opportunities for entry and
 24 expansion in the office products industry?
 25 A. I think they are quite good. George Stigler who won the

1 Nobel Prize about 10 or 15 years ago in his book often stated
 2 the most important factor in entry and expansion is how fast
 3 an industry is growing. If an industry is growing, people
 4 want to come in because there's a lot of new business. If an
 5 industry is declining, people don't want to come in because
 6 you have to fight it out, and it is harder to make profits.
 7 In this industry, for instance, the gentleman from Wal-Mart
 8 testified that their office supply sales are going up 10 to
 9 12 percent a year. Because of this type of growth, they find
 10 it profitable to expand. He testified in his deposition they
 11 were expanding. Here again if you look at the graph up on
 12 the board DX-1839 --
 13 Q. It is actually DX-6067. I think the underlying data
 14 comes from 1839.
 15 A. Excuse me about that. You will see Stockwell Associates
 16 estimates a 5 to 10 percent growth rate. Smith Barney, 9.3.
 17 Staples 10 to 11 percent. As I said, Wal-Mart says their own
 18 sales are expanding at 10 to 12 percent. What Professor
 19 Stigler said is if you are growing faster than the real
 20 interest rate, which now is probably about 3 or 4 percent,
 21 that that is a big impetus or big incentive for growth and
 22 that, of course, exactly is what is going on here. We know
 23 this also. You don't have to look at the data.
 24 A lot of companies have downsized. People have
 25 gone into running their own small businesses. I remember

1 AT&T announced last year they would lay off 40,000 people. A
 2 lot of those people became consultants to AT&T and
 3 consultants to other telecommunications companies. We know
 4 this sector of the economy is growing, both from what we read
 5 in the newspaper and also the data show us growth prospects
 6 here are very good which is a good thing for entry and
 7 expansion.
 8 Q. Relative to other industries, how would you characterize
 9 a growth rate of 9.3 percent or 10 to 11 percent?
 10 A. For retailing, it is excellent. I mean this isn't
 11 growing as fast as Intel is growing, producing computer
 12 chips; but certainly for retailing this would be at the top
 13 end of the scale, so this is quite high.
 14 Q. Professor Hausman, have you studied the ability of firms
 15 that are currently are selling office supplies to expand
 16 their sales of office supplies?
 17 A. Yes. As I said, Wal-Mart, which anybody who is in
 18 retailing anywhere is always frightened of -- as they well
 19 should be since Wal-Mart is a fierce competitor -- they
 20 said they were going at 10 to 12 percent and they were
 21 expanding. And there's other record testimony that other
 22 large retailers are entering the business as well. And
 23 that's all on the record.
 24 Q. What is it about office products that seems to make
 25 entry relatively easy for firms?

1 A. Well, I think the main thing is that there are no
 2 fashions in it. In other words, it is not -- some retailing
 3 you have men's fashions, wide ties, small ties; I guess
 4 women's fashions might be more fashionable. But if you pick
 5 the wrong products, you are in big trouble. You lose a lot
 6 of money, and you go out of business. Toys perhaps are the
 7 same way.
 8 But here we are talking about Post-It notes and
 9 stuff which really don't go out of fashion. A Post-It note,
 10 maybe they will come out with a new color, but it is still a
 11 Post-It note. The second thing is the product doesn't
 12 spoil. If you try to go into the food business and don't do
 13 as well, your inventory spoils, and you are in bad trouble.
 14 Here you can keep it on the shelf. If you don't sell it
 15 right away, if it takes you a little longer to get going, you
 16 will do okay.
 17 So it doesn't take special skills to sell. There's
 18 no fashions. All you have to do is increase your shelf
 19 space. You don't even have to do that. If somebody like
 20 Wal-Mart wants to sell more, they can just some more
 21 advertisements on this and use their same shelf space so long
 22 as the inventory keeps up they will be okay. So it is really
 23 quite easy to expand here.
 24 Q. From your review of the competitive forces in office
 25 products, what is your conclusion with respect to the ability

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

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

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

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

1 supplies as the FTC defines it apart from paper. You will
 2 see in the bottom left, it says excluding paper. The reason
 3 I excluded paper is that paper goes up and down as I
 4 testified earlier, Your Honor. There is this paper cycle,
 5 sometimes prices are high, sometimes low. The superstores
 6 don't compare paper. It depends on how the newspapers are
 7 going, how the pulp cycle is going. So I took out paper.
 8 What you see in this index is you start off in 1993
 9 at a hundred. That's just how an index works. You start it
 10 off at a hundred in the upper left. What you see is in the
 11 one firm areas have fallen to about 87 percent. In four
 12 years, adjusted for inflation, they have fallen by about 13
 13 percent; and you will see the two-firm and three-firm areas
 14 have fallen a little bit more. But all three prices are
 15 down. This says consumers are made better off. Lower prices
 16 help consumers. More money in their pocket.
 17 Q. The one-firm markets, those are what kind of markets?
 18 A. Those are markets where there's only Staples and no
 19 other superstore. They have other competitors like Wal-Mart
 20 and all. That's the reason they are dropping their prices
 21 along with the lower costs they get. But there's no Office
 22 Depot or OfficeMax competition there.
 23 Q. Could you pull your microphone a little bit closer? I
 24 note you are going in and out.
 25 A. I'm sorry.

1 definition?
 2 A. Well, that's incorrect because, they are leaving out a
 3 lot of the important competitors. There's a lot of testimony
 4 that the competitors certainly believe they compete. The
 5 Sam's, the Wal-Marts, the computer superstores. Staples and
 6 Office Depot respond to their prices of these other
 7 competitors. The hits analysis, the econometric analysis
 8 demonstrates that; but also they just have the economic
 9 theory wrong, again. If there were an office supply
 10 superstore market, Your Honor, see this one firm, if there
 11 were only an office supply supermarket, that would be a
 12 monopoly.
 13 Q. That's the red line?
 14 A. The red line would be a monopoly. I would typically not
 15 expect to see the prices coming down just about as fast in a
 16 one-store area because they wouldn't have any competition.
 17 They would just put it into their pocket. It would drop
 18 prices somewhat, but not nearly as much. That goes back to
 19 the gross margin point I made before that if the FTC were
 20 correct and only the office superstores were the market, we
 21 would expect the margins in this one-firm area to be much
 22 higher than in the three-firm area; but it is just not so.
 23 That again demonstrates that there are other competitors out
 24 there.
 25 Q. Dr. Hausman, now let's move to your work on pricing.

1 Q. Professor Hausman, what significance is there
 2 economically to the fact that the prices in the three-office
 3 superstore markets have fallen along with the one-office
 4 superstore markets?
 5 A. Well, it says that there's somewhat more competition in
 6 the three-firm areas. That's what my econometrics
 7 demonstrates that we will talk about later. It is just not
 8 competition from OfficeMax and Office Depot. It is also that
 9 as my report shows that in the three-firm areas you typically
 10 have more office supply competitors. You have more computer
 11 superstores, you have more Wal-Marts, you have more Sam's.
 12 So the three-firm areas, you know, the place to
 13 think about is Los Angeles. There is a lot of competition
 14 there. The two-firm areas are places like Boston and
 15 Washington, which are somewhat in the middle. The one-firm
 16 area is West Lebanon, New Hampshire, Bangor, Maine and so
 17 on.
 18 We know Los Angeles has the most retail
 19 competition. It is known as the most highly competitive
 20 place in the country. Washington and Boston are in the
 21 middle. Bangor, Maine probably has the least competition.
 22 Q. Let's move on to market definition. Dr. Hausman, the
 23 FTC is attempting to prove that the relevant product market
 24 in this case is what they call the sale of office supplies by
 25 office superstores. In brief, what is your opinion of that

1 Have you conducted any econometric analysis of the likely
 2 effect of the merger on pricing?
 3 A. Yes. I've done two such studies.
 4 Q. Briefly, what was the first analysis that you did?
 5 A. The first analysis was a study I did back in February
 6 and submitted to the FTC staff. I looked at a price index
 7 there.
 8 Q. What was your result?
 9 A. My result there was that overall, that if -- this is a
 10 hypothetical example -- if all the Office Depot stores were
 11 to close, and there were no new entry or no new expansion
 12 which, of course, are contrary to fact but that's how you do
 13 it with an econometric model, you do a simulation, that
 14 prices would go up by 0.9 percent, just a little bit less
 15 than 1 percent.
 16 Q. That's before considering the effects of entry and
 17 efficiencies; is that correct?
 18 A. Yes. If you take into account efficiencies and cost
 19 saving pass-through, the price change will actually be
 20 negative. Prices will go down to consumers from the merger
 21 and they will be made better off.
 22 Q. We will get to this in a minute. But have you had a
 23 chance to review PX-400 Dr. Ashenfelter's seven-column
 24 simulations?
 25 A. Yes.

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1 Q. All right. What's your understanding of columns 1 and
 2 2, Professor?
 3 A. Well, here Dr. Ashenfelter was trying to reproduce my
 4 results; and as I understand it, he got 1.1 percent and 0.8
 5 percent. He found results very similar to mine right around
 6 0.9 percent.
 7 Q. We had a lot of testimony on Wednesday, Professor
 8 Hausman, about the Hausman sample and the complete sample.
 9 Do you see those lines?
 10 A. Yes.
 11 Q. Dr. Hausman, did you include California in your 0.9
 12 percent result?
 13 A. Yes. I had two models for reasons I'll explain
 14 shortly. Ut I had a model for California and a model for the
 15 rest of the United States.
 16 When Dr. Ashenfelter did this, this is actually
 17 mislabeled. It is not the Hausman sample. He left out the
 18 California stores in what he called the Hausman sample. He
 19 wasn't informed, I presume, by the FTC -- there must have
 20 been some kind of foul up -- there were actually two models,
 21 one for California, one for the rest of the country. What he
 22 calls the Hausman sample is only the rest of the country. So
 23 I guess California is left out of what he did. I don't
 24 guess, I know that California is left out in what he calls
 25 the Hausman sample. So that's mislabeled.

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

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

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

1 A. No. But you haven't let me finish why the gross margins
2 are better.

3 Q. Why don't you finish your answer?

4 A. The first reason is you can look at all the SKUs. You
5 don't look at 200. You look at 7,000. The next thing is
6 when you do a price index, you have to assume that everybody
7 at every Staples store in the country has the same buying
8 pattern.

9 So in other words the price index uses weights.
10 You have to assume that its the same. But we actually know,
11 for instance, that people in Los Angeles buy a different mix
12 of office supplies than people in Bangor, Maine. To use the
13 old saying of the 1930s, the way that Maine goes is not the
14 way California goes; at least in terms of buying office
15 supplies. So if you do the gross margins, each store you
16 actually are looking at what people buy.

17 Then the third thing that it allowed me to do was
18 rather than using two years of data, it allowed me to use
19 four years of data. So you just get a lot more data, you can
20 get a better econometric model because of that as well.

21 Q. Let me direct your attention to PX-3. Dr. Hausman, have
22 you reviewed PX-3?

23 A. Yes, I have. I think the FTC calls that their main
24 exhibit or something.

25 Q. Right. PX-3 is a whole bunch of charts, but I want to

1 Washington, for instance, there are seven Best Buys, as I
2 remember, there are none up around Bangor. There are a lot
3 more Wal-Marts and Sam's and all. So this idea that after
4 the merger that Washington becomes Bangor or West Lebanon
5 doesn't make economic sense.

6 Q. I have seen some cross-sectional analyses that are in
7 PX-400. What's your view of cross-sectional analyses in
8 connection with trying to analyze this merger?

9 A. I don't think they are a very good idea because it is
10 hard to get all the competitive factors. There's actually a
11 way to test this. And this is not self-serving PR, I hope,
12 but there's a test out there called the Hausman specification
13 test which I invented and published in Econometrica back in
14 1978. It is a pretty famous test.

15 You can test whether you should use
16 cross-sections. And if you test it, you will soon come to
17 the conclusion that cross-section leads to biased and
18 inconsistent results. You can't use it. So this is a
19 standard test in econometrics. It is in all the textbooks.
20 You will just conclude you can't use cross-section analysis.

21 Q. Let's go back to PX-400. This is Dr. Ashenfelter's
22 seven simulation runs. Let's put that back up. Just to be
23 clear, Dr. Hausman, you created two models in connection with
24 your February work. One for California and one for the rest
25 of the country; is that correct?

1 direct your attention and focus you in on one of the early
2 charts in PX-3 which basically buckets prices into one office
3 superstore, Staples-Office Depot, two, Staples-OfficeMax, and
4 three-office superstores. What kind of an analysis is this,
5 Dr. Hausman?

6 A. Well, that might be called a cross-section analysis. It
7 is comparing different areas of the country although it is
8 really not a correct cross-section analysis because it leaves
9 out all sorts of competitive variables. We might call that
10 it.

11 Q. What variables does it leave out, for instance?

12 A. It leaves out all the competitors, it leaves out all the
13 differences in costs, it leaves out all the differences in
14 commuting patterns. So everything that makes for
15 competition, it leaves out.

16 Q. Should we use PX-3 to predict the effect of this merger?

17 A. No. That would be absolutely wrong to do so because it
18 leaves out all these different competitive effects. It
19 assumes, for instance, after the merger that Washington D.C.
20 which currently has an Office Depot and -- excuse me, an
21 Office -- an Office Depot and a Staples, it predicts or
22 assumes that Washington, D.C. will become Bangor, Maine and
23 there will only be Staples. If we know anything about
24 Washington, it is not going to become Bangor next week in any
25 respect, certainly not in terms of competition; because in

1 A. Yes.

2 Q. And you combined the results after running the two pools
3 of data separately in different models; is that correct?

4 A. Yes. What you do is you do one model, get predictions,
5 do the other model, get the predictions and then take an
6 average. There is no problem at all.

7 Q. So is it correct that you left out California?

8 A. No. It is incorrect. I definitely took into account
9 California and I sent the FTC the California model. I went
10 back and checked. On February 18 I Federal Expressed them
11 the disk to Dr. Levinson there. I know they have the data
12 because when they did their production to us, the data were
13 there. So they certainly received it.

14 Q. How did you determine that California should be modeled
15 separately when you did this work in February?

16 A. The most famous test in econometrics is called the Chow
17 test, not the Hausman test, the Chow test. Professor Chow
18 actually teaches at Princeton; and what it does, the Chow
19 test says can you pool the data together or is it a mistake
20 to pull it in. It is a test to allow you to test that. If
21 you incorrectly pool data together, aggregate it together
22 when you shouldn't, you get biased and inconsistent results.

23 Q. Let's finish up our tour of statistical tests. Did you
24 include all of the Staples stores in your February work?

25 A. No. I left out a few stores. I left out 15 stores in

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1 California which are in rural areas, again based on a Chow
 2 test, and I left out 35 stores in Pennsylvania where there
 3 were no Office Depots with one exception. There was one
 4 Office Depot that competed with Staples within 20 miles.
 5 Again, a Chow test said those shouldn't be included. But I
 6 had all the other stores, except for those two groups that I
 7 left out.

8 Q. Why did you exclude the 16 California stores?
 9 A. Well, in talking to Mr. Stenberg when I was first trying
 10 to understand competition, he said there were some rural
 11 stores in California that they thought behaved differently.
 12 And I said well, what criterion do you use? He said well, if
 13 there are less than 4 computer superstores within 20 or 25
 14 miles, we consider those to be rural stores.

15 So I just didn't take Mr. Stenberg's word for it.
 16 So I went off and did this Chow test to see whether these
 17 stores did behave differently. The Chow test said there was
 18 a one in 10,000 chance of them behaving the same, so they
 19 should be treated separately.

20 Q. Suppose you included those 16 stores, would your results
 21 have changed dramatically?
 22 A. No. In fact, I went back and checked. If you put all
 23 the stores back in, so if you put in the 16 from California
 24 that I dropped out, and the 35 from Pennsylvania that I
 25 chopped out, based on the Chow test, you get exactly the same

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1 result, 0.9 percent. It actually goes up a bit. It goes
 2 from 0.9 to 0.91 percent.

3 But I mean in these type of econometrics, as
 4 Dr. Ashenfelter testified, a difference of one one-hundredth
 5 of one percent certainly doesn't matter. I certainly agree
 6 with him on that.

7 Q. I want to direct your attention back to the screen on
 8 PX-400. I apologize because this is not up there. But
 9 Dr. Ashenfelter testified about a hypothetical column 8. So
 10 I'm going to ask you to envision that, even though it is not
 11 on the exhibit. Have you considered his so-called column 8
 12 analysis?
 13 A. Yes, I have.

14 Q. And what did you conclude from analyzing that?
 15 A. Well, if you do his column 8 and start off with that and
 16 then put the efficiencies and all in, and the cost savings
 17 and how much is passed on to consumers, you would still end
 18 up predicting that the merger will lead to lower prices to
 19 consumers.

20 Because the efficiencies in cost savings are high
 21 enough that as I remember when I did this, the prediction is
 22 that the prices would go down to consumers between 1 and 1.5
 23 percent.

24 So here is how I did it. If you start off again
 25 and you use Dr. Ashenfelter's analysis but you add my

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1 variables because he testified that he would like to add
 2 them, he thought it was a good idea, I agree you should
 3 also.

4 You start off with 6.4 percent. Those are only the
 5 stores -- those are the stores where Staples competes with
 6 Office Depot. Then if you look at all the stores again, go
 7 down to 3.36 percent; then if you look at all the items
 8 Staples sells, it is 2 percent. If you subtract off pretty
 9 much 3 percent, you get minus 1.05 percent.

10 So even if you started off with Dr. Ashenfelter's
 11 analysis and apply the efficiencies and cost savings, that
 12 will be passed on to consumers, prices still end up going
 13 down for consumers.

14 Q. Let's go back to DX-400. Let's put that one back up.
 15 You said you ran the Chow test. Can you explain what results
 16 you got running the Chow test on the inclusion of those
 17 stores, the California stores?
 18 A. Well, I think the first thing I should do is explain to
 19 His Honor what a Chow test is and why you need it.

20 Q. If you can do so briefly, that would be fine?
 21 A. I doubt if he has looked in his econometrics textbook
 22 recently, if he has one.

23 Q. Nor has somewhat learned counsel.
 24 A. Here is the reason you might need a Chow test. Let's
 25 see the government changes the subsidy program for dairy

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1 farmers. So we have a sample of the dairy farmers in the
 2 United States. Well, each state has different regulations
 3 for dairy farmers. And you might say to yourself, well, will
 4 dairy farmers in Vermont react the same way as dairy farmers
 5 in Alabama given that they are very different regulations?
 6 So what you do is you say I'm going to run it
 7 separately for Vermont, separately for Alabama, or there
 8 could be states around Vermont like New Hampshire, Maine, and
 9 so on. Then what you say is do you get approximately the
 10 same results. If you do get approximately the same results,
 11 the Chow test says it is okay to put them together. If you
 12 get very different results, it says no, there's really
 13 something different about Alabama than from New Hampshire or
 14 Vermont and your model can't pick it up because econometric
 15 models aren't perfect. If they were we would all be rich on
 16 Wall Street. It allows you to test to see if you can do it.
 17 As I said it is the most famous test published in
 18 Econometrica 20 years ago and in every textbook.

19 Q. More famous than the Hausman test, is it?
 20 A. Right. I admit to that.

21 Q. Let me direct your attention to 6220. Would you
 22 describe for the court what that refers to?
 23 A. Sure. This is a curve which determines the probability
 24 that the Chow test says you can add together California and
 25 the rest of the country which is what Professor Ashenfelter

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

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

16 Q. Quite apart from a statistical test, is there a
17 common-sense test we could apply to the result that
18 Dr. Ashenfelter got in his regression and simulation?
19 A. Well, I'm not quite sure I like the common sense as
20 opposed to statistics, if my students find out about this.
21 But the answer is yes. There is another way to look at it.
22 Actually, Chow in his original paper said another thing you
23 can do is to look at the predictions and the predictions from
24 the rest of the model that you pool together, California,
25 Pennsylvania here, should be the same -- or not the same but

1 very similar to what you get from the first model; and if
2 they are very different, that's just another way the Chow
3 test says that you can't put the models together. That's
4 what I did.
5 Q. Let me show you Defendant's Exhibit 6215. Could you
6 describe what work you have done here?
7 A. Yes. This is the other side of the Chow test. It is
8 really just doing the same thing. What this says is if you
9 take those other areas that I left out based on a Chow test
10 and do the predictions based on them, what you will see is
11 that the FTC's model leads to a 73 percent prediction of
12 price increases of stores in Los Angeles. Now, that just
13 can't be realistic.

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

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

1 describe your methodology in terms of distance?
2 A. My original model had stores within five miles, 10
3 miles, 20 miles because I think that's where most of the
4 competition comes from.

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

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

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

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

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

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

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

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

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

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

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

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

14 MR. GIDLEY: Thank you, Dr. Hausman.

15 THE COURT: Mr. Orlans, are you up?

16 MR. ORLANS: Yes, Your Honor.

17 THE COURT: Thank you.

18 CROSS EXAMINATION

19 BY MR. ORLANS:

20 Q. Good morning, Professor Hausman?

21 A. Hi, Mr. Orlans.

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

25 A. Well, more than one, but yes.

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

3 A. Yes.

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

7 A. Among other things, yes.

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

10 A. Yes.

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

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

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

19 MR. GIDLEY: Objection.

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

22 THE WITNESS: I think I told the people yes, there
 23 were two models. It would take me a while to get the data
 24 ready. It was within a week that I sent it. So I think I
 25 told them at the time. They have known the whole time. When

1 I sent the data to Mr. Levinson, I sent him a letter saying
 2 here is the California model, so I can't understand why there
 3 could be any confusion.

4 BY MR. ORLANS:

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

7 A. Yes. Yes. I said here is the California model. Here
 8 is a model for the rest of the country. Here it is. I mean.

9 I think the letter itself is self-explanatory saying here is
 10 the California model. You know, I said California model. I
 11 sent him the data. I sent him a computer file. All they had
 12 to do was put it on a PC, and the data would come out --

13 excuse me, the results would come out. In a phone call I
 14 specifically said to them, Did you have any trouble running

15 the models. They said, No, the computer programs worked
 16 fine. We were able to get you your results. We had about
 17 three or four phone calls; and if they had a problem, I

18 presume they would have told me. I had conversations with
 19 John Baker whom I have known for years, the chief economist,
 20 and asked him point blank were you able to reproduce my
 21 results; he said well not absolutely exactly, but very
 22 closely; so we didn't have a problem.

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

25 A. I think you can. Dr. Ashenfelter came very close. You

1 never get it exactly to a hundred decimal points. In fact,
 2 it depends just on what computer software you use. But as I
 3 understand it, you have the California data, you have the
 4 California model; you have the rest of the country. I sent
 5 you a SAS program which is the most widely used computer
 6 software. All you do is put it on a PC and you get the
 7 results.

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

10 A. No. That's absolutely untrue. I asked him point blank
 11 were you able o run the computer blanks to get the results.
 12 They said yes. John Baker told me, not to a hundred decimal
 13 places but close enough, we were able to get your results.

14 We had a meeting. I asked him just as we walked out of
 15 Mr. Pitofsky's office and he told me that.

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

19 A. No. If you put in -- if you run the regressions
 20 together, of course, you won't because you flunk the Chow
 21 test. You have to run them separately. So the idea is when
 22 you run them separately, and then take the average, you get
 23 0.9 percent. If you do the wrong thing, of course you get
 24 the wrong results. But I didn't certainly confuse the FTC.
 25 I said here is the California model, here is the other

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

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

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

1 model?
 2 A. Back in February, you mean?
 3 Q. In February and up until today?
 4 A. Yes. When you deposed me the other night there was
 5 sheets with the Chow tests. When you deposed me 10 days ago
 6 there were sheets with the Chow test. And back in February,
 7 I certainly told Dr. Baker and the staff the reason I had the
 8 two models was on the basis of the Chow tests. Everybody
 9 knows about Chow tests. All economists. Those are very
 10 famous.
 11 Q. Now, Dr. Ashenfelter essentially followed your results,
 12 started out with your approach to the price equation, didn't
 13 he?
 14 A. His left-most column did, yes.
 15 Q. And then what he did was to add in the MSA variables as
 16 a proxy; is that correct? Or zones?
 17 A. Yes, that's what he did.
 18 Q. And you agree that's a reasonable thing to do?
 19 A. I agree that's reasonable. I didn't have the data to do
 20 so. But you were able to get it, by subpoena I imagine. So
 21 that's why I included in it my subsequent model, my margin
 22 model.
 23 Q. All right. Dr. Ashenfelter, using the full sample,
 24 including California and Pennsylvania got a price increase of
 25 8.6 percent in the overlap markets; isn't that right?

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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1 A. Yes, it was about two weeks before I went to Australia,
 2 right.
 3 Q. And now according to your margin study, the price
 4 increase is 2.4 percent not .9 percent?
 5 A. You are comparing apples and oranges. It is 1.3 percent
 6 rather than 0.9 percent. So you are incorrect.
 7 Q. Let me ask you this, sir: Under your new analysis, if
 8 costs fall at a Staples store, doesn't your equation predict
 9 the margin would not change?
 10 A. No. If costs fall, prices would also fall, and that's
 11 what margins look at.
 12 Q. Maybe I need to rephrase that.
 13 A. I may have misunderstood you.
 14 Q. Let me try it again. Under your new analysis, if costs
 15 fall at a Staples store, isn't it true that your equation
 16 predicts that the margin would not change?
 17 A. No. That would be incorrect.
 18 Q. Isn't that the way you specified the regression?
 19 A. What happens is as costs change, holding everything else
 20 equal, but of course as costs change, other things change as
 21 well. That's why you do a regression, and the margins change
 22 as well.
 23 Q. In terms of your sales hits study, sir, isn't it true
 24 that only Best Buy gave you a 7 percent number or close to a
 25 7 percent number? All the other numbers were much lower?

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

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

1 Q. Let me show you Plaintiff's Exhibit 18, sir?

2 A. Thank you.

3 Q. Plaintiff's Exhibit 18, if you will turn to the fourth

4 page in, which is entitled '97 Budget Model Impact of

5 Competition and Cannibalization, shows the impact on the

6 company of various stores opening; is that correct?

7 A. I don't know actually.

8 Q. So you are not familiar with that document?

9 A. I will take your word for it.

10 Q. What I want to point you to, sir, is doesn't this

11 document show the impact of a Best Buy is only .06 percent?

12 A. Well, what I don't know is whether this is across the

13 whole company or for an individual store on average. If this

14 is across a whole company -- if this is -- you know, I'm not

15 sure exactly what it is saying. You know Mr. Stenberg would

16 know this better than me, but, you know, if it is across the

17 whole company, it depends where stores are opening.

18 Certainly, they went back and did the analysis

19 after I presented stuff to the Commission and looked at what

20 happened in places like in Pennsylvania when the Best Buy

21 opened. I think they found that in Redding, as I remember,

22 it was perhaps 13 percent. They found an even bigger effect

23 than me. But as I say, I don't know exactly what this

24 document is saying.

25 Q. In this document, sir, it shows that the impact of a

1 1.3 percent if you just look at the overlap stores.

2 Q. Sir, would it surprise you to know that when we ran

3 California separately with the original model, we got over

4 2 percent, as a number?

5 A. No. My memory again is if you do California separately,

6 you get about -- I'm speaking from memory but I think it is

7 closer to 1.3 or 1.4 percent.

8 Q. So it would surprised you if we used your original model

9 and ran California separately and got a 2 percent number?

10 A. Yes. It should be 1.2 or 1.4.

11 Q. Isn't it true, sur --

12 A. Two percent is still a low number. It is not going to

13 change the economic analysis. My memory is you get 1.3 or

14 1.4.

15 Q. And again, sir, you have no explanation for why we've

16 been unable to reproduce those results of yours, do you?

17 A. Well, it just -- it may depend on how you are doing the

18 simulations, whether you are taking the log of the means or

19 the means of the log. It can lead to small differences such

20 as Professor Ashenfelter testified. No. I'd have to read

21 your computer code. I'm not sure I could figure out

22 exactly. Remember, we found these mistakes in Professor

23 Ashenfelter before that there could be there are small

24 mistakes that lead to small changes. You know, 1.4 percent,

25 2 percent. As I said, the economics is the same.

1 Best Buy is .06 percent compared to a .55 percent impact of

2 Office Depot and a 1.17 impact of OfficeMax; is that right?

3 A. Yes. But whether it is across the whole company or

4 individual stores, as I said, I don't know.

5 Q. Is Wal-Mart mentioned on here, sir?

6 A. No, I don't see it.

7 Q. Okay. I have a couple of questions, sir, about material

8 we already covered. I think they will be brief.

9 A. Sure.

10 Q. First of all, did I understand you in your testimony to

11 say that the .9 percent number that you got in your price

12 equation covered the entire country and not just the overlap

13 markets?

14 A. Yes.

15 Q. Sir, let me read to you from the paper that you provided

16 to the Commission entitled Post-merger Price Change

17 Analysis: Discussion of Methodology, at the bottom of page

18 3, you stated, "The result of the experiment demonstrate that

19 Staples would hypothetically be able to raise price on

20 consumable office supplies by only a small amount at its

21 stores with one or more Office Depot stores in the vicinity

22 (.9 percent)." Those are the overlap markets aren't they?

23 A. That's a misstatement IF I said that.

24 Q. So this is wrong?

25 A. That's wrong. It is 0.9 across the whole country and

1 Q. Let me talk briefly about your 15 or 16 or however many

2 California stores. Those stores are dropped entirely; right?

3 A. Not from the analysis that -- the margin siting but

4 the --

5 Q. From the price study?

6 A. Yes.

7 Q. Doesn't Chow say you should estimate separately but not

8 drop?

9 A. Yes. The problem was with only 15 stores in two years

10 of data I didn't think there was enough to be reliable. But

11 I looked a those as well, yes. So I estimated. That's how

12 you do Chow. That's the graph I had here up on the board

13 before.

14 Q. Would you agree, sir, when you are trying to define a

15 market in the economic sense that -- excuse me, that --

16 strike that. Let me try it again.

17 Would you agree, sir, that when you are trying to

18 define a market in the economic sense, that competition means

19 the ability to constrain prices?

20 A. Oh, yes. Sure. I always say that.

21 Q. So in defining a market you start with the smallest

22 group of competitors and determine whether if they acted

23 together as a monopoly they could raise prices five or

24 10 percent without being constrained by others; isn't that

25 right?

1 A. That's the way the Merger Guidelines does it. I'm not
 2 sure everybody thinks that's the best way.
 3 Q. If they are so constrained you add the next group of
 4 competitors; right?
 5 A. Well, the problem with the Merger Guidelines is who are
 6 the next group of competitors? It doesn't tell you who they
 7 are. You often have a whole plethora of choices. So it is
 8 sort of a problem with the way the Merger Guidelines goes out
 9 and does it. I have written academic papers showing there
 10 are better ways but that is, as I said, a way.
 11 Q. But you do agree that the mere fact a company or
 12 companies may sell the same product doesn't mean that they
 13 constrain price; isn't that right?
 14 A. Sure. Absolutely.
 15 Q. And again, to put this in context, let's suppose we are
 16 looking at a merger of supermarkets trying to decide whether
 17 7-11s are in that market. You believe that supermarkets
 18 constrain the price of 7-11s, don't you?
 19 A. What I testified to at my deposition was I believe
 20 supermarkets constrain 7-11s but I never studied the
 21 supermarket industry, and I don't know whether 7-11s
 22 constrain supermarkets.
 23 Q. So it may well be that even if supermarkets constrain
 24 7-11s, that 7-11s don't constrain supermarkets; isn't that
 25 right?

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

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

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

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

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

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

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

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

1 includes Bangor, does it not?
 2 A. Yes.
 3 Q. And doesn't that show, sir, that Bangor has far lower
 4 costs than any of the other markets? And particularly far
 5 lower costs than -- well, strike that.
 6 Far lower costs than any of the other markets,
 7 compared to Los Angeles levels?
 8 A. Yes. In terms of rent. I certainly agree that it does,
 9 yes.
 10 Q. And it would include advertising here, too, wouldn't it,
 11 sir?
 12 A. I don't think this does include advertising but I'm not
 13 absolutely sure. I don't think so. But I'm not positive of
 14 that.
 15 Q. Do you have any basis for saying it doesn't, sir?
 16 A. I have seen things in Bangor which show that it's higher
 17 than Boston, although Boston is not on this graph. This is
 18 on a per-store basis. So that is what leads me to believe
 19 that, as well.
 20 Q. But according to this exhibit, sir, Bangor is lower cost
 21 than these other markets; is that correct, including
 22 Manhattan, Los Angeles, Philadelphia, is that right?
 23 A. Yes. It certainly would have to be cheaper than
 24 Manhattan.
 25 Q. Now, Mr. Stenberg yesterday said -- strike that.

1 half, and advertising costs are a fraction of what they would
 2 be in more populous areas. Not going at the small towns
 3 sooner was the dumbest thing we ever did."
 4 Do you agree with that?
 5 A. Well, I don't know about whether it is the dumbest thing
 6 they ever did.
 7 (Laughter)
 8 THE WITNESS: As I testified, if you actually look
 9 at advertising costs, there are Staples documents that show
 10 this, Bangor, Maine has considerably higher advertising costs
 11 on a per-store basis than, for instance, Boston, so I
 12 disagree with that. Certainly rent is smaller. But when you
 13 look at something like costs, if you are selling more
 14 computers, although the wages may be lower in Bangor, you
 15 have to provide more service. So that's going to lead
 16 actually to that extent to higher costs. It depends on how
 17 you look at it. You need to look at it from an economic
 18 point of view.
 19 Q. Sir, let me direct your attention to Defendant's Exhibit
 20 6069. I have some excerpts from it. May I approach, Your
 21 Honor?
 22 THE COURT: Yes, sir, certainly. .
 23 THE WITNESS: Thank you.
 24 BY MR. ORLANDS:
 25 Q. Sir, if you look at that exhibit, the last page here

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

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

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

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

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

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1 buying better and the -- and the economies of scale, it seems
 2 reasonable to me.
 3 Q. So to the extent Ms. Goodman relied on it, that would be
 4 a misuse of the document?
 5 A. You'd have to ask Ms. Goodman that, sir.
 6 Q. I think she asked us to ask you, sir?
 7 A. Okay. I can't tell you whether Miss Goodman relied on
 8 it. What I'm saying is I went out and did the regression.
 9 It gives reasonable results. That's what it should be used
 10 for.
 11 Q. Well, isn't it true, sir, that when you look at the
 12 actual chart, that over half the items go the wrong way?
 13 That is the company with greater scale actually paid a higher
 14 price?
 15 A. Well, it turns out that 54 percent do. So you are
 16 correct and 46 percent; but most of those are buying very
 17 similar amounts. It is when one company is buying a good
 18 deal less or more, you do a regression. That's what
 19 regression tells you. If says there are small scale effects
 20 but if they are buying about the same amount, sometimes it is
 21 higher, sometimes it is lower. It is just -- dependss on the
 22 skill of the buyer. It is 54-46. You are correct.
 23 Q. When you did your regression, sir, isn't it true that
 24 the regression had an R square of only .03 which means you
 25 only explain 3 percent of the variation in cost difference?

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1 A. Yes. You get a significant T-statistic as I remember;
 2 but there's a lot of variation. There's a lot of skill
 3 apparently. I found this very interesting in this case that
 4 some people are better buyers than others, but regression
 5 definitely says there's a scale effect.
 6 Q. So you are telling me skill is really what is at the
 7 base of this? The bottom of this: is that right?
 8 A. No. I'm saying two things. Skill is important, but
 9 also there are scale effects. Regression says that when you
 10 buy more, you do get lower prices on averages. So both
 11 matter.
 12 Q. You do agree that to the extent skill matters, that
 13 Staples or Office Depot could simply hire more skilled
 14 people; isn't that right?
 15 A. No. I disagree with that. Becasue if they could do it,
 16 why haven't they done it? Everybody wants to get the lowest
 17 cost. Here is Mr. Fuente, the chairman of Office Depot. If
 18 he could just run an ad in the Washington Post, or some
 19 newspaper saying, "Wanted skilled buyers that can get me
 20 lower costs," he should have done it, because he's trying to
 21 make money for his shareholders. So it is not so easy as
 22 economic textbooks make it sound to go out and find skilled
 23 people.
 24 Q. Sir, isn't it true that given your 3 percent R square
 25 that that means that your regression doesn't explain very

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1 much of what is going on? There are other factors?
 2 A. There are a lot of other factors. Skill is very
 3 important. I certainly agree with you, sir.
 4 Q. And isn't it also true sir if one of the 97 percent of
 5 the other factors was correlated with a units purchased that
 6 your regression would not be reliable and your T-statistic
 7 would fall below two?
 8 A. Not for this type of regression because this is more of
 9 a predictive regression. If you did know about the other
 10 factors, you'd probably want to put them in.
 11 Q. Isn't it true, sir, this is simply not very reliable to
 12 predict anything?
 13 A. Well, I'm not using it to predict anything. I'm saying
 14 that it does demonstrate that there are scale effects. I'm
 15 not use, to it predict anything.
 16 Q. Okay. And, in fact, you wouldn't suggest it should be
 17 used to predict anything?
 18 A. I probably wouldn't. There's a lot of noise. It
 19 definitely shows -- there are documents I've have seen that
 20 are in my report that also says that Office Depot gets lower
 21 prices on average. That's what you would expect. I don't
 22 think anybody could sit here and argue with a straight face
 23 that bigger stores don't get lower costs. Economics -- I
 24 have worked in the telecommunications area for years. Every
 25 time you get bigger, every time I've been in a merger, you

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1 get significantly lower telecommunications costs.
 2 So to argue there are no scale effects would be
 3 silly in my view.
 4 Q. Sir, in your direct testimony, you talked about how all
 5 prices were going down. Do you agree that a relevant factor
 6 to consider in this case is whether prices would go down
 7 faster without the merger than with it?
 8 A. Yes. That's what I analyzed.
 9 Q. Okay.
 10 A. Prices would go down 2 percent faster with the merger
 11 than without it. You do want to take into account this is a
 12 competitive industry, and with the prices falling, that helps
 13 come to that conclusion. The right standard is would prices
 14 fall faster.
 15 Q. Isn't it true, sir, that in recent years, Staples'
 16 prices on non-price-sensitive items had gone up to the point
 17 where they were about 3 percent over Office Depot's prices?
 18 A. They had gone up, but now they had started to come down
 19 because people in the company realized that was making them
 20 uncompetitive both with them and with the superstores.
 21 Excuse me, with the warehouse clubs as I remember. So that
 22 you know this is the whole thing. Market power. Can you
 23 rise prices for a substantial period of time? They found
 24 they couldn't. They started to get hurt in the market and
 25 had to raise prices. That's how competition works.

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

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

1 data for OfficeMax. Your staff might. I can't go look at
 2 OfficeMax. I certainly expect them to, yes, sir.
 3 Q. Sir, at your deposition, your first deposition, page
 4 134, did I not ask you the following question and did you not
 5 respond as follows: "Question: I thought we've agreed --
 6 correct me if I'm wrong -- that OfficeMax had higher costs
 7 and higher prices than both Staples and Office Depot?
 8 Answer: No. I don't think we ever agreed to that. What I
 9 said was that -- I said two things: That Office Depot has
 10 lower prices than either OfficeMax or Staples. I said the
 11 merged company will have lower -- sorry, let me step back. I
 12 said that Office Depot has lower costs than either OfficeMax
 13 or Staples."
 14 A. Yes. That's what I said.
 15 Q. Okay.
 16 A. That's an inference of mine. As I just testified, I
 17 can't be sure since I have never seen the OfficeMax data.
 18 Because it is bigger and has greater scale, I expect it to,
 19 yes.
 20 Q. And you agree, sir, that Staples prices are lower in
 21 areas where it competes with Office Depot than in areas where
 22 it doesn't?
 23 A. Yes. And Office Depot office with their lower cost and
 24 lower prices sets lower prices, and they force all the
 25 competition, Staples, Wal-Mart everybody, to come down. I

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

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

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

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

1 nobody else could provide. Of course, in this merger
 2 Wal-Mart sells the same Post-Its that Staples and everybody
 3 else sells. But in that case, I absolutely said that. I
 4 still stand by it today. You had these incredibly
 5 sophisticated computer systems. Nobody else could provide
 6 them. They were a huge barrier to industry. In that
 7 industry as I testified, it was declining at a rate of about
 8 5 to 10 percent a year. You don't expect any new entry. It
 9 is different from this industry where it is increasing at
 10 10 percent a year. That's what I said. That's why I said
 11 it.
 12 Q. Sir, if there is an office superstore market, the shares
 13 are very high of these three companies; is that right?
 14 A. Yes. In my view there's not, as you know, but that
 15 would be true.
 16 Q. You said in your direct examination that companies with
 17 only 10 percent of the market can't cause a competitive
 18 problem; is that correct?
 19 A. Right.
 20 Q. Okay. Let me for the moment accept your broad market
 21 definition and say these companies had 10 to 13 percent or a
 22 broader market. Let me try this hypothetical on you.
 23 Suppose an automobile market exists. That's a reasonable
 24 assumption isn't it?
 25 A. I think the Courts have often decided that, yes.

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1 Q. And a combination of BMW, Mercedes, and Lexus would have
 2 less than a 5 percent market share; isn't that right?
 3 A. Yes.
 4 Q. And isn't it true, sir, that the price could well
 5 increase in the United States if those three companies
 6 merged; yes or no?
 7 A. Yes, I said that in my paper that is being published in
 8 the Law Review.
 9 MR. ORLANS: I have no further questions.
 10 THE WITNESS: And the reason that that can happen
 11 is that people consider Lexus and BMWs to be close
 12 substitutes but a Post-It note from Wal-Mart is the same as a
 13 Post-It note from Staples, and that's why it is a different
 14 situation.
 15 THE COURT: Thank you sir.
 16 Redirect?
 17 MR. GIDLEY: It will be brief.
 18 REDIRECT EXAMINATION
 19 BY MR. GIDLEY:
 20 Q. Dr. Hausman, I'm putting up on the monitor Defendant's
 21 Exhibit 1968.
 22 Are you able to read that?
 23 A. Yes, I am. Thank you. It is not in color, but we can
 24 read it.
 25 Q. Dr. Hausman, what is going on in this exhibit which

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

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

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

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1 on supermarkets. Can you give me any distinctions or
 2 similarities between supermarkets and office superstores in
 3 your economic view?
 4 A. Sure. I think there is a gigantic difference. I think
 5 this whole focus on supermarkets is wrong. I don't know the
 6 exact percentage but supermarkets sell about 80 or 90 percent
 7 I think of a lot of different food items.
 8 So we also know that the price elasticity for food
 9 is pretty low. If supermarkets drop their prices overall,
 10 they are not going to get much more business. People aren't
 11 going to eat a lot more chicken, not drink a lot more coke.
 12 Maybe eat a little more chicken. But people eat what they
 13 eat. There's not this big incentive for supermarkets overall
 14 to drop their prices.
 15 However, if you look at office superstores, we
 16 could argue whether it is five or 10 or 20 percent, they have
 17 80 percent of the market to gain out there. If Mr. Stenberg
 18 can go and get an extra five or 10 percent, he's going to
 19 make his shareholders very happy people and all of them make
 20 Mr. Stenberg a very happy person. So if there's so much
 21 business out to get, that's what keeps driving your prices
 22 lower. That's why the whole industry is coming down.
 23 You can gain more and more share of the
 24 supermarkets unless they can convince people to eat more,
 25 which would not be good by and large. You are not going to

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

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

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

1 A. Sure. That's exactly what has happened here is that
 2 Staples and Office Depot they were the -- they started this.
 3 They brought the prices down and got lower costs. They
 4 forced other people to get lower costs. I believe the
 5 gentleman from Wal-Mart said we get lower costs when they get
 6 lower costs a lot of the same times. They have contracts
 7 which force lower costs. When someone is out there that is
 8 competitive, you have to be more competitive, too.
 9 To run to my daughter again, you are economic dead
 10 meat. This forces you to be competitive and makes the
 11 overall economy more competitive, leads to more jobs, helps
 12 people. That's my view of this.
 13 Q. Have you heard of the term dynamic efficiencies?
 14 A. Sure. That's the most important types of efficiencies
 15 we teach our students. Those are efficiencies that when one
 16 firm becomes more competitive, then other firms have to be --
 17 excuse me, when one firm becomes more efficient, other firms
 18 have to become more efficient. In fact, my colleague Bob
 19 Solof won the Nobel Prize by demonstrating that dynamic
 20 efficiencies are much more important to the economy than
 21 static efficiencies, and they are the main reason of economic
 22 growth since World War II.
 23 Q. We are going to return in the final time in my redirect
 24 to econometrics.
 25 The topic is more forensic in nature. But the door

1 information -- you caused this information to be sent to the
 2 FTC; is that correct?
 3 A. Yes. Federal Express.
 4 Q. And in the first line, the reference to the separate
 5 model at the end of the sentence contains the data for
 6 California stores for which we estimated a separate model.
 7 What did that refer to?
 8 A. That meant that on -- if you look at the next sentence,
 9 it says the files are similar in format to those sent on
 10 February 12. What that sentence is saying is we sent you the
 11 previous model for the rest of the country on February 12,
 12 but here is model for California, and we estimated a separate
 13 model.
 14 Q. The reference to the data sent on February 12, what had
 15 been sent then?
 16 A. We sent a computer file with all the data and also with
 17 the program to run on SAS for the rest of the country.
 18 Q. The reference in the next sentence that the file is
 19 named REG 2.SAS, what does that refer to?
 20 A. That means there is a SAS program, as I said SAS is the
 21 most commonly used econometric software, I believe. All you
 22 have to do is stick this on a PC. It is called a
 23 self-executing program. You don't have to do any programming
 24 yourself. You just put it on your computer, say execute SAS
 25 file reg.2.SAS and the results come printing out of your

1 was opened.
 2 We have had a lot of discussion, Professor Hausman,
 3 with the inclusion, the exclusion of the California stores.
 4 Can you first identify what I'm going to be asked
 5 to have marked as DX-9010. Are you able to read that?
 6 A. Oh, sure, no problem.
 7 Q. Could you identify that for the record?
 8 A. Yes. Dr. Robert Levinson is an economist at the Bureau
 9 of Economics at the Federal Trade Commission.
 10 Q. Who -- I'm sorry.
 11 A. Excuse me. Ms. Karen Hull is a research assistant who
 12 works for me and is employed by Cambridge Economics which is
 13 a consulting company that I own. I told Dr. Levinson we
 14 would send him the California model. It would take a little
 15 bit of time to get it into shape. We did. All this says is
 16 this is a memo she sent him on February 18 that I was
 17 referring to. It says look here is the California model.
 18 There's a separate model. It said the enclosed diskette
 19 contains data for California stores which we estimated in a
 20 separate model. Then there's a bunch of computer lingo. It
 21 says this is an ASCII file that you can run this. So as I
 22 said there would be no problem running the regression. I
 23 checked with Dr. Baker who is head of the Bureau of Economics
 24 later and he said they had no trouble running it.
 25 Q. Just so the record is clear. You sent this

1 computer as soon as it can do the calculations.
 2 Q. The final sentence of the first paragraph, "The
 3 regression variables are the same as those contained in the
 4 data file sent on February 12."
 5 What does that refer to?
 6 A. I had a phone call or meeting -- I think both
 7 actually -- with the staff in between and told them all the
 8 variable I used in the rest of the country model. This just
 9 says that this is really the same model. It is just
 10 estimated separately for California.
 11 Q. The next line "Please feel free to call me with any
 12 questions." Do you see that?
 13 A. Yes, I do.
 14 Q. And did anyone call you from the Bureau of Economics
 15 with questions about the California model?
 16 A. Well, this is from Karen Hull. I asked her. She said
 17 no one ever called her. No one called me. Of course I
 18 always encourage people to call me. As I said, I asked
 19 Dr. Baker. He said they had no problems running it.
 20 Q. In the February time period did you have extensive
 21 discussions with the Bureau of Economics at the FTC?
 22 A. Yes. I had a number of phone calls on Sunday afternoon,
 23 as I remember. Once at night. I went down there a number of
 24 times. I talked to Dr. Baker by himself and myself at least
 25 two or three times for probably an hour or so on the phone.

1 MR. GIDLEY: Your witness.
 2 THE COURT: Would you like to do any recross?
 3 RECCROSS EXAMINATION
 4 BY MR. ORLANS:
 5 Q. Just one question, sir?
 6 A. Sure.
 7 Q. Regarding the slide that Mr. Gidley just had up, did you
 8 say anything about stores that were excluded, the fact there
 9 were 16 stores missing?
 10 A. I told Dr. Baker we excluded some stores. I didn't go
 11 into detail. It doesn't say that.
 12 Q. It doesn't say anything about Pennsylvania either does
 13 it?
 14 A. No.
 15 THE COURT: Thank you, Dr. Hausman.
 16 (Recess)
 17 THE COURT: How are we doing on timing now.
 18 MR. KEMPF: Let me ask the main controlling
 19 person. Do you have a current status there?
 20 THE DEPUTY CLERK: Just a moment.
 21 MR. KEMPF: Sure.
 22 THE COURT: A few minutes ago the defendants had 12
 23 hours and 16 minutes. The plaintiffs had about -- around 11
 24 hours and 10 minutes or so. I am just worried about the rest
 25 of the day.

1 MR. KEMPF: I understand, Your Honor. As soon as I
 2 get this exactly.
 3 THE DEPUTY CLERK: For plaintiffs, I have 12 hours,
 4 4 minutes. For defendants, I have 12 hours and 24 minutes.
 5 MR. KEMPF: We are running pretty close. That
 6 means we have about split time left, Your Honor.
 7 Here is my proposal. Going to the list I had
 8 outlined to the Court this morning, I have two that I thought
 9 would be about a quarter hour each. One is the consumer
 10 one. The two of them in total in terms of our usage of the
 11 clock would be less than half an hour. That would be the
 12 consumer presentation and Mr. Jacober. I would propose to do
 13 that and then rest. What I would like to do -- and I will
 14 gather the few declarations I referenced this morning, Your
 15 Honor, turn those in at that time.
 16 I would then rest. What I would like to do is I
 17 would very much like to use the Stephan videotape, and I will
 18 discuss with the government over the noon hour either doing
 19 that then or if they say we could run the full day resting
 20 subject to showing that if I have more time on the clock. If
 21 not, I will trust the Court to consider looking at that
 22 videotape.
 23 THE COURT: You are proffering to the plaintiffs if
 24 they get their rebuttal starting around 2:00, if we start at
 25 1:30?

1 MR. KEMPF: They may want to cross Mr. Jacober. As
 2 I said, his direct would be 15 minutes. Then we would turn
 3 it over to them.
 4 THE COURT: Mr. Cary, your estimate of rebuttal
 5 time?
 6 You have -- I forgot how much time you have left.
 7 You may have 3 hours left, or a little less. Can you get
 8 it?
 9 MR. CARY: We have a relatively extensive
 10 examination of Mr. Painter, who is our expert on the
 11 efficiency issues. We would then anticipate a relatively
 12 short rebuttal by Dr. Warren-Boulton, and it is likely that
 13 we would have a short rebuttal by Dr. Ashenfelter.
 14 THE COURT: Well, let's see how long they are.
 15 I think maybe we can still get it in this
 16 afternoon. It may be later this afternoon when we finish.
 17 MR. KEMPF: We will accommodate our
 18 cross-examination to fit the clock.
 19 THE COURT: We will be back at 1:30 after lunch.
 20 (Recess)
 21 AFTERNOON SESSION
 22 MR. ORLANS: One quick housekeeping matter. I would
 23 like to offer and mark a document I should have marked and
 24 offered before. It is the one with the .9 percent number we
 25 all thought was the overlap market. It turns out not to be

1 that. We would like to mark it as Plaintiff's Exhibit 411.
 2 MR. KEMPF: I have no objection. This is actually
 3 one of the tabs to defendant's declaration for Mr. Hausman.
 4 He has this attached as one of the attachments.
 5 THE COURT: 411 then. Are we ready to go with the
 6 next witness, then?
 7 MR. KEMPF: We are, Your Honor. The afternoon
 8 schedule -- first, let me make one announcement.
 9 Mr. Fuente's chair is not filled this afternoon. His
 10 daughter who is a junior in high school has her prom this
 11 evening. He promised here he would be back for that. I told
 12 him he could leave. He will be back for the oral argument.
 13 The next thing we are going to do, Your Honor, is
 14 the presentation of consumer evidence, which will be
 15 relatively, short followed by Mr. Jacober; and my partner
 16 Tefft Smith will do both of those.
 17 THE COURT: All right.
 18 MR. SMITH: Good afternoon, Your Honor. Just
 19 briefly before I begin, I would like to introduce to the
 20 Court Colin Cass, my able associate who has worked very long
 21 on this case for me and Doug Jaczinski, a legal assistant
 22 from White & Case. He and his staff have done yeoman work
 23 and are here to be acknowledged.
 24 I am here to briefly review what the consumers have
 25 to say, and then we will talk about -- in those immortal

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

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

5 DX-1075.

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

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

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

D. Dinkell
Inconsistent Deps

1 that I felt was unreasonable I would seek the lowest price
 2 source for my supplies elsewhere.
 3 "I wrote the original letter because I am a cost
 4 conscious consumer and felt the price disparities were not
 5 justified. I shop office supplies on a continuous basis."
 6 He then went on to say that, "In fact, my office in
 7 Leesburg is only a quarter of a mile from a Wal-Mart store
 8 and less than one-half of a mile from a Kmart. These stores
 9 simply did not have the variety of office supplies that I
 10 need for my business, including essential items such as the
 11 toner for my copy machine and packages of 100 third-cut file
 12 folders."
 13 You may have wondered yesterday while Mr. Assaf
 14 pointed out that little spot over on the DX- number which --
 15 I don't have the number, I can't quite read the number, but
 16 you remember the big photograph in there in the Wal-Mart
 17 planogram are 100 cut-file folders.
 18 MR. CARY: Again, Your Honor, we objected
 19 yesterday. We asked for documentation of what this shows.
 20 None has been provided.
 21 MR. SMITH: That's because it all was provided
 22 previously to them, Your Honor.
 23 THE COURT: These are the blown-up pictures you are
 24 referring to?
 25 MR. SMITH: Yes, of which they had small pictures

1 percent; and having what they need in stock, 21 percent.
 2 This is DX-1836.
 3 Purchasers stated that they had an average of 4.7
 4 available office supply sources in addition to Staples.
 5 The central conclusion of this study -- quoting
 6 from the study -- is that a great deal of competition
 7 exists. Only 1 percent of Staples customers name Staples as
 8 the single source of office supply products that they buy.
 9 Now, I know we are -- and this is the detail on the
 10 results of that study; that's the next thing. I know the
 11 Court did not give much credence to the FTC Internet web site
 12 survey; but in any event, it is here for purposes of the
 13 record. But the final -- this is the up side, downside sort
 14 of numbers we have experienced here generally.
 15 As you can see under the FTC's own web site,
 16 unsolicited, it was 62.3 percent in favor of the merger, 38.7
 17 opposed; and what was interesting, the FTC closed down the
 18 web site.
 19 The FTC itself has spoken as a consumer as we saw
 20 in the opening argument. 105 different suppliers.
 21 Your Honor, I would now like to call Mr. Jacober.
 22 THE COURT: Thank you.
 23 STEVEN JACOB, DEFENDANTS' WITNESS, SWORN
 24 MR. SMITH: Your Honor, the exhibits we are going
 25 to use with Mr. Jacober are at the very back end of this

1 before. They certainly have the ability to talk to Wal-Mart
 2 and know the background on that.
 3 THE COURT: Go ahead.
 4 MR. SMITH: There have been a number of consumer
 5 surveys in the record. IN 1995, Office Depot conducted what
 6 they called a VIP survey of consumers. That VIP survey
 7 showed that 40 percent of the people surveyed say they
 8 purchased office products most often from somewhere other
 9 than an office supply superstore. 40 percent say they use
 10 warehouse clubs. Thirty percent say they use mail-order.
 11 Thirty-five percent use local dealers.
 12 These are in-store customers. Forty percent say
 13 price determines where they shop.
 14 A survey that was just completed here over the last
 15 month in April and early May by the respected firm of Shapiro
 16 & Associates which is in the record as -- concludes that it
 17 was a survey of seven city pairs, 14 markets, and 700 double
 18 blind interviews. That is to prevent any bias from being
 19 obtained, that there was anybody that was influencing the
 20 outcome as to who was doing it.
 21 And the conclusion of that study which has been
 22 provided to counsel for some time states that when deciding
 23 where to purchase office supplies, price is by far the most
 24 important factor, 78 percent; followed by delivery, 30
 25 percent; convenient location, 28 percent; quality, 28

1 binder. I think it is under tab C at the very, very back
 2 end.
 3 THE COURT: All right.
 4 DIRECT EXAMINATION
 5 BY MR. SMITH:
 6 MR. SMITH: If I may have a minute, Your Honor,
 7 just to give him a set of the exhibits.
 8 Sorry, Your Honor.
 9 Q. Could you please introduce yourself to the Court,
 10 Mr. Jacober?
 11 A. My name is Steven Jacober.
 12 Q. And by whom are you currently employed?
 13 A. I am currently employed by the School & Home Office
 14 Products Association otherwise KNOWN as SHOPA, as president.
 15 Q. And can you tell us what SHOPA is?
 16 A. SHOPA is a trade organization, a trade association
 17 comprised of approximately 1400 corporate members,
 18 manufacturers, retailers, wholesalers, manufacturer
 19 representatives, all of whom are involved in the distribution
 20 of school and home office supplies.
 21 Q. I'd like to direct your attention to DX-1819 which is
 22 now up on the screen and is in your book there. And ask you
 23 what that is?
 24 A. That is a membership list of SHOPA as of December 1996.
 25 Q. Now, are the office supply superstores members of SHOPA?

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

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

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

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

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

1 Q. Now, does dominant mean that you don't face any
 2 competition other than those firms that have a similar
 3 format?
 4 A. No. Based on our perspective and our view of the
 5 industry, the industry is extremely competitive. You know,
 6 period.
 7 Q. Is that competition based solely on price or are there
 8 other factors that have an effect?
 9 A. When you take a look at what really motivates the
 10 consumer to shop for a product at a given location, there are
 11 basically three parts of the value equation. Price, of
 12 course, is exceedingly an important part of this equation but
 13 also service, convenience, translate into value for the
 14 consumer.
 15 Q. Now, I would like to direct your attention, sir, to
 16 Defendants' Exhibit 1759. Can you tell us what that document
 17 is? Let's hold off putting that up for one second. Let's
 18 just look at DX-1759. Can you tell us what that document
 19 is?
 20 A. This is a piece of information that was presented at the
 21 1995 SHOPA educational seminar.
 22 Q. Can you tell us a little bit about that educational
 23 seminar, what happens at a SHOPA educational seminar? Who
 24 the participants are?
 25 A. Basically at the 1995 seminar, there were a little over

1 200 retail manufacturer executives in attendance. The format
 2 basically took the course of, you know, having industry
 3 experts speak on given topics that impact the industry.
 4 Q. Now, as part of that educational presentation -- and if
 5 we can put on the overhead -- this is taken from pages 19 and
 6 20 of DX-1759, -- can you tell us what this is and what the
 7 point was that was made as part of that presentation?
 8 A. Basically, this piece of information attempts to
 9 capsule the development of what is going on in the retail
 10 marketplace, specifically in the school and home office
 11 supplies industry; and that as players in the industry,
 12 competitors in the industry seek to increase volume, increase
 13 sales, basically expand, grow their business, creating larger
 14 organizations which, in turn, place themselves in a position
 15 to have leverage with their manufacturer suppliers, whether
 16 it be in the terms of lower prices, greater efficiencies in
 17 the distribution process; more or less to take operating
 18 costs out of the system.
 19 As this occurs, these retailers gain additional
 20 sales, become more profitable, reinvest in their
 21 infrastructure and their distribution processes to continue
 22 to lower costs, which, in turn, completes what we call the
 23 productivity loop in that increasing sales and volume.
 24 Q. There are two parts to this exhibit. One talks about
 25 the opportunities; one talks about the risks.

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

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

1 beyond that. If one takes a look at the old retail 80-20
 2 average where 20 percent of your merchandise mix generates
 3 approximately 80 percent of your volume, if you look at in it
 4 this respect -- and I think it is applicable -- that the
 5 broad and deep range of product offering basically provide an
 6 opportunity to gain incremental sales volume.
 7 In addition to that, also create efficiencies for
 8 dealing with manufacturers who offer a broad range of product
 9 so that by being able to satisfy those needs and work with
 10 the supplier, again make a statement to the consumer so that
 11 when that consumer does, indeed, go to shop for a specific
 12 product, that consumer can be guaranteed that product will be
 13 in stock and on store shelves.
 14 Q. Now, what are some of the alternatives that you would
 15 see from the work that you have done for consumers if
 16 Staples/The Office Depot, the new company, were to after the
 17 merger, the day after, ceteris paribus -- isn't that the
 18 phrase you used, Dr. Warren-Boulton, isn't that the
 19 phrase? -- all things being equal, prices would just jack up
 20 five percent the day after the merger? Are there
 21 alternatives that consumers would have to go if that were to
 22 occur?
 23 A. In my opinion, yes, it would be based on the research we
 24 have done for the strategic overview and distribution trends
 25 report measuring wholesale shipments to a variety of channels

1 of distribution. Those channels include traditional discount
 2 stores, whether it be a Kmart, Target, Wal-Mart, wholesale
 3 clubs. If I am an owner of a small convenience store when I
 4 go to pick up my coffee filters and gum, pick up office
 5 supplies, whether it be drug stores and supermarkets which
 6 are also becoming very involved in the office supplies
 7 market, to the traditional dealers, contract stationers,
 8 mail-order houses; again I think that opportunities are
 9 there.
 10 Q. Has SHOPA been tracking the Internet?
 11 A. To some degree, yes, we have. The Internet and its
 12 potential impact on the consuming public. I have been
 13 exposed to reports that claim anywhere from five to 15
 14 percent of total retail sales can at one point be done or
 15 could at one point be done electronically.
 16 Q. Now, are you familiar with the concept of a profit
 17 maximizing strategy for a company?
 18 A. That's a company's reason for being.
 19 Q. And would it be in Staples/The Office Depot's profit
 20 maximizing self-interest to raise prices after this merger
 21 based upon your experience and knowledge in the industry?
 22 MR. BROYLES: Objection, foundation, Your Honor.
 23 THE COURT: Go ahead. I will allow it. He is
 24 testifying to experience after 11 years in the discount
 25 industry.

1 THE WITNESS: Could you repeat the question.
 2 BY MR. SMITH:
 3 Q. The question is whether it would be in the profit
 4 maximizing self-interest of the new entity Staples/The Office
 5 Depot to raise prices suddenly the day after the merger in
 6 office supplies without regard to any change in demand or
 7 supply or anything else?
 8 A. Based on my experience, when prices rise consumers shop
 9 or seek to -- you know -- obtain product through different
 10 alternatives.
 11 Q. Now have you or your organization done any specific
 12 study analyzing this proposed merger?
 13 A. No, we have not.
 14 Q. Are you or your organization either in favor or opposed
 15 to this merger?
 16 A. We are neither in favor nor opposed to this merger.
 17 Q. Now, I would like to show you what is another page from
 18 DX-1759. And ask you to describe what this is.
 19 A. Basically again this is one of the results of -- from
 20 the 1995 educational seminar sponsored by SHOPA.
 21 Q. What does this -- is this graphic that comes from page
 22 15 of DX-1759 designed to show?
 23 A. Basically, this is designed to show the types of
 24 pressures and challenges which confront basically all of our
 25 members across segments that, you know, the intensely

1 competitive situation in the marketplace is truly creating
 2 challenges for the retailer and supplier to maximize their
 3 efficiencies and to satisfy the continued consumer demand for
 4 price and value.
 5 Q. Now, within that box or however you want to call that
 6 nifty looking thing that all the arrows are pointing at are
 7 the office superstores there?
 8 A. Yes.
 9 Q. As well as the other entities that I think that we
 10 saw -- technology is -- we didn't get it.
 11 I wanted to show the multitude of competitors
 12 chart.
 13 Now, -- there we go. The consumer, you say, plays
 14 an important role in this whole industry dynamic. Why is the
 15 consumer so important?
 16 A. Basically, in our opinion the consumer is what is
 17 driving the marketplace today unlike in times past. The
 18 consumer today is extremely sophisticated, exposed to more
 19 information, better information, is more aware of their
 20 alternatives that they have. There's not a single retailer
 21 nor manufacturer that can dictate to the consumer where they
 22 will buy at what price they will buy.
 23 Q. Now for SHOPA'S -- any of SHOPA'S membership, is there a
 24 negative from this merger?
 25 A. Yes. There is. We include as our members many

1 studies relative to individual retailers. Just based on my
 2 experience.
 3 Q. So you can't tell the Court today how high prices would
 4 have to go before consumers would turn to these other
 5 alternatives, can you, Mr. Jacober?
 6 A. That's correct, sir.
 7 Q. And when you said in your declaration that if prices
 8 rose after the merger, that consumers could also turn to
 9 contract stationers, you also did not have any specific
 10 information as to how high prices would have to go before
 11 they would turn to those alternatives, did you?
 12 A. Yes, sir. That's true. We have not conducted any
 13 specific surveys relative to that.
 14 Q. Nor do you know for sure how mail-order prices for
 15 office supplies compare to retail sales for office supplies;
 16 is that correct?
 17 A. In terms of again individual specifics with regard to
 18 individual companies, no, I don't.
 19 Q. But you think that generally mail-order prices are
 20 higher than retail prices; is that correct?
 21 A. Yes, sir.
 22 Q. Now, you referred to the -- I guess the yin or the yang
 23 I guess in response to Mr. Smith's question about the impact
 24 on your members. Have any of your manufacturer members come
 25 to you and told you that they will have to give lower prices

1 manufacturers both large and small who given a larger retail
 2 customer will be forced to negotiate much more efficiently,
 3 whether that be, again, in the sense of lower prices, greater
 4 promotional support; again helping to take costs out of the
 5 distribution process.
 6 Q. Is there a yin to that yang?
 7 A. Well, basically, as people work to take costs out of the
 8 distribution process, lower operating costs, eventually it
 9 ends up being in the best interests of the consumer who again
 10 drives the marketplace.
 11 MR. SMITH: No further questions, Your Honor.
 12 THE COURT: Thank you, sir.
 13 Mr. Broyles?
 14 CROSS EXAMINATION
 15 BY MR. BROYLES:
 16 Q. Good afternoon, Mr. Jacober?
 17 A. Good afternoon.
 18 Q. You mentioned in your direct testimony that there are
 19 several retail firms that consumers could turn to if prices
 20 were to go up after the merger?
 21 A. Yes, sir.
 22 Q. And is it -- it is correct that you have no personal
 23 knowledge of the price practices of any of these retail
 24 firms; is that correct?
 25 A. No specific knowledge nor have I done any specific

1 to Staples/Office Depot after the merger?
 2 A. We have not discussed with any of our members any of the
 3 specifics about this merger.
 4 Q. But you do know that office supply superstore prices
 5 vary from city to city; is that correct?
 6 A. Yes, sir.
 7 Q. And you know that because you've observed these
 8 different prices in different cities, isn't that correct?
 9 A. Yes, sir.
 10 Q. And you are not in a position today, Mr. Jacober, to
 11 deny the allegation that those price differences correspond
 12 to the number of superstores in those particular cities; is
 13 that correct?
 14 A. I'm not quite sure whether I can or I cannot. I would
 15 have to take a look at other types of information. Granted,
 16 the number of stores in a marketplace play a role in setting
 17 prices, but there are other factors such as retail costs,
 18 retail real estate costs, costs of labor, advertising
 19 efficiencies, things like that. So I couldn't say one way
 20 are the other.
 21 Q. That's not something you have done?
 22 A. Correct, sir.
 23 Q. So you are not in a position to deny that allegation?
 24 A. Correct, sir.
 25 MR. BROYLES: Nothing further, Your Honor.

1 THE COURT: Thank you, Mr. Broyles.
 2 MR. SMITH: I have no further questions, Your
 3 Honor.
 4 THE COURT: Thank you, Mr. Jacober. You may step
 5 down.
 6 THE WITNESS: Thank you.
 7 (Witness excused)
 8 MR. KEMPF: I am handing the government two
 9 declarations, Mr. Fuente's, which we marked as DX-9015 and
 10 one from Mr. Helford, which we marked as DX-9060.
 11 MR. CARY: We strenuously object to this. They
 12 were supposed to have their case in about three weeks ago.
 13 Nonetheless, they have continued to provide declaration after
 14 declaration after declaration even after discovery cut off.
 15 They provided even more declarations. To now provide a
 16 declaration from a witness that has signed a declaration,
 17 been deposed and another one from their client, obviously
 18 they could have gotten that declaration before the Court's
 19 ordered cutoff without giving us an opportunity to
 20 cross-examine is prejudicial.
 21 MR. KEMPF: They have taken the depositions of both
 22 of these witnesses, Your Honor. Mr. Fuente I cut in the
 23 interest of time. I have one point that is in there. I
 24 think it is -- comes with ill grace for Mr. Cary to talk
 25 about late arriving exhibits.

1 the witness list. He was expected to testify. I don't see
 2 any prejudice to bringing in a document that was earlier
 3 filed. I had one or two others..
 4 MR. KEMPF: I had one or two others, Your Honor. I
 5 will get my list here.
 6 One I mentioned this morning. This is not it.
 7 Hold it.
 8 This is a declaration we filed yesterday. It is a
 9 one-page declaration of Mr. Becker. The question came up who
 10 made this, where did they get the numbers on that chart on
 11 the stock market prices I used in my cross-examination of
 12 Dr. Warren-Boulton.
 13 And we put that in to show where that was made
 14 from. That was Mr. Becker, who is my associate, who is both
 15 a lawyer and a Ph.D. in economics.
 16 That was actually provided last night.
 17 I then said -- I see Mr. Assaf here. Do you have
 18 that?
 19 MR. ASSAF: I do, sir.
 20 MR. KEMPF: I said to him, I'll bet they went out
 21 and cherry-picked those eight items at McWhorter's. Why
 22 don't we send everybody to the -- why don't we send somebody
 23 out and see if we can't find eight items that go the other
 24 way. I bet we can. Sure enough, we could, Your Honor. My
 25 only purpose in that is to respond to what they put in

1 THE COURT: I am going to do this. Because
 2 Mr. Fuente was here the whole week and expected to be a
 3 witness and because of time constraints cannot be, I don't
 4 think it is unfair to attach his -- whatever relevant portion
 5 of the deposition -- of the declaration the parties
 6 defendants want to put in. There's rebuttal. If you want to
 7 put in some part of his declaration that's not included, the
 8 government can do that or put part of the deposition in that
 9 may refute that.
 10 What is the other declaration?
 11 MR. KEMPF: I have one from Mr. Helford, Your
 12 Honor, who was scheduled to be a witness. We cut him
 13 yesterday. The -- it is a one-pager. All it does is
 14 attach -- all it does is comment on one other document that
 15 is already an exhibit, DX-855. DX-855 was a declaration that
 16 the FTC drafted for his signature back in.
 17 Mr. Helford reviewed it. Took a lot of time. Made
 18 line-by-line edits. Gave them a couple of riders to attach
 19 to it, including the information to the FTC he thought the
 20 merger would intensify competition for office product sales.
 21 This is a document they had since February. It is -- as I
 22 say the document is already in evidence. He just
 23 authenticates it here and says that this is indeed something
 24 I sent to them.
 25 THE COURT: I will accept it. I think he was on

1 evidence on cross examination. They weren't under any
 2 obligation to disclose it. Having disclosed it yesterday, I
 3 said I'll bet we can get eight items that go the other way.
 4 Sure enough we could.
 5 I want to show that in the record, Your Honor. I'm
 6 sure McWhorter's on the average charges more in terms of its
 7 greater service to the community commitment. I just want to
 8 show the story is not as one-sided as the government would
 9 have the Court believe. Our people went out last night, got
 10 that. Here it is right now.
 11 THE COURT: Those will be marked in as part of your
 12 case. That's McWhorter's and Becker's.
 13 MR. KEMPF: I had one other item of information
 14 that really didn't -- I really didn't focus on until during
 15 the trial. I had someone get this information. There's been
 16 a lot of talk about the store openings planned by OfficeMax
 17 and during discovery, we did get from them highly
 18 confidential information on that score which is in the record
 19 that the Court has heard references to 120 to 150 store
 20 openings. Some of those openings are in so-called two-to-one
 21 towns, towns where the merger will change it from
 22 two-to-one.
 23 I said in my opening, very quickly, if any of those
 24 change from ones back to twos because of store opening
 25 plans. We have that in there. It occurs to me one of the

1 benefits of the merger is the existing and increasing store
 2 openings planned by newco. I asked the Staples people if
 3 they had a schedule of store openings, and they sent that to
 4 me. It is like about a five-line document that says here is
 5 the current schedule of our store openings, Your Honor. Five
 6 line declaration with an attached computer printout of
 7 what -- of their plan. I would ask that this be marked
 8 highly confidential.

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

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

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

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

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

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

5 MR. KEMPF: Thank you, Your Honor.

6 THE COURT: Mr. Cary?

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

11 THE COURT: Thank you, sir.

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

17 THE COURT: Let me see what the contents are.

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

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

23 MR. BROYLES: Yes, Your Honor.

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

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

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

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

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

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

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

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

4 MR. CARY: Same witnesses.

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

7 THE COURT: Looks like some are, some aren't.
 8 Go ahead.

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

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

15 MR. BROYLES: You have it.

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

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

25 Paragraph 1.

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1 "My name is Tom Russ. I am writing this affidavit
 2 to set the record straight and to clarify any confusion that
 3 may exist between the statement that I signed on May 7, 1997
 4 and my opinion about the merger between Staples and Office
 5 Depot. I am the same Tom Russ who wrote a letter on March
 6 17, 1997, to William Baer, the director of the Bureau of
 7 Competition at the Federal Trade Commission, in which I
 8 enclosed advertising circulars showing that the prices at the
 9 Office Depot store in Leesburg, Florida were significantly
 10 higher than the prices at the Office Depot stores in Orlando,
 11 Florida for the identical items. As the owner of a Leesburg,
 12 Florida real estate agency with seven employees, I am very
 13 concerned about this merger".
 14 I will skip down to paragraph 3.
 15 "After further reflection and time to compose my
 16 thoughts, I would like to clarify my statement with the
 17 following observations and information. In Leesburg, Florida
 18 there is only one office supply superstore -- an Office Depot
 19 store. Unlike Orlando and other cities in Florida, the
 20 Office Depot store in Leesburg does not compete against
 21 Staples. The higher prices in Leesburg compared to Orlando
 22 is no secret. I observed the price differences after
 23 comparing Sunday advertising circulars for the same items at
 24 the same time earlier this year. In fact, I sent a letter to
 25 David I. Fuente, the chairman and CEO of Office Depot on

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1 February 11, 1997 pointing out these price differences and
 2 enclosed copies of the front page of the flyers, and I
 3 requested him to personally review the pricing issue.
 4 Mr. Fuente has yet to respond to my letter or explain in any
 5 way why Office Depot charges more for the same office supply
 6 items in Leesburg than in Orlando. I believe that the lack
 7 of competition in Leesburg explains the higher prices
 8 compared to the Office Depot stores in Orlando."
 9 Skipping down to paragraph five.
 10 "As a result of these price differences, I am very
 11 worried that Staples and Office Depot will be able to raise
 12 prices in markets where they directly compete, such as
 13 Orlando, Florida. Although I said in my May 7, 1997
 14 statement that I would seek the lowest price for my office
 15 supplies elsewhere if there would be a 'unreasonable' price
 16 increase in Leesburg, in reality, there is nowhere else for
 17 me to shop in the Leesburg area where I can buy all of the
 18 office supplies that I need for my business. I have looked
 19 at the office supplies sold in Wal-Mart, Kmart and other
 20 retailers. In fact, my office in Leesburg is only a quarter
 21 of a mile from a Wal-Mart store and less than one-half of a
 22 mile from a Kmart. These stores simply do not have the
 23 variety of office supplies that I need for my business,
 24 including essential items such as the toner for my copy
 25 machine and packages of 100 third-cut file folders. "

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1 Paragraph 6: "Mail-order office supply companies
 2 send me catalogs from time to time, but I do not use them
 3 because I am usually in immediate need of office supplies."
 4 Skipping down to the last sentence of that
 5 paragraph. "In addition, I usually do not buy enough items
 6 to meet the minimum purchases necessary to avoid shipping
 7 charges."
 8 Paragraph 7: "In reality, a 'unreasonable' price
 9 increase that would cause me to shop elsewhere would have to
 10 be greater than 10 percent. This is why I am so concerned
 11 about the merger. If the prices for office supplies in
 12 Leesburg increase 5 to 10 percent, I effectively have nowhere
 13 else to shop for my office supplies in the Leesburg area and
 14 I would have to pay the higher prices. This is what I fear
 15 will happen in Orlando and markets across the country where
 16 Staples and Office Depot directly compete."
 17 Finally from paragraph 9: "I remain committed to
 18 my belief that the merger between Staples and Office Depot
 19 will eliminate competition that benefits consumers like me."
 20 And his last sentence: "Make no mistake about it,
 21 I am opposed to the merger."
 22 I would now like to turn to the binder which is our
 23 rebuttal to the defendant's featured declarations.
 24 THE COURT: All right.
 25 MR. BROYLES: AS you will see, declarants still say

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1 they can't constrain Staples-Office Depot price hikes.
 2 This is the rest of the Defendants' Exhibit 863.
 3 Paragraph 11 states, "Through our price-checking,
 4 we have noticed that the office supply superstores have
 5 different prices in different areas of the country. These
 6 price differences appear to be related to the number of other
 7 office supply superstores in the same area and not the
 8 existence of Wal-Mart or other retailers."
 9 Paragraph 12 and 13 of Defendants' Exhibit
 10 863: "Based on our price-checking, in areas where Staples and
 11 Wal-Mart exist, Staples' prices are, on average, higher than
 12 in areas where Staples competes against Office Depot, even if
 13 Wal-Mart or other discounters are present. Our
 14 price-checking shows that Office Depot generally has lower
 15 average prices on consumable office supplies than either
 16 Staples or OfficeMax."
 17 Paragraph 13 continues: "Our price-checking
 18 information shows that mail-order firms do not significantly
 19 affect the retail prices of office supplies. Mail-order
 20 firms sell office supplies at prices that are significantly
 21 higher than the office supply superstores."
 22 Finally, paragraph 16: "I believe that if
 23 Staples and Office Depot were to merge, the combined firm
 24 will likely raise prices in areas where there is less
 25 competition. The merged Staples and Office Depot will be

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1 able to raise prices on thousands of office supply items or
 2 SKUs. In addition, Wal-Mart cannot prevent the merged firm
 3 from raising prices on many of the same SKUs that Wal-Mart
 4 also carries."
 5 Sam's Club cannot constrain office superstore
 6 pricing. A declaration of Mr. Mike Pratt, paragraph 6, and
 7 this is Plaintiff's Exhibit 172.
 8 "The presence of Sam's Club stores in an area does
 9 not appear to significantly affect the average price level at
 10 an office supply superstore compared to the level of
 11 intensity of another nearby office supply superstore.
 12 Paragraph 7: "If Staples and Office Depot were to
 13 merge, the combined firm could raise prices on many of the
 14 thousands of office supply items or SKUs that each firm
 15 carries because they no longer will be directly competing
 16 against each other. In addition, Sam's Club cannot prevent
 17 the merged Staples and Office Depot from raising prices."
 18 Mr. Atkinson who was here and testified in front of
 19 you on Monday, it seems like a long time ago.
 20 Paragraph 7 of his declaration which is at
 21 PX-171: "Over the past year the office supply superstores,
 22 especially Staples and OfficeMax have raised their prices on
 23 several consumable office supplies by more than 5 percent
 24 despite the presence in many markets of lower-priced club
 25 stores such as BJ's. The office supply superstores increased

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1 their prices even as BJ's lowered its prices for some
 2 consumable office supplies."
 3 Going down to paragraph 8: "I believe any
 4 decisions by Staples to raise prices or change prices in any
 5 way will not be affected by whether or not BJ's, or another
 6 club store, also raises its prices for consumable office
 7 supplies. As described above, I believe BJ's prices for
 8 consumable office supplies do not affect price changes by
 9 Staples for such products."
 10 The first part of paragraph 8 reads: "It has been
 11 my experience that office supply superstore prices vary
 12 depending on how many office supply superstore firms that are
 13 in a market. Where both Office Depot and Staples compete
 14 with each other in a market, prices for consumable office
 15 supplies generally are lower than where only Staples is in a
 16 market. Based on this experience, if Staples acquires Office
 17 Depot, I would expect generally to see higher prices similar
 18 to what occurs in markets now where Staples is the only
 19 office supply superstore in the market."
 20 Your Honor, the next two pages are from Target and
 21 they are under seal so I will pass those by.
 22 THE COURT: All right.
 23 MR. BROYLES: The next two tabs.
 24 I looked at those. All right.
 25 MR. BROYLES: Okay. The tab after that is from

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1 Jack Miller, who was on the defendant's witness list from
 2 Quill. This is from his deposition, Your Honor. It is at
 3 PX-339, pages 16 to 17.
 4 "Question: It is true, is it not, Mr. Miller, that
 5 you would not solicit more customers within the D category,
 6 customers with buying potential of less than \$1,000 a year,
 7 if -- even if office supply superstores raised their prices
 8 by 5 percent? Answer: I would not -- that wouldn't affect
 9 my decision."
 10 Irwin Helford, also on the defendant's witness
 11 list, Your Honor, PX-328, at his deposition, office
 12 superstores would have to increase prices by 10 percent or
 13 more before Viking sales would increase. "Question: Isn't
 14 it true that the office supply superstore prices would have
 15 to increase by 10 percent or more before a non-office supply
 16 superstore would see any significant increase in its sales
 17 volume? Answer: Well, I don't know the answer for
 18 non-superstore competitors, but in Viking's view, that is
 19 probably correct."
 20 Mr. Helford did submit a declaration for the
 21 defendants but he also reviewed a draft and refused to sign
 22 Staples' declaration saying prices would not rise
 23 post-merger. The bottom part of it is the part I will read
 24 that he would not sign. That says in that draft, "I am
 25 certain of one thing -- the new combined company will be in

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1 no position to raise prices, injure competition or otherwise
 2 harm consumers in any way."
 3 The handwritten writing says "delete".
 4 MR. KEMPF: Your Honor, I make a fairness objection
 5 at this time that goes to this designation. Mr. Helford did
 6 something in addition to that. He added substitute language
 7 that -- he eliminated what is up on the board there,
 8 beginning with the word "other sellers" which is part as you
 9 can tell from a continuation from the prior page. And when
 10 he deleted those, he substituted in for two long sentences
 11 one short one that makes essentially the same point. What he
 12 said was, "All of this should benefit consumers."
 13 To show he deleted this without changing it
 14 basically to a simple sentence that says the same thing I
 15 think is a fairness item. I can put that on the screen.
 16 THE COURT: In a minute. Let him finish going
 17 through these. Then you can bring that back.
 18 MR. BROYLES: Passage from the deposition. The
 19 passage appears on page VO 660 from the same paragraph, "Why
 20 did you delete that? Answer: Because I don't know that
 21 that's the truth or a fact."
 22 Brad Zenner from Office One, from his declaration,
 23 he says at paragraph 8, PX-170, paragraph 8. "Prices in
 24 office supply superstore markets are set by the three
 25 leaders, Staples, Office Depot and OfficeMax. Smaller office

1 supply superstore chains, such as Office One, have little, if
 2 any, impact on prices where one or more of the leaders
 3 exist. Prices are higher where Staples, Office Depot, or
 4 OfficeMax face no competition from each other, even if there
 5 is another office supply superstore, such as Office One, in
 6 the market. Because Office One cannot effectively compete
 7 with the leaders on price, we follow the prices they set."
 8 Sometimes Staples featured declarants still believe
 9 that entry is difficult.
 10 Again, from Mr. Helford's deposition which is again
 11 PX-329, pages 27 to 28.
 12 "You believe it would be difficult for a new
 13 office supply superstore chain to enter and compete
 14 successfully against Office Depot and Staples? Answer: I
 15 believe so, yes."
 16 Brad Zenner, from Office One, "In the office
 17 superstore industry, Staples, Office Depot, and OfficeMax are
 18 the only firms that can realistically enter these large urban
 19 markets on a sufficient scale to be successful. I am unaware
 20 of anyone else who is considering entering these markets and,
 21 in my opinion, it is very unlikely that anyone would do so in
 22 response to a 5 percent price increase by the incumbents."
 23 Finally, Your Honor, from Mr. Aram Rubinson of
 24 Payne Webber, "On the strategic front, the merger leaves the
 25 combined company with a dominant share of close to 40 of the

1 manufacturers, and bring wholesale prices down." And then he
 2 did more than deleted it. He asked that this be put in:
 3 "All of this should benefit consumers."
 4 So that's what he fully did.
 5 MR. BROYLES: Your Honor, I would respond
 6 Mr. Helford was asked about this why he deleted that at his
 7 deposition. You saw his answer. He said it was not a true
 8 statement.
 9 MR. KEMPF: It was not true as is, but as he
 10 revised it, it was.
 11 THE COURT: we have the deposition in evidence as
 12 well as the declaration.
 13 I think we can go to the next witness for the FTC.
 14 MR. BROYLES: One final housekeeping matter.
 15 THE COURT: Sure.
 16 MR. BROYLES: I would like to offer the binder as
 17 Plaintiff's Exhibit 414, Your Honor.
 18 THE COURT: 414. This is the binder entitled
 19 Rebuttal Defense Featured Declarations. That will be 414.
 20 Plaintiff's 414.
 21 You are up next, Mr. Carry?
 22 MR. CARY: I am. Back again, Your Honor.
 23 MR. KEMPF: Your Honor, just so the court knows,
 24 the cross-examination of Mr. Painter will be handled by
 25 Mr. Chris Curran, Your Honor.

1 top 50 markets and its \$12 billion size gives it a wide lead
 2 over its nearest competitor."
 3 Your Honor, I would also like to formally
 4 introduce -- never mind, Your Honor.
 5 Thank you.
 6 THE COURT: All right. Thank you.
 7 Mr. Kempf, you wanted to fill in with an affidavit,
 8 you said?
 9 MR. KEMPF: Yes, Your Honor, if I could. If I may
 10 confer with Mr. Assaf for just a second here?
 11 This is what Mr. Helford did. I'll show you the
 12 prior page 9, next word after what you are reading here would
 13 be "other."
 14 With other. What he did is said let's cut out the
 15 rest of that, but let's substitute in what I have highlighted
 16 which says all of this should benefit consumers.
 17 So he didn't delete it simply. He replaced it with
 18 a shorthand version. In his final declaration, which is in
 19 evidence as DX-854, you can see looking at this sentence here
 20 where he wrote in prices down, and then it has delete and all
 21 of this to show that that was indeed what he wanted added in
 22 here, here is what his final declaration looks like. It is
 23 now paragraph 11, right after -- the whole paragraph now
 24 reads, "I predict that a combined Staples/Office Depot will
 25 move aggressively to obtain greater price concessions from

1 THE COURT: All right.
 2 MR. KEMPF: He is from White & Case.
 3 MR. CARY: Your Honor, at this time we would like
 4 to call Mr. David Painter as our next witness.
 5 (DAVID T. PAINTER, PLAINTIFF'S WITNESS, SWORN)
 6 THE COURT: we will probably take a break about
 7 five after 3:00 or so. We are going to switch reporters
 8 around that time.
 9 MR. CURRAN: Your Honor, may I make an objection
 10 right off the bat, please? We did not receive copies of
 11 these demonstrative exhibits prior to just now when I believe
 12 under the agreement between the parties and the Court those
 13 are supposed to be exchanged on the prior day.
 14 MR. CARY: Your Honor, these exhibits are all
 15 included with the possible exception of two summary charts in
 16 PX-3-B which was produced consistent with the Court's
 17 scheduling order as part of our final submission.
 18 MR. CURRAN: was it an oversight we didn't get
 19 these demonstratives yesterday?
 20 MR. CARY: As I said, we had given them to you.
 21 THE COURT: All right. I will allow you to go
 22 ahead. It is late in the rebuttal phase of the case in any
 23 event.
 24 Let's go ahead.
 25 DIRECT EXAMINATION

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

1 and under a consent order, oftentimes a bundle of assets is
 2 assembled for divestiture to another party in order to
 3 restore the alleged lost competition in the marketplace
 4 because of that merger.
 5 And it would be up to myself or people on my staff
 6 to determine whether an Applicant that is brought forward to
 7 purchase those assets is financially viable, has the means,
 8 the wherewithal to, in fact, take those assets and make them
 9 viable in the marketplace, competitively available in the
 10 marketplace. It is from a financial standpoint, however.
 11 Q. And during the past 10 years, for example, how many
 12 mergers have you had occasion to analyze?
 13 A. I'm sorry. How many years did you say?
 14 Q. I said last 10 years, Mr. Painter?
 15 A. I've heard -- myself personally?
 16 Q. Yourself personally or people under your supervision?
 17 A. It probably -- for myself -- probably for myself, it
 18 would be in terms of sort of substantive kinds of things, we
 19 get many, many mergers that come through many -- there's sort
 20 of just little bits and pieces of things we fill in.
 21 Maybe 15 to 20 a year for myself. And maybe 20 to
 22 25 a year for others on my staff. I have a staff of two
 23 people, Your Honor.
 24 Q. Can you give me a little description of your employment
 25 history prior to assuming the position of assistant director

1 inquiry.
 2 Q. What kind of accounting issues arise in the course of a
 3 merger investigation?
 4 A. There are a variety of issues but the principal ones
 5 would be a failing company assertion. They generally are all
 6 claims made by parties to the merger offered in defense or as
 7 evidence to consider in terms of whether to bring the action
 8 or not. And one of the issues is a failing company defense.
 9 One of the parties may assert that they are a
 10 failing company or a weakened competitor such that they are
 11 not offering a competitive impact in the marketplace such
 12 that the merger is irrelevant in terms of reducing
 13 competition.
 14 Another major one is, in fact, the issue here.
 15 That is efficiency claims or cost savings claims. A party
 16 may offer -- may assert cost savings claims or efficiencies.
 17 There's sort of a broader -- a broader category than cost
 18 savings, as something that should be considered in
 19 recognition of whether or not to bring the case; and it is up
 20 to myself or people on my staff to assess that claim and
 21 determine the validity of the claim in terms of trying to
 22 assess what, in fact, are the cost savings that ought to be
 23 considered in the merger.
 24 I guess the other -- sort of major category would
 25 be sort of -- many investigations lead to a consent order;

1 for accounting?
 2 A. Yes. I became assistant director for accounting in
 3 1992. It was actually a title change from chief accountant
 4 in the Bureau of Competition, the accounting office of the
 5 Bureau of Competition. I held that position since 1980, and
 6 prior to that, I was a staff accountant within that same
 7 office, that was headed by somebody else, I guess from 1973
 8 to 1980.
 9 From 1967 to 1973, I was also employed by the
 10 Federal Trade Commission, but I was within their Bureau of
 11 Economics in a program of the division called called the
 12 division of financial statistics. It was really a program in
 13 which financial statistics, financial profit and loss
 14 statements, balance sheets and so forth were received from a
 15 cross-section of manufacturers in the country who happened to
 16 be about 10,000 and assembled, aggregated together for
 17 purposes of a quarterly publication called The Quarterly
 18 Financial Report for Manufacturing.
 19 I started in that office as a staff accountant and
 20 when I left that office, I was head of the accounting review
 21 section of that office. The accounting review section was
 22 responsible for reviewing the financial reports that would
 23 come in and making sure they were prepared in accordance with
 24 generally accepted accounting principles, that they were
 25 prepared consistently from period-to-period so when they were

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1 aggregated in a publication, they would -- it would be
 2 reliable to compare across periods and to compare across
 3 industries.
 4 MR. CURRAN: If it would speed things along, we are
 5 willing to stipulate Mr. Painter is an accountant who has
 6 been employed by the Federal Trade Commission his entire
 7 career.
 8 THE COURT: I think they may want a little more
 9 than that.
 10 MR. CARY: Yes, Your Honor.
 11 THE COURT: Go ahead.
 12 THE WITNESS: That would be easy.
 13 BY MR. CARY:
 14 Q. Briefly, Mr. Painter, could you describe the purposes to
 15 which this publication is put?
 16 A. The publication, it is still being done today, actually
 17 when I left it was being expanded into retail trade. There
 18 are two publications now, one for manufacturing, one for
 19 retail trade. The title may have changed somewhat. I get,
 20 receive them each quarter. It is circulated to generally
 21 government agencies, the Council of Economic Advisers, a
 22 variety of agencies like that, the Federal Reserve Board for
 23 purposes of assessing the information and making fiscal
 24 policy. There's also a fairly long subscription list
 25 generally of libraries and those kinds of institutions.

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1 Q. Have you ever testified at any -- in any trial?
 2 A. I have testified in administrative proceedings and I
 3 have also testified in Federal Court.
 4 Q. In the administrative proceedings that you testified,
 5 were any of those merger cases?
 6 A. Yes. Some were merger cases.
 7 Q. In which matters have you testified either by
 8 declaration or in person in Federal Court?
 9 A. In Federal Court, I've testified by declaration in one
 10 matter, the FTC-Himow matter; and actually that was on the
 11 same issue that I'm addressing in this matter, the
 12 efficiencies defense. I also testified in the FTC versus
 13 Abbott Labs. I think it went by. That was the infant
 14 formula case that was a conspiracy allegation. I testified
 15 on damages in that matter.
 16 Q. That was here in the District of Columbia?
 17 A. Yes, it was.
 18 Q. Have you also supervised the expert testimony of others
 19 on your staff?
 20 A. I have, yes.
 21 Q. And consistent with Mr. Curran's stipulation, I won't
 22 ask you whether you have been with the Federal Trade
 23 Commission for 30 years now.
 24 Can you identify the matters that you have
 25 supervised that have been in Federal Court?

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1 A. Two occur to me now. One is the FTC versus PPG I
 2 think -- I know it as the PPG Swedlow matter. One of the
 3 people on my staff at that time -- I think I had maybe three
 4 or four people, testified on market -- prepared market
 5 statistics, market share exhibits and testified on that.
 6 And I believe that was -- there was live testimony
 7 on that, maybe by affidavit.
 8 On the FTC versus Harbor Group, I believe that was
 9 in front of Your Honor, I -- one of the people in my section
 10 testified as an expert on the failing company assertion in
 11 that matter. I believe testified as an expert.
 12 Q. As part of your responsibilities as assistant director
 13 in the Bureau of Competition, are you obligated to give
 14 expert testimony when the Commission Staff so requests?
 15 A. Obligated to give testimony?
 16 Q. I'm not obligated no.,
 17 Q. Is it within your discretion whether to testify on a
 18 matter or not?
 19 A. It is solely within my discretion.
 20 Q. How do you make the decision as to whether or not to
 21 testify?
 22 A. Generally, I do not on my own make the decision that I
 23 want to be an expert witness in some matter. I'm often
 24 approached and if, in fact, the facts are things that lead to
 25 an opinion that is relevant to the proceedings, I may or may

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1 not. I have only testified as you can see a handful of times
 2 over the course of the years.
 3 Q. When were you first asked to look at the efficiency
 4 claims in the present matter?
 5 A. Formally asked somewhere in early February when we
 6 received what is -- I have referred to in the declaration I
 7 prepared as the efficiency book. I think it was February 5.
 8 I have have been asked within a day or two of that to look
 9 through it and try to make an assessment of it. Informally,
 10 I don't think I was asked -- but informally, I had reviewed
 11 synergies, it was called, not -- a term called synergies as
 12 they were sort of quantified in investment and banker
 13 analyses that were prepared for the board in this merger.
 14 Q. Now, in preparing your or in arriving at your
 15 conclusions and opinions in this matter, what did you do?
 16 A. I'm sorry, Mr. Cary, could you repeat that?
 17 Q. In forming your opinion in this matter, what were the
 18 steps? What did you do? How did you go about doing that?
 19 A. Well, the first thing was to, in fact, try to understand
 20 what the claims were that were being asserted. My
 21 recollection is that sort of -- I hate to characterize it out
 22 of the blue, but I received some information that, in fact,
 23 cost savings claims were being asserted that were
 24 dramatically higher than what I had associated previously
 25 with the merger; and the very first thing I did was to try to

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1 take a look through the book and understand in fact what was
 2 driving cost savings that were being posited and try to
 3 understand what the rationale is behind it, supporting
 4 documentation was behind them.
 5 It was sort of in conjunction with that very
 6 hastily, I think shortly after that there were two or three
 7 depositions taken of people that had input into preparing the
 8 cost savings; and those depositions were very helpful in
 9 terms of at least getting an initial handle on what the
 10 claims were all about.
 11 Subsequent to that, I began looking through
 12 documents, reading testimony, participating in other
 13 depositions, and again time and time again, reading the
 14 sufficiency analysis because, to be honest, at that point I
 15 still didn't have a good handle on what this was all about;
 16 and simply over the course of time in doing all of those
 17 things, looking through documents, reading testimony,
 18 actually rereading testimony, and rereading testimony even a
 19 third time, I picked up on various things I had been seeing
 20 in some testimony that seemed to be conflicting with other
 21 testimony, I ultimately came to prepare this declaration and
 22 to testify here.
 23 Q. Did you also review various documents that were produced
 24 by the parties in their compliance with the Pre-merger
 25 Notification Act?

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1 A. Yes, I did. I'm not sure if I -- we received those same
 2 identical documents as part of a response to the second
 3 question, and I'm not sure whether early on I had seen them
 4 as part of the initial filing. They were effectively the
 5 board analyses, Your Honor, which are required to be filed as
 6 part of the initial filing with the commission.
 7 They were duplicates that were certainly submitted
 8 with respect to our second request which asked for an
 9 abundance of information. I think more than either side
 10 would like to get. Certainly, I looked through those as well
 11 as related information and so forth.
 12 Q. Mr. Painter, how many hours roughly have you devoted to
 13 reviewing this material since February? And in preparing
 14 your report?
 15 A. It's been about a thousand hours.
 16 Q. A thousand hours since February of this year?
 17 A. About a thousand hours. Actually, I'm sure I'm sort
 18 of -- maybe below average with respect to everybody else
 19 that's here and what they've done. But it has been more than
 20 I could take.
 21 (Laughter)
 22 BY MR. CARY:
 23 Q. By my calculus, that's about an average of 70 hours a
 24 week. Does it sound about like that?
 25 A. I'm sure it is. My wife often says it is 24 hours a

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1 day.
 2 Q. Through this review and analysis, have you referred any
 3 opinions regarding the efficiency claims in this matter?
 4 A. I have.
 5 Q. And have you prepared a report?
 6 A. Yes, I have.
 7 MR. CARY: Your Honor, at this time I would like to
 8 hand up to the bench a copy of some demonstrative exhibits we
 9 prepared to illustrate the testimony and also a copy of the
 10 report of David Painter marked as PX-282.
 11 MR. CARY: May I approach witness, Your Honor?
 12 THE COURT: All right.
 13 MR. CARY: Mr. Painter, I will hand you the same
 14 documents.
 15 THE WITNESS: Thank you.
 16 BY MR. CARY:
 17 Q. Mr. Painter, referring your attention to the first
 18 slide, my question is have you reached any conclusions with
 19 respect to the efficiency claims, and if so, can you please
 20 summarize those conclusions?
 21 A. Well, the -- I had asked that some visual graphics be
 22 prepared sort of summarizing things that were in the
 23 declaration, and they are sort of summarized here. Rather
 24 than read them, I guess --
 25 Q. Why don't you just state them?

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1 A. The first point that is obviously highlighted here is
 2 that it is sort of the catalyst to my starting to look at the
 3 efficiency claims in this matter. That is that the
 4 efficiency book that is the document of defendants that
 5 reflects their current estimates when it was presented, I
 6 realized that it was many times higher than what in fact the
 7 cost savings were that had been proposed at the board
 8 analysis of the two companies.
 9 The board analyses actually of the two companies
 10 reflected not only a conservative case presentation, or base
 11 case presentation, but they also reflected in the rest of the
 12 case presentation and even in the terms of the aggressive
 13 case the cost savings were an order of magnitude several
 14 times larger. That is in fact what is presented in this
 15 very -- sort of this first bullet point so to speak that the
 16 current claims are much higher than what was originally
 17 estimated for this.
 18 I also -- as part of this, you see it says with
 19 respect to documents filed with the Securities and Exchange
 20 Commission, there has been a proxy statement filed with the
 21 Securities and Exchange Commission dated January 3, 1997.
 22 The efficiency book that was sort of -- again, it sort of
 23 precipitated all of this, was provided on February 5. As a
 24 result of depositions and testimony, I learned that, in fact,
 25 the efficiency book was simply a sort of -- maybe a slight

1 oversimplification, but a reformatting of efficiency savings
 2 that had actually been finalized or nearly finalized on
 3 January 14 of 1997, so that was nine days earlier.
 4 So this first bullet point relates to the fact
 5 that, in fact, they are an order of magnitude much higher
 6 than what was presented to the board and much higher than
 7 what was presented in the proxy statement.
 8 Q. Mr. Painter, before you move on to the other bullet
 9 points, let me ask you, in your experience, when parties come
 10 in on merger transactions and argue an efficiency claim, how
 11 do the efficiency claims argued before the agencies, how do
 12 they typically compare with what is presented to the board of
 13 directors?
 14 A. I haven't looked through files or anything as far as --
 15 to research this out. I was astounded. I don't think I can
 16 recall an instance in which -- I may be wrong, Your Honor.
 17 I'm just not certain. Certainly, it has been far, far, far
 18 less than the general rule, that is I don't recall ever
 19 seeing an efficiency assertion made to the commission as part
 20 of a proposed merger in which the cost savings that were
 21 being asserted were higher or certainly very much higher.
 22 I'm not sure that I can recall one where they were
 23 higher at all than what had been presented to the board in
 24 terms of trying to determine whether, in fact, there was a
 25 merger -- the merger made financial sense or strategic sense

1 and presented before the board came from?
 2 A. The efficiency estimates, the cost savings estimates
 3 that were presented to the board, they call them synergies,
 4 they were -- they were based upon management's estimates at
 5 that point. That is -- that actually is contained in the
 6 board analyses. They were prepared, I believe, by the
 7 investment bankers. They were certainly incorporated and
 8 made part of the investment banker analyses. They
 9 specifically say on their face they represent management's
 10 estimates of what the cost savings would be with respect to
 11 the merger.
 12 Q. You recited the history of the compilation of the book
 13 that eventually became the efficiency book in January, and
 14 the subsequent filing with the Securities and Exchange
 15 Commission.
 16 Let me show you a document that we have blown up.
 17 Is this the proxy statement filed with the Securities and
 18 Exchange Commission that you referred to?
 19 A. It is.
 20 Q. And what information did you glean from the proxy
 21 statement?
 22 A. Two bits of information at least that hit me right now.
 23 One is that in fact the savings that were posited in the
 24 proxy statement are identical to the savings that were
 25 presented to the board in terms of the dollars. Actually

1 to pass on.
 2 In fact, many times what is ascertained to the
 3 commission are savings that are, in fact, less than what is
 4 presented to the board. The reason for that is because there
 5 is often recognition by the parties asserting it, and this
 6 may be because it dates back to some of the old guidelines or
 7 whatever, that all the commission will consider, all the
 8 antitrust authorities will consider are the merger-specific
 9 savings. The savings that are posited at a board, presented
 10 to the board are not necessarily merger-specific. They
 11 simply are cost savings that the two firms might be able to
 12 achieve; and that doesn't mean that they couldn't achieve
 13 some part of that in some other way. So oftentimes we have
 14 evaluated efficiency savings that are less than what is
 15 presented to the board; but I don't recall ever having
 16 efficiency claims -- certainly an order of magnitude anywhere
 17 close to this, exceeding the board analyses.
 18 Q. How much higher are the efficiency claims that are being
 19 put forward here relative to the efficiency claims in the
 20 original board production?
 21 A. In terms of dollars, they are about five times higher as
 22 a percentage of sales -- my recollection is they may be
 23 three, to three-and-a-half times higher.
 24 Q. Do you have an understanding of where the -- do you have
 25 an understanding of where the efficiency estimates included

1 maybe there's three things that sort of hit me now. The
 2 second thing is that the proxy statement says -- again it was
 3 prepared nine days after the finalization of essentially the
 4 cost savings that are now currently being presented.
 5 The proxy statement said that those reflected --
 6 and I can read the exact language -- but essentially it is
 7 that they reflected the best estimates of management; and I
 8 think the third point would be that the proxy statement --
 9 did present projected earnings per share for the merged
 10 entity afterward, and they were premised upon those savings
 11 that were in the proxy statement. So those would be sort of
 12 the three bits of information that struck out at me in the
 13 proxy statement.
 14 Q. Okay. Now what was your reaction when you learned that
 15 the efficiency claims that were being presented to you in
 16 defense of the merger were five times larger than the
 17 efficiency claims presented to the board of directors?
 18 A. I wanted to understand why they were that; and to be
 19 perfectly honest, I was skeptical. I'm skeptical when any --
 20 when any claim is put forth to the agency. I think that's
 21 part of my job. Skepticism doesn't mean that I -- that I
 22 lead to a doubt of the claim or anything. It is a matter of
 23 trying to assess the claim and trying to validate whether the
 24 claim is completely 100 percent accurate; whether it is
 25 understated; whether it is -- half-stated.

1 To try to bottom line it, to try to get an
 2 assessment that allows the decision-makers to make an
 3 assessment and factor it into their overall decision.
 4 Q. Did you have a view of whether a report filed with the
 5 Securities and Exchange Commission should accurately reflect
 6 proposed cost savings?

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

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

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

15 MR. CURRAN: Same objection, Your Honor.

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

19 BY MR. CARY:

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

23 MR. CURRAN: Objection, Your Honor.

24 THE COURT: I will overrule the objection.

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

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

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

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

12 (Recess)

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

4 Let me explain.

5 It certainly raises questions in my mind when the
 6 language -- the actual language in the proxy statement is
 7 what raises questions in my mind. Actually the two points
 8 within -- it says that those are the very best estimates of
 9 management. I'm not sure if the word "very" is in there.

10 But they are the very best estimates of management. At the
 11 same time that seems inconsistent with the language being
 12 used to describe the current efficiency claims that were
 13 prepared earlier. Essentially the language there is they are
 14 based upon known facts and realistic estimates to date.
 15 Words to that effect. That seems inconsistent to me.

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

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

1 (Brief recess)

2 THE COURT: Mr. Cary, I was looking at what the

3 plans were this afternoon and perhaps part of this evening.

4 I would like to move it along, so since Mr. Painter is the

5 expert in efficiencies and cost savings, I expect we can have

6 him do some of that now in his testimony and move things

7 along quickly, if we could.

8 MR. CARY: Yes, Your Honor.

9 BY MR. CARY:

10 Q. Now, Mr. Painter, let's go to this one. Mr. Painter,

11 let me set forth a plan for you, a proposal for you in terms

12 of complying with the Judge's request that we try to do this

13 efficiently. You have a very thick report and you have a lot

14 of detail in there, but we obviously can't cover it all. Why

15 don't we attempt to illustrate various observations you've

16 made about the efficiency report in the context of the

17 particular types of cost savings with a few examples,

18 touching on the various categories and the various criticisms

19 in an overview sort of way. Let's start with this chart.

20 Does this chart represent the breakdown of the

21 efficiencies that the parties have claimed as a result of

22 this transaction?

23 A. This is premised upon a single year, 1988, and it does

24 then provide a breakdown of the five major categories of

25 savings that they assert.

1 product cost area, one of the major categories is lower

2 vendor prices. And actually that -- there is two captions to

3 that. There is lower vendor prices, and then also some

4 imputed interest that they have calculated based upon

5 extended payment terms. That is, after the merger they would

6 presumably have a longer time to pay their bills. I am

7 focusing only on the lower vendor prices right now.

8 The merchants, the five merchants for Staples. for

9 the five major categories -- product categories, were asked

10 to estimate what the post-NEWCO, the merged entity. would

11 receive in terms of improved terms after the merger. Each --

12 four of the five did it this way. They took the 1996

13 Staples' terms. Staples was being used as a proxy for Office

14 Depot as well. And they then estimated what the 1997 Staples

15 terms would be without the merger. They called that

16 pre-NEWCO.

17 And they then, from that step, estimated what the

18 merged entity would receive in improved terms over and above

19 what the 1997 Staples terms were.

20 Q. Let me interrupt just for a minute. What do you mean by

21 a "Staples merchant"? What is a merchant?

22 A. A Staples merchant is the merchandising manager, the

23 person that's responsible for the buying of the SKU items

24 within each of the five departments they have. The five

25 departments being furniture; computers; accessories; business

1 Q. 1998?

2 A. 1998.

3 Q. And the biggest category is product cost savings?

4 A. Yes, it is.

5 Q. Let's talk about product cost savings with reference to

6 the slide we had up originally of your overall observations

7 about the efficiency claims. There are three criticisms with

8 regard to product costs that are highlighted here. Can you

9 describe each of those criticisms for me?

10 A. Yes. The first bullet point is that Staples claims

11 ignore the substantial efficiencies the firms can achieve on

12 their own. That, I have estimated to be approximately 40

13 percent, a little more than 40 percent of the total savings

14 that are attributed to lower vendor prices; to be savings

15 that would occur without the merger, simply on their

16 stand-alone basis.

17 Q. All right. Let's go to a slide here and I will ask you

18 to explain what you mean when you say that the parties have

19 ignored certain efficiencies they might be able to achieve on

20 their own?

21 A. Yes. I think I have to back up a little bit from this

22 chart and just give you some background, Your Honor. When

23 the -- as I understand it, when the efficiency savings were

24 put into motion; that is, when they were determined to start

25 making some estimates of what the savings would be. In the

1 machines; and paper, housewares and office supplies.

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

3 did.

4 A. They then provided that information, as I understand it,

5 to the finance department, who was then to take the terms and

6 then apply the -- determine what the purchases were from each

7 of the vendors and figure out what the savings were based on

8 those improved discount terms.

9 And the first cut that was actually made to do that

10 estimate took the difference, the amount attributable to the

11 merger, as the difference between what the 1997 terms were

12 going to be for Staples -- again, Office Depot is also sort

13 of embodied in that in that Staples was a proxy for them --

14 and what the post-NEWCO terms would be. And that difference

15 was then called the incremental benefit from the merger.

16 They actually assigned the terms

17 premerger/post-merger to that calculation. There came a

18 point at which they -- a decision was made, as I understand

19 it by Mr. Rich Gentry, to --

20 Q. Who is Mr. Gentry?

21 A. Mr. Gentry is -- I'm not sure of his exact title, but he

22 heads the merchandising effort, the merchandising group for

23 Staples -- to in fact do it in a different way. And that is

24 to eliminate what the 1997 stand-alone improvements would be

25 and to measure the difference as the difference between the

1 1996 terms and what the post-NEWCO or the merged entity would
2 get.

3 There is a rationale that has been given for that
4 and I can get into that if you would like. But in any event,
5 as a result of doing that, about 43 percent of the savings
6 were effectively the stand-alone savings that would have been
7 realized. So of their total savings that were captured as a
8 result of doing that, 43 percent of them would have been --
9 approximately 43 percent would have been related to the
10 stand-alone improvement from 1997 -- six, I am sorry, to the
11 1997 terms on a stand-alone basis.

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

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

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

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

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

17 That does not seem fair to me, certainly, and
18 particularly in light of the fact from 1994 to 1995 there
19 were substantial improvements in virtually all of the vendors
20 and certainly all of the product categories. And from '95 to
21 '96 there was substantial improvements, and one would expect
22 at least the trend to continue, if not the order of magnitude
23 to continue.

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

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

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

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

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

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

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

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

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

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

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

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

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

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

1 getting the best price. And that is not uncommon, at least
 2 in my experience. I mean, the last case I worked on was
 3 Time-Warner, Turner Broadcasting, and they had -- the
 4 industry was prevalent with those, and with review
 5 provisions.
 6 Q. Mr. Painter, let me ask you another question along those
 7 same lines. Is it the case they eliminated all of the 1997
 8 pre-NEWCO improvements in discounts, even among vendors that
 9 had not gone through any kind of renegotiation through that
 10 period?

11 MR. KEMPF: Objection, leading.

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

14 It is all right. Go ahead.

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

19 BY MR. CARY:

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

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

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

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

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

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

17 Q. Here are the final three.

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

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

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

1 that Staples now presents.

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

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

12 There is also a budget that has been prepared for
 13 1997 that also says that we will have approximately 70 basis
 14 points of improvement on a stand-alone basis. I will try to
 15 give some sense of what that means, 70 basis points. The
 16 total improvement attributed to the merger was 161 basis
 17 points in this area. 70 basis points were effectively
 18 expected to be achieved on a stand-alone basis. That
 19 actually -- by coincidence or whatever, that is actually very
 20 close to what the merchants themselves estimated on a
 21 stand-alone basis as sort of an aggregate form. It was
 22 roughly the same amount of basis points they were estimating
 23 to be achieved on a stand-alone basis as well.

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

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

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

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

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

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

1 estimated certain cost savings; is that correct?

2 A. Yes.

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

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

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

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

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

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

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

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

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

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

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

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

17 I hope I am not going too fast.

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

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

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

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

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

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

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

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

7 The vendor term savings I think quantify to about
 8 1.2 billion, just lower prices. And I could have this wrong,
 9 but another couple of hundred million, I believe, improved
 10 vendor terms -- I mean, I'm sorry, for the longer payment
 11 terms. And this, to about 743 million over the five years
 12 from Global Product Sourcing.

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

16 A. Yes.

17 Q. What was the methodology they used?

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

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

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

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

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

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

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

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

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

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

10 What happens then is 51 of the SKUs are said to be
 11 about 15 percent of the total purchases of all SKUs, the
 12 total of -- within the Global Product Sourcing. And so if
 13 you calculated 8 million dollars, which is what they did,
 14 calculated 8 million dollars on savings on those SKUs; then
 15 by using a divider of 15 percent calculates to, as my
 16 recollection, 54 million dollars of savings for Staples. In
 17 1996 based on the methodology that was employed. Staples
 18 saves 54 million dollars on its Global Product Sourcing.

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

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

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

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

19 Q. Now, when we talk about --

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

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

1 that Ms. Goodman talked about, sourcing things overseas?
2 A. It is essentially that. It is more than that, but it's
3 -- I am sure Staples can describe it better. But it
4 consists of products that are imported by Staples or arranged
5 under a contract manufacturer by Staples to avoid a middle
6 person.

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

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

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

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

3 The 66 basis points, by my recollection, was
4 expected what they expected to be the basis points
5 translation for the post-merger entity. The 133 basis points
6 I just referred to was actually reduced to 85 basis points
7 when it was applied to a greater sales volume for Office
8 Depot. The proper comparison is that the estimate that was
9 done by Staples for the purposes of this efficiency book is
10 85 basis points of improvements for the combined sales of the
11 post-merger entity. Underlying document says that it ought
12 to be 66 basis points based on opportune SKUs, and reduces
13 the 66 basis points to 45 basis points in recognition they
14 were opportune and they are not necessarily representative of
15 what the remaining SKUs would be.

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

24 Q. Okay. Let me break you down a little bit. The GPS
25 program you are talking about is the private label program

1 MR. GIDLEY: Objection, leading.

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

4 Why don't you rephrase it.

5 BY MR. CARY:

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

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

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

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

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

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

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

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

1 A. What happened is that in computing the average for that
 2 particular product group -- unlike the other ones, because
 3 there were some that were not showing improvement. The ones
 4 that did not show improvement were simply not included in the
 5 calculation. So the improvement for those that did show
 6 improvement was the sole basis for determining what the
 7 average improvement should be for the "all other." In my
 8 view, if you are going to compute the average, then you ought
 9 to be computing the average for all of the vendors that are
 10 selected.
 11 Q. So in this case there were a total of 39 vendors.
 12 According to the chart, 19 of them had zero savings, 20 of
 13 them had savings. What did they do in calculating the
 14 savings for the entire group?
 15 A. Again, maybe I am misunderstanding your question. I
 16 thought I answered that. But that is, to determine the
 17 savings for the "all other," they computed an average of
 18 1.63. My recollection is that if you computed an average
 19 based on all 39, it would be half that amount. Roughly half
 20 that amount. But -- the 0.83, I think. 1.63 is the figure
 21 that is then used, however, to determine what the savings are
 22 from the all other vendors.
 23 Q. Are the 19 that are excluded in the "all other"
 24 category?
 25 A. No. Those are selected vendors.

1 Q. And once the 1.63 is applied to the "all other" vendors,
 2 what did they then do?
 3 A. They determined an estimated improvement for the "all
 4 other" vendors. And as a consequence of using the 1.63
 5 average rather than a 0.83 average, they determined there was
 6 5 million dollars worth of savings from those "all other"
 7 vendors. It was an overstatement of the savings from the
 8 "all other" vendors:
 9 Again, Your Honor, the amount is not nearly so
 10 significant as Hewlett-Packard. What is -- what is
 11 concerning to me about this is that it is a methodology that
 12 seems clearly inappropriate. And even in this instance where
 13 I don't believe it sort of creates a lot of additional cost
 14 savings, it -- there are lots of methodologies that I have
 15 not been able to figure out or uncover. There are lots of
 16 things that are unsupported. And it creates, at least in my
 17 mind, reliability concerns about estimates that have not been
 18 substantiated or which are unexplainable in terms of
 19 underlying documentation. So I think that is the emphasis
 20 that I think this merits.
 21 Q. All right. And once these savings are estimated, are
 22 they then projected out over a period of time?
 23 A. Yes, they are.
 24 Q. And do they make any -- do they make any assumptions in
 25 the efficiency report as to how those savings ought to be

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

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

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

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

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

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

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

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

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

21 That is one category of distribution.

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

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

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1 talking about only the freight management aspect?
 2 Q. Right, the freight management.
 3 A. I have found no documentation either in the efficiency
 4 book, or in underlying documents that have been uncovered, or
 5 in the Kearney uncovered boxes of documents that have allowed
 6 me to come to some sort of conclusion that it is or it isn't
 7 included. And I am left with that.

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

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

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

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

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

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

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

1 savings.

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

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

14 But with that said, the underlying documents that I
15 have uncovered with respect to measuring this cost savings in
16 these two areas focuses on 1996 costs. It takes Office Depot
17 1996 costs and it takes Staples 1996 costs, and some of the
18 underlying documents then say these are the savings you can
19 get from taking those costs and post-merger then we would
20 have savings from that.

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

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

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

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

18 Did you review the Kincannon report?

19 A. I did.

20 Q. What is the Kincannon report?

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

1 clearly it certainly doesn't suggest that it has been
2 measured -- the savings to the merged entity has been
3 measured from the optimal distribution system and what those
4 costs would be for the optimal distribution system. And in
5 fact, in this instance, it doesn't even measure it from the
6 1997 stand-alone savings or costs that either of the two
7 companies would have. And both companies, to the best of my
8 recollection, were projecting cost savings from 1996 to 1997
9 in the distribution systems.

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

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

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

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

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

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

8 Q. How is that related to this merger?

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

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

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

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1 A. Yes.

2 Q. Referring you back to the Kincannon market analysis

3 report, did you find that that report substantiated the

4 claims that were asserted with respect to best practices and

5 leveraging scale in the marketing?

6 A. It did not substantiate the claims, in the sense that it

7 was simply a document that talked about best practices and

8 scale. And when it started to quantify dollars, it simply

9 had X's, or add signs inserted into it. And actually, on the

10 face of the document it says, we have not been able to

11 precisely -- we are not quantifying this in terms of

12 precision, but it serves in terms of direction. I mean,

13 there would be savings.

14 And so again, it didn't allow me to validate or not

15 validate. I mean, you know, the marketing savings that were

16 being posited. There are other aspects of marketing that I

17 can get into that also, I think, are relevant to these cost

18 savings, but --

19 Q. Given the shortness of time, there is a section in your

20 report that goes into those in some greater detail?

21 A. Yes, there is.

22 Q. Okay. Let's talk a minute about other goods and

23 services claims. Were there savings claimed in the other

24 goods and services category?

25 A. Yes there were.

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1 Q. Do you have any criticisms or observations about those

2 claims?

3 A. Again, I find that they are -- they don't provide

4 significant substantiation of what the savings would be for

5 the merger. There were several examples of other goods of --

6 they are called indirect goods and services. And actually,

7 in underlying documents they are captured as -- at least in

8 part -- as part of general administrative expenses, GNA

9 expenses.

10 And the total category -- there were, I think, six

11 different area of goods and services that were sort of --

12 they looked -- Staples looked to its historical savings in

13 those areas and sort of extrapolated those savings into what

14 the overall savings for all goods and services would be from

15 this merger. Goods and services represent about 4 percent of

16 the overall -- 4 percent of sales for the combined entities.

17 The items that were quantified, these six items or

18 areas that were quantified and used as a basis for estimating

19 the overall goods and services saving, represented when you

20 quantify them about 15 percent of the overall savings that

21 were being attributed to goods and services. Not a real well

22 -- again, it was 15 percent of the 100 percent. There were

23 -- within those categories it was clear to me that at least

24 some of those savings were things that could be realized --

25 savings that could be realized without the merger. And that

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1 is not to say there won't be some savings with the merger,

2 but there were -- again, I think it is unfair to attribute

3 savings that would occur without the merger to the merger.

4 I mean -- and I think we got into a little bit of

5 that the other day with Ms. Goodman. And that is that I

6 think about one-fourth of the overall savings in employee

7 health care and employee benefits related to changes in the

8 actual plan design; that is, there were going to be changes

9 such that the employees, the dropout rates or the

10 non-participation rates would be less with the merger,

11 because they would be forced to pay more. Or they would be

12 paying higher co-ops, or whatever. But all of it effectively

13 resulted in some savings.

14 I have concerns about those kinds of savings, I

15 guess for two reasons. I think the corporation fairly can do

16 what it chooses to do, and I think they make sound business

17 decisions when they make changes in plan design. My guess is

18 the cost savings that you would achieve by reducing the

19 benefits to employees more than offsets what negative aspects

20 might flow from that. My concern would be if there are

21 negative aspects that flow from that -- productivity

22 declines, for example -- then that is an offset. That should

23 be taken away from the savings.

24 I think more importantly, though, in this instance,

25 it is the merger specificity part of it. If Office Depot on

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1 its own, without this merger, wants to in fact change its

2 plan design, it can do so. And again, for that reason, I

3 don't believe it is fair to say that, hey, if Staples will --

4 once we acquire them, we will change the plan design and call

5 that savings attributable to the merger.

6 Q. Going back to the board, listed up there are six

7 categories. Are those the only specifics that are given with

8 respect to the total claimed savings of 553 million dollars

9 in the other goods and services category?

10 A. Again, I don't recall. I believe so. I'm not sure

11 about the telecommunications. That may have quantified out

12 something. But at one time I reviewed these exhibits and

13 they were -- they effectively were drawing from my

14 declaration. As I sit here today and go through this

15 declaration, I believe that is an accurate portrayal of

16 exactly what was quantified out. I know that the employee

17 benefits were quantified at 8 to 11 million, and I am

18 virtually certain the American Express was quantified at 2.7

19 million. And I can't recall if there was a zero

20 quantification or some quantification in one or two of the

21 other categories.

22 American Express actually is an example that I

23 would like to point to, perhaps, as some indicator of, again,

24 a concern that I have here. American Express is clearly one

25 of the -- one of the companies that they have charges with,

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1 but so are Visa and Mastercard. And those companies are --
 2 with respect to the total volume of Staples, are three times
 3 -- I believe it was three times than American Express was.
 4 I think American Express provided a letter saying, Yeah, with
 5 this merger we will reduce our savings -- we're going to
 6 reduce our rates and you will save a certain amount of
 7 money. I think it was 2.7 million.
 8 I would like to have seen, given that Visa and
 9 Mastercard were so significantly larger, the same kind of
 10 documentation from Visa and Mastercard to fall back on to see
 11 if they also believe the higher volume would lend themselves
 12 to comparable savings.
 13 Q. How were these examples extrapolated to the full 553
 14 million in total claimed savings in the category?
 15 A. Well, these savings were effectively the basis for
 16 estimating what the total savings were in all goods and
 17 services. Again, the quantification that is shown there is
 18 about 15 percent of the total. And there is no -- there is
 19 no documentation, at least to my memory, that shows -- that
 20 makes that leap. It gets from the 15 percent that is shown
 21 as these examples to the ultimate total shown in the
 22 efficiency report.
 23 And obviously those are then expanded. There is
 24 savings that increase each year because they are a percentage
 25 of projected sales.

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1 Q. Mr. Painter, do you have an estimate of how much of the
 2 efficiency claim is subject to these criticisms?
 3 A. I have prepared an estimate. I broke down my estimate
 4 of the overall savings and I did it as a percentage of sales,
 5 which is effectively, I think, the more relevant thing to
 6 look at, since that sort of is what is applied to the
 7 projected sales each year. And I have tried to take out what
 8 either is erroneously attributed, in my opinion, to the
 9 merger, or what is not substantiated, at least in my opinion,
 10 in a way that allows for me to perform informed judgments
 11 about the accuracy or reliability of the cost savings.
 12 And in the product cost area, I have taken out of
 13 their 2.46 percent or 246 basis points, 23 basis points that
 14 would relate to the Hewlett-Packard situation. I have also
 15 taken out 47 basis points for savings that related to the 97
 16 stand-alone improvements that, as I explained earlier, I felt
 17 there was evidence to suggest that went without the merger.
 18 I also have taken out 28 basis points, and that is
 19 all of the basis points that actually relate to getting
 20 longer payment terms from vendors. I did that because I have
 21 reviewed about 48 -- 40 declarations from vendors; and I have
 22 interviewed, participated in some interviews of vendors; and
 23 I don't see anything to substantiate that those savings would
 24 be realized. And not a single vendor, given the opportunity
 25 to comment -- I assume given the opportunity to comment about

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1 whether there would be lower prices -- and they did comment
 2 about the likelihood of lower prices -- ever mentioned longer
 3 payment terms. And the ones that I talked to said, "We are
 4 not giving longer payment terms. If we do, it is coming out
 5 from somewhere else. That is not a cost savings for us to
 6 give them longer savings terms." I don't see where there is
 7 any basis, at least in my opinion, for concluding these 28
 8 basis points in savings from longer payment terms are
 9 appropriate.
 10 I would like to add something to it. The imputed
 11 interest rate that was used to determine what the savings
 12 would be was 10 percent imputed interest rate. It was
 13 obtained from the Treasury Department, according to
 14 Mr. Patriarca, who testified in this matter in deposition.
 15 And there are underlying documents when you get to these
 16 other goods and services that seem to suggest an internal
 17 imputed interest rate of 5.8 percent being used to assess
 18 accounts receivable.
 19 Again, you know, it makes a huge difference as to
 20 what the interest rate is. If the interest rate is fairly
 21 5.8 percent instead of 10 percent, you are cutting your
 22 savings from longer payment terms -- even accepting that you
 23 get them -- by almost half. So again, I don't -- you know, I
 24 am -- in sum, I am taking away 28 basis points, all of the
 25 savings for longer payment terms.

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1 With respect to the GPS savings, I am taking away
 2 42 basis points.
 3 Q. That is the global products sourcing?
 4 A. Global Product Sourcing, Your Honor. Again, that is
 5 half of -- essentially half of what was estimated by Staples
 6 to be the gross in global product sources savings.
 7 In the area of distribution, because there was some
 8 testimony that they could achieve some freight savings on
 9 their own, freight management savings on their own, I have
 10 assumed that is consumed, it's attributed to the merger as
 11 well. And to that extent I am taking it out of the
 12 distribution savings. That is 15 basis points.
 13 We get to our unsubstantiated category, which is
 14 effectively all of the rationalization of the distribution
 15 systems. I find no substantiation for the full amount. Now,
 16 I will say this, that I believe that there will be some
 17 savings. And I -- it may be small or medium or large. I
 18 don't know. There will be some savings, I believe, from
 19 rationalization of even the optimal systems that each of the
 20 two companies have, by the post-NEWCO entity. I have taken
 21 it all away because it is not substantiated. I think,
 22 clearly, there is something there that would probably result
 23 from this merger.
 24 In the marketing area I mentioned the example of
 25 the catalog. That is the only thing that I am taking away in

1 terms of erroneous, that I think is unfairly attributable to
 2 the merger. But there is a portion that is not
 3 substantiated. It is the remainder.
 4 In the general administrative area, there has been
 5 51 basis points. We didn't touch on this area. But Staples
 6 looked to some historical experience of its own, and it
 7 looked at two or three other companies to get a snapshot.
 8 How does general administrative expense decline as volume
 9 increases. They determined that 51 basis points is what
 10 would be saved as a result of meshing these two companies.
 11 But I have looked at their own GNA reductions over volume
 12 changes. And, one, they were -- and again, my recollection
 13 may be slightly off. But as Staples was going from a
 14 billion-dollar company to a five-billion-dollar company, its
 15 GNA was only declining by 20 or 30 basis points, not 51. In
 16 fact, if you look at their budget from 1997 to the year 2000,
 17 when it is doubling in size from a 5 billion to a
 18 10-billion-dollar company, its GNA is only declining by 19
 19 basis points.
 20 And the third thing is Office Depot. If you look
 21 at Office Depot, its historical experience, you could
 22 extrapolate out the same kind of thing. As they have grown
 23 in orders of magnitude, very significant orders of magnitude,
 24 their GNA has not been declining by the 51 basis points
 25 shown. So I believe there is an overstatement in the GNA as

1 percentage point savings. It will be somewhere in between
 2 there.
 3 Q. Were you in the courtroom yesterday when a gentleman
 4 from Ampad testified?
 5 A. Mr. Stoudt. Yes, I was.
 6 Q. And did you hear Mr. Stoudt's testimony with regard to
 7 savings based on 1996 items?
 8 A. Yes, I did.
 9 Q. And what relevance was that testimony to your analysis?
 10 A. I think there were a couple of points that were
 11 relevant. One is in fact, as I understood Mr. Stoudt -- and
 12 as I understood his testimony, the savings that he was
 13 estimating to -- that he would realize, the cost savings he
 14 would realize, which he would share in -- largely, he said,
 15 with Staples and Office Depot after the merger -- were
 16 premised upon the combined volumes that he estimated he could
 17 get and that they were higher than what he was presently
 18 achieving from Staples and Office Depot. And largely, on the
 19 Office Depot side, were premised on 1996.
 20 Again, to the extent there would be additional cost
 21 savings from volume increases that would occur on a
 22 stand-alone basis, I think that that is improperly counted,
 23 at least in terms of, I think, what was intended by that
 24 testimony to the merger.
 25 Second, I think there may well be -- again, I don't

1 well, and I have taken 21 basis points away from that, and
 2 given credit for the rest.
 3 And the other goods and services, I have taken away
 4 for the medical insurance that is the -- what Office Depot
 5 can do on its own. And for the employee benefits, there are
 6 two captions there. My recollection is I thought they were
 7 together, but apparently there were two captions.
 8 Bottom line, Staples claim -- this is all premised
 9 on 1988 I believe. 1998, rather, I am sorry. They are
 10 claiming 5.3 percent of savings from this merger. I find
 11 that at least in terms of erroneous or improperly attributed
 12 savings to this merger, 1.94 percentage points of that 5.03
 13 to be improper.
 14 Unsubstantiated, 1.66 percent. But I will say that
 15 I think a part of that -- and it is probably going to result
 16 -- there will probably be savings. It is just not
 17 substantiated. There will be some savings that come out of
 18 that category.
 19 And the remaining, I think it is called possible
 20 efficiencies. I think that -- let me correct that right
 21 now. I think "possible" is too strong. The remaining
 22 efficiencies, if you take away all of the erroneous stuff and
 23 unsubstantiated stuff, comes to 1.43. The actual savings
 24 from the merger are probably about 1.43. It will be between
 25 1.43 and if you add 1.66, which gives you about a 3

1 have the evidence, but here -- the savings that are being
 2 attributed by Ampad, the cost savings from Ampad -- let me
 3 back up.
 4 They also indicated that he would bid aggressively,
 5 even if the merger doesn't go through, for the Office Depot
 6 volume. To the extent that he can get the Office Depot
 7 volume without the merger, that is part of the savings that
 8 ought not be attributed to the merger. He did say that there
 9 was a higher likelihood of getting it with the merger. But
 10 he did say that he would bid aggressively for it without the
 11 merger.
 12 To the extent that there are cost savings from the
 13 combined volumes on a stand-alone basis without this merger.
 14 it would make sense to me if he were bidding at the mark to
 15 frame that bid at the margin, to bid the lowest price he can
 16 that reflects the cost savings he would have if he had the
 17 combined volume. So he may or may not get the volume without
 18 the merger.
 19 But I think there may be even a third problem too.
 20 Office Depot has, for whatever reasons, determined it doesn't
 21 want to buy all four product categories from Ampad. It is
 22 buying two of four, I believe. It is buying another two from
 23 another vendor. There may be reasons that ought to be taken
 24 into account in terms of assessing the cost savings for why
 25 Office Depot is buying from those other two.

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1 It may be buying from the other two because it
 2 wants to provide a different choice to the consumer. I am
 3 not -- I can't sit here and tell you from an economic
 4 standpoint I know how that plays out, but it is clearly a
 5 different choice to the consumer. If they are buying lower
 6 volumes from Ampad, and then buying additional volume of the
 7 same products from another supplier, they may be doing that
 8 because they want to, again, provide another choice to the
 9 consumer.

10 They may also be doing it because they want to have
 11 dual supply. A good example is in case there is a disruption
 12 of the delivery. At least you are getting it from one of the
 13 two. There may be reasons why in fact it is doing it. The
 14 most obvious reason is that for the two products that they
 15 are not buying from Ampad right now they may not be buying
 16 them because they are getting a better price from whoever it
 17 is providing it to them.

18 The savings that should be attributed to the merger
 19 should start from the better price, if there is indeed a
 20 better price, of the vendor presently providing it to him.
 21 Not from what the Staples price is, or however that was
 22 computed.

23 And so, again, I don't think that tells the whole
 24 story as it was spelled out in the testimony.

25 MR. CARY: Thank you very much.

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1 THE COURT: I will take a short break. That was a
 2 pretty long witness this afternoon. And we will come back
 3 and see if we can finish up this evening or not. I will take
 4 about a 10-minute break.
 5 (Brief recess).

6 MR. CURRAN: Given the restraints of time, I will
 7 attempt a point-by-point addressing of the issues. We
 8 believe many of those issues can be addressed in our
 9 post-hearing brief, so I will try to make it a focused
 10 cross-examination.

11 CROSS-EXAMINATION

12 BY MR. CURRAN:

13 Q. Mr. Painter, at the beginning of your direct testimony
 14 you -- Mr. Cary asked you if were being compelled to testify
 15 here today. And your answer was that you were not; is that
 16 correct?
 17 A. That is correct.

18 Q. And you are appearing as an expert witness?
 19 A. Yes, as I understand it. Certainly an expert at trying
 20 to assess efficiency claims.

21 Q. And Mr. Cary also, I think, elicited from you the
 22 statement that you make up your own mind as to whether you
 23 will be testifying as an expert on the behalf of the FTC; is
 24 that correct?
 25 A. That is correct.

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1 Q. You are an employee of the FTC and you have been for a
 2 number of decades; is that correct?
 3 A. For 30 years.

4 Q. And in that 30 years, have you ever been compelled to
 5 testify as an expert?
 6 A. Never.

7 Q. It has always been at your own volition?
 8 A. Yes, it has.

9 Q. And you have always given careful consideration to the
 10 issues you've been asked to opine about, before you testify?
 11 A. The best I could.

12 Q. Now, when Mr. Cary asked you about your prior testimony,
 13 first he asked if you had ever testified by affidavit or live
 14 testimony in any administrative proceeding or court
 15 proceeding. Do you remember that?
 16 A. I remember him asking about that, about my testimony,
 17 yes.

18 Q. And you said, "yes;" right?
 19 A. Yes.

20 Q. Including in merger cases; right?
 21 A. Yes.

22 Q. And then Mr. Cary asked you to identify the Federal
 23 Court cases in which that applied; right?
 24 A. I believe he did.

25 Q. And you identified the Imo case and the Abbott Labs

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1 case; correct? Imo is I-m-o. FTC v. Imo; correct,
 2 Mr. Painter?
 3 A. Yes.

4 Q. Both of those cases were in this court?
 5 A. They were in Washington. One of them was in front of
 6 Judge Sporkin, the Abbott Labs. And I can't recall the other
 7 one.

8 Q. But it was in this courthouse?
 9 A. Yes.

10 Q. All right. Now, one thing that was not elicited by
 11 Mr. Cary in his preliminary questioning regarding your prior
 12 testimony was another merger case in which you served as an
 13 expert witness by affidavit; correct? At least one?
 14 A. I don't recall.

15 Q. You don't recall. Mr. Painter, do you still have up
 16 there the report you submitted to Judge Hogan in this case?
 17 A. Yes, I do.

18 Q. Can you take a look at the first page, please? The
 19 first page of text?
 20 A. I got it here.

21 Q. On number -- page 1, do you see that?
 22 A. Yes.

23 Q. I direct your attention to paragraph 4 there.
 24 A. All right.

25 Q. Let's start with the third sentence. I have appeared as

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1 a witness in several administrative hearings "before the
 2 Commission, two of which involved a merger challenged under
 3 Section 7 of the Clayton Act. I have testified by affidavit
 4 in Federal Court in the matter of FTC v. Imo Industries" --
 5 and there's a cite. "And appeared as an expert witness in
 6 Federal Court in the matter of FTC v. Abbott Labs". And then
 7 there is a cite, period. Do you see that?
 8 A. Yes.
 9 Q. There again, you are acknowledging that you testified in
 10 the administrative proceedings as well as in Federal Court
 11 proceedings, but you only identified by name the Federal
 12 Court proceedings; correct?
 13 A. That is correct.
 14 Q. Just like you did under Mr. Cary's testimony; right?
 15 Under Mr. Cary's questioning?
 16 A. I don't believe he asked for the administrative
 17 proceedings. That is correct.
 18 Q. He didn't ask you to identify those by name?
 19 A. Right.
 20 Q. So the information conveyed in the report you submitted
 21 to Judge Hogan is basically the same information that
 22 Mr. Cary elicited in his preliminary questioning; right?
 23 A. I'm not sure I understand what you are saying, but it is
 24 what it is in paragraph 4.
 25 Q. Do you remember testifying in the B.A.T. case, don't

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1 you?
 2 A. The potential entry case?
 3 Q. Do you recall submitting an expert report in that case?
 4 A. No, I didn't. I did not submit an expert report in that
 5 case. Actually, this is something that came up in
 6 discussions with counsel. I can get into it if you would
 7 like.
 8 Q. Well, I am going to get into it.
 9 Do you recall the Federal Trade Commission
 10 proceeding entitled In the Matter of B.A.T. Industries,
 11 Limited, and Appleton Papers, Inc.?
 12 A. I sure do.
 13 Q. That was a merger case, wasn't it?
 14 A. It was a potential entry case. It was a merger case,
 15 yes.
 16 Q. That is Section 7 of the Clayton Act as well?
 17 A. Yes.
 18 Q. That is one of the statutes that's at issue in this
 19 case; right?
 20 A. Yes.
 21 Q. And that case was tried in the Federal -- in the FTC
 22 administrative proceeding?
 23 A. Yes. In front of Judge Morton Needleman, I think it is.
 24 Q. You don't forget his name, do you?
 25 A. I don't.

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1 Q. In that case, as you mentioned, the FTC was challenging
 2 an acquisition after it had occurred; right?
 3 A. I think so. You are testing my memory about that. I
 4 think so.
 5 Q. And in that case the FTC argued the acquiror, Wiggins
 6 Teap, a subsidiary of B.A.T., could have properly entered the
 7 market on its own without having to acquire Appleton Paper,
 8 Inc.
 9 A. That is correct.
 10 Q. Technically, as you suggested, the issue is whether
 11 Wiggins Teap was an actual potential entrant; is that right?
 12 A. Yes.
 13 Q. Now, you submitted an expert analysis as an accountant
 14 in that proceeding, didn't you?
 15 A. There were two -- there may have been more than two
 16 exhibits, but there were at least two exhibits that occur to
 17 me that were received into evidence without testimony,
 18 without being sponsored through testimony. Stipulated to.
 19 Q. You prepared a model analyzing the expenses connected to
 20 possible entry by Wiggins Teap; right?
 21 A. Yes, I did. I think it was more than one model, but
 22 yes.
 23 Q. And you were opposing analyses prepared by people on
 24 behalf of Wiggins Teap and B.A.T.; correct?
 25 A. That is correct.

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1 Q. And those people had sufficiently more experience and
 2 day-to-day dealings in their business than you do or than you
 3 had as an FTC employee; correct?
 4 A. Yes.
 5 Q. Do you remember what the product involved in that case
 6 was?
 7 A. I think it was carbonless paper.
 8 Q. That is a consumable office supply, isn't it?
 9 A. I think it is.
 10 Q. And so the people who were opposing your model, your
 11 analysis, were people in the consumable office supply
 12 industry; isn't that right?
 13 A. In that sense, yes.
 14 Q. So, Judge Morton Needleman in that case was faced with
 15 testimony, expert testimony presented by people within the
 16 office -- the consumable office supply industry, if I can use
 17 that, and yourself; correct? And he had to resolve a
 18 conflict of expert opinions?
 19 A. There were more witnesses than myself. There was -- but
 20 maybe you could ask the question again, because I got lost in
 21 terms of number of witnesses. But tell me again now. I am
 22 sorry, sir.
 23 Q. You were an expert on behalf of the FTC; right?
 24 A. Again, you know, this is maybe it is a technicality,
 25 because, again, I didn't know if that is something I should

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1 list. But during the course of that trial I prepared some
 2 models, financial models. "What if" scenarios on what the
 3 likelihood of profitability would be on entry. They were
 4 received in evidence on stipulation of both counsel.
 5 And you know, I was never offered -- to my
 6 knowledge, I was never offered as an expert. I didn't
 7 testify in that.
 8 Q. Whose side were you supporting?
 9 A. I was representing Federal Trade Commission in that.
 10 Q. And there were people, there were other people who were
 11 serving as expert witnesses by affidavit or by testimony?
 12 A. On both side.
 13 Q. Who had opposite views from you; right?
 14 A. Oh, yes. Yes.
 15 Q. And your analysis didn't fare too well in that case, did
 16 it?
 17 A. No, it didn't. In a sense that the case was -- judge
 18 Needleman found against the Commission. Actually, I think he
 19 did. I'm not even sure if on appeal -- I think it went to
 20 appeal and the Commission voted it 5/0 against the case, as
 21 well.
 22 Q. So you lost both at the ALJ stage and the Commission
 23 stage?
 24 A. I believe so, yes.
 25 Q. Let's take a look at what Mr. Needleman thought of your

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1 analysis as opposed to the analysis presented by the people
 2 who were in the consumable office supply business on a day-in
 3 and day-out basis, on a real-world basis for many years.
 4 Okay?
 5 A. Correct.
 6 MR. CURRAN: John Early, Your Honor, is assisting
 7 me with the Elmo machine, and Matt Lewis is over here if we
 8 need the overhead projector.
 9 THE COURT: All right.
 10 BY MR. CURRAN:
 11 Q. Mr. Painter, can you see the text that has been put up
 12 from page 91 of the decision of Morton Needleman?
 13 A. Yes, I can.
 14 Q. I have highlighted in yellow. The language I think is
 15 most pertinent here. I will read it, you can read along.
 16 "However, when Painter inserted a base paper
 17 penalty into the Horowitz model, he took a 3 percent
 18 reduction, from 12.5 percent in model 1 of table 5 to 9.5
 19 percent in model 3, on grounds that the change from
 20 Appleton's integrated operation to the new entrance
 21 non-integrated mode might result in savings in the 'other
 22 expenses' category."
 23 "The savings were to flow, for example, from the
 24 prospect that the WT finance department officials would not
 25 have to check pulp prices. The chief executive of WT" -- as

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1 we mentioned, that is the B.A.T. subsidiary -- "would not
 2 have to develop long-range plans related to paper making.
 3 The WT engineering department would not have to plan the
 4 proper loading of paper" -- over to the next page --
 5 "machines, and warehousing expense attributable to paper
 6 making would be eliminated."
 7 "Whether any of these predicted savings would
 8 approach 3 percent of net revenue is sheer conjecture. An
 9 equally plausible line of speculation might lead to the
 10 conclusion that WT as a new entrant may have a different set
 11 of other expenses which could conceivably exceed 3 percent.
 12 What the record shows on this point is that other expenses,
 13 other distribution costs and department expenses in
 14 Appleton's financial statements comprise freight, shipping,
 15 finished goods warehousing, operation services, marketing,
 16 R&D, and the expense of the president's office.
 17 "The last three; marketing, financing and the
 18 president's office, clearly relate to Appleton's total
 19 business, not to specifics such as the manufacture of paper,
 20 and these expenses are not likely to be reduced by merely
 21 substituting the purchase of paper for in-house production.
 22 "Insofar as freight and warehousing are concerned,
 23 these charges, and at least the bulk of them, relate to the
 24 finished CCP product."
 25 CCP, again, is "carbonless" --

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1 A. I think it might be just carbonless --
 2 Q. Copy paper?
 3 A. That's it.
 4 Q. "Whether a roll of CCP is made with internally produced
 5 or purchased base, it still must be coated. And after it is
 6 coated, it must still be shipped. Thus it incurs a freight
 7 charge, and would do so for WT's plant just as it does for
 8 Appleton's. And whether coating of CCP takes place on a
 9 paper machine, as in the case of Appleton, or off the paper
 10 machine, as in the case of the hypothesized unintegrated new
 11 entrant, the category called operations services; that is,
 12 industrial relations, fringe benefits, freight planning and
 13 distribution planning is not likely to change."
 14 Have I read that correctly?
 15 A. Yes, you have.
 16 Q. I would like to turn your attention to the following
 17 page, page 94. On that page do you see paragraph 111?
 18 A. Yes, I do.
 19 Q. It says, "Several other components of the Horowitz
 20 model, all largely adopted in the Painter models, involve
 21 various degrees of still additional controversy."
 22 Did I read that part right?
 23 A. Yes. Well, there is a finish on it, findings, 112 to
 24 117.
 25 MR. CURRAN: Thank you, Mr. Painter.

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1 Your Honor, I will pass up to you, if I may, the
 2 copy of this, if you would like to read along.
 3 BY MR. CURRAN:
 4 Q. The next excerpt I would like to read, Mr. Painter, is
 5 over on page 123. At the top of that page, see where it
 6 says, "Since the burden rests with Complaint counsel, this
 7 means that their entire case depends on the validity of the
 8 Horowitz-Painter models."
 9 Did I read take part right?
 10 A. Yes, you did.
 11 Q. Now, let's look over to the final page. Page 128,
 12 paragraph eight. "Although WT had an interest and an
 13 incentive in evaluating the feasibility of US entry, the
 14 model of entry advanced by Complaint counsel does not
 15 constitute reliable, probative and substantial evidence that
 16 it would have been in WT's economic self-interest to enter
 17 into by means of a non-integrated greenfield coating
 18 operation."
 19 Did I read that correct?
 20 A. Yes, you did.
 21 Q. "Complaint counsel" is counsel for FTC in these
 22 proceedings; is that right?
 23 A. Yes.
 24 Q. And the model of entry advanced by Complaint counsel,
 25 they are talking about your model there, aren't they?

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1 A. Yes. They are talking about, I guess, a
 2 Horowitz-Painter model. I mean, there were dozens of models
 3 that ultimately that came out of all of this very lengthy
 4 case. And some of those models were entitled
 5 Horowitz-Painter, some of those models were entitled
 6 Hippus-Painter, some of those were titled Horowitz models.
 7 Some, I think, were Elliott models. Some were called Hippus
 8 models, and they just went on and on and on.
 9 Q. And you remember this?
 10 A. I am sure these relate to the combination of Horowitz
 11 and Horowitz-Painter models, because we were the only two
 12 that were addressing the financial modelling.
 13 Q. So it's your understanding and recollection that the
 14 model of entry advanced by Complaint counsel in paragraph 8
 15 on the last page, that is talking about your model, isn't it?
 16 A. I am sure it is. It's certainly encompassed.
 17 Q. And Judge Needleman found that that model did not
 18 constitute reliable and probative and substantive evidence;
 19 is that right?
 20 A. Yes, he did.
 21 Q. Now, you recall that that case went up on appeal to the
 22 full Commission; right?
 23 A. That is my recollection. It was a 5/0 vote, I think, to
 24 dismiss.
 25 Q. Do you remember what they said about your models there?

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1 A. No, I don't.
 2 Q. Why don't we take a look at that.
 3 Mr. Painter, I have now put on the screen -- my
 4 colleague has put on the screen some of the language out of
 5 the Commission's consideration of this case.
 6 MR. CURRAN: Your Honor, may I hand around this
 7 decision as well.
 8 BY MR. CURRAN:
 9 Q. Can you read that?
 10 A. I believe so. I think so, yes.
 11 Q. I will read where I highlighted. "Complaint counsel
 12 relied upon modifications in the Horowitz models prepared by
 13 David Painter, chief supervising accountant in the
 14 Commission's Bureau of Competition. Painter relied upon
 15 Appleton's actual 1977 costs, \$902 per ton, and added to that
 16 a \$72.34 per ton base paper penalty, and subtracted three
 17 percentage points from the other expenses category to account
 18 for Appleton's base paper production expenses. Note 104."
 19 Did I read that part right?
 20 A. You did. I didn't pick up on the last. Something 104.
 21 Q. That is a footnote. Why don't we take a look at what
 22 they said in the footnote. Footnote 104.
 23 "The ALJ criticized Painter's reduction in the
 24 other expenses percentage from 12.5 percent to 9.5 percent,
 25 characterizing the view that the predicted savings would

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1 approach 3 percent of net revenue as sheer conjecture. The
 2 'other expenses' category included, in Appleton's case,
 3 freight, shipping, finished goods, warehousing, operations
 4 services, marketing, research and development, finance, and
 5 the expense of the president's office."
 6 Did I read that part right?
 7 A. Yes, you did.
 8 Q. I would like to flip over to the conclusion. Following
 9 page, page 32 of this Lexis printout.
 10 "Complaint counsel have failed to demonstrate that
 11 B.A.T. was an actual potential entrant into the United States
 12 CCP market. The Commission has therefore determined to
 13 dismiss the Complaint in this matter in all respects."
 14 That was the end of the B.A.T. case, wasn't it,
 15 Mr. Painter?
 16 A. Yes, it was.
 17 Q. You were sitting in this courtroom yesterday when Shira
 18 Goodman was in that chair, weren't you?
 19 A. If it was yesterday, yes. I was in the courtroom. I
 20 have been losing track of days.
 21 Q. You have been here just about every day, haven't you?
 22 A. Yes, I believe so.
 23 Q. Because you are an expert witness, not a fact witness;
 24 right?
 25 The fact witnesses were excluded from the courtroom

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1 prior to their testimony. Are you aware of that?
 2 A. I wasn't.
 3 Q. You heard Ms. Goodman testify about the process that
 4 they followed at Staples and Office Depot in identifying and
 5 quantifying the efficiencies?
 6 A. Yes, I did.
 7 Q. You don't dispute that within days of the announcement
 8 of the proposed merger in September, the two companies began
 9 devoting personnel resources and money to identify and
 10 quantify their efficiencies to be gained from the merger?
 11 A. That is my understanding. I believe she referred to
 12 charts and task forces and so forth that have been set up.
 13 Q. You don't dispute the facts of her testimony in that
 14 regard, do you?
 15 A. No.
 16 Q. This is one of the charts that you recall from
 17 Ms. Goodman's testimony?
 18 A. I believe so.
 19 Q. And that identifies the 15 integration task forces they
 20 have set up, doesn't it?
 21 A. Yes, it does.
 22 Q. Do you see there are task forces for marketing up there,
 23 and distribution, financial processes, merchandising? Do you
 24 see those various categories?
 25 A. Yes.

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1 Q. You don't dispute there were task forces formed for all
 2 of those various issues, do you?
 3 A. No, I don't.
 4 Q. And you don't dispute that the function and the purpose
 5 of these task forces was for people that spend day-in and
 6 day-out in the business to try to identify the efficiencies
 7 to be gained from the potential merger; right?
 8 A. To identify -- they probably had a variety of tasks, and
 9 I am sure some of them had to do with identifying the cost
 10 savings that would be realized by the merged entity. Again,
 11 I distinguish that from merger specific. I think they
 12 obviously had other functions in terms of planning for the
 13 integration of the two companies.
 14 Q. Let's talk about the people on these task forces, okay.
 15 They included senior executives from Staples and Office
 16 Depot?
 17 A. As I understand, yes.
 18 Q. You have heard a lot of documents in this case, haven't
 19 you?
 20 A. I have.
 21 Q. And so you have more than just some understanding as to
 22 who was on these task forces, don't you?
 23 A. I don't. I can't tell you who was on the specific task
 24 forces. I know there were a variety of high ranking
 25 officials, probably outside people. I know Kearney, for

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1 example, was part of distribution; as was Mr. Watts. In that
 2 sense I agree, yes, there was a number of senior people
 3 involved, and outside experts.
 4 Q. And you went to a number of depositions in the FTC
 5 investigation and this litigation?
 6 A. Yes, I did.
 7 Q. And you sat there while people from Staples and Office
 8 Depot testified about their participation in these task
 9 forces; right?
 10 A. Yes.
 11 Q. So, with respect to at least some of these people, you
 12 have seen them testify about their role in these task forces;
 13 right?
 14 A. Yes.
 15 Q. You are not disputing their credibility or their
 16 truthfulness, are you?
 17 A. No. To be honest, I can't recall the specific people
 18 and the specific task forces, but I am certainly not
 19 disputing it.
 20 Q. And you acknowledged, did you not, senior executives
 21 participated in those task forces; is that right?
 22 A. Yes.
 23 Q. Those senior executives have spent years and years of
 24 their lives in this industry; right?
 25 A. I'm sure.

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1 Q. Do you recall reading documents or hearing testimony to
 2 the effect that there were more than 200 people involved in
 3 these task forces?
 4 A. I don't recall that. I don't recall that.
 5 Q. You mentioned a moment ago that you recalled there were
 6 some consulting firms --
 7 A. Yes.
 8 Q. -- that participated in these task forces; right?
 9 A. Yes, there were.
 10 Q. What type of consulting firms?
 11 A. I think A.T. Kearney was involved. EDS was involved.
 12 Bain Associates was involved. Those were our people that
 13 worked with the firms.
 14 Q. Take a look at this chart. Do you recognize this chart
 15 from Ms. Goodman's testimony yesterday?
 16 A. Yes, I do.
 17 Q. I think you mentioned Bain. BCG, do you know who that
 18 is?
 19 A. Yes, Boston Consulting Group.
 20 Q. Alexander Group?
 21 A. Yes.
 22 Q. Direct Tech, A.T. Kearney, Brand Equity, Management
 23 Horizon. Do you see those consultants listed there?
 24 A. Yes, I do.
 25 Q. That is a pretty top-flight list of management

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1 consulting firms, isn't it?
 2 A. I certainly heard of Bain, BCG and A.T. Kearney, as a
 3 result of this case. I've heard of the others beforehand.
 4 Alexander Group. They all sound very impressive to me.
 5 Q. They get a lot of MBAs coming right out of the best
 6 schools, don't they, those firms?
 7 A. I think so.
 8 Q. You see the totals of the numbers of people that were
 9 involved in these task forces?
 10 A. I do now, yes.
 11 Q. And do you see 43 full-time people on the task force?
 12 Do you see that in the left column?
 13 A. I do see that.
 14 Q. 124 part-time people?
 15 A. I see that.
 16 Q. And 94 advisory personnel, do you see that?
 17 A. Yes, I do.
 18 Q. Do you see there are 20 from A.T. Kearney in the
 19 distribution task force?
 20 A. Yes.
 21 Q. Do you see there are 15 advisory people in the
 22 merchandising task force?
 23 A. Yes.
 24 Q. You don't dispute that these people, these 200-plus
 25 people, devoted substantial time, effort, energy and

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1 commitment to try to identify the efficiencies to be achieved
 2 through the merger of these two companies, do you? You don't
 3 dispute that?
 4 A. I don't dispute it. I know that a large part of the
 5 integration task forces was aimed at identifying cost savings
 6 from the merger, and I am sure that the bulk of it was also
 7 aimed at non-quantifiable kinds of things that sort of --
 8 trying to come up with plans for integrating the companies
 9 and so forth. And -- but I think I understand the gist of
 10 your question, and I certainly don't dispute it.
 11 What -- I just, I only say that I don't know that
 12 all of these people were working on cost savings, but there
 13 is no question in my mind but that a substantial number was
 14 -- were in that area.
 15 Q. You have heard people testify from in your presence that
 16 over 200 people committed themselves to these task forces; is
 17 that right?
 18 A. I believe so, yes.
 19 Q. Do you have any reason to doubt their testimony?
 20 A. No, I don't. Well.
 21 Q. Do you have a reason to doubt their testimony?
 22 A. Only in the sense, Mr. Curran, that-- I mean, one of the
 23 people that presented testimony here was Ms. Goodman. And
 24 obviously she is sponsoring an efficiency book that has
 25 calculated in it the cost savings that Staples is asserting

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1 as part of this proceeding would occur from the merger. And
 2 obviously I have disputed that.
 3 I mean, in that sense, anything that relates to
 4 things that are contained in my efficiency report that
 5 disputes things that are contained in the efficiency book,
 6 those would be things that I dispute. I can't hand-pick
 7 which, you know, people are involved and which task forces
 8 are involved, but those are the things I dispute.
 9 Q. You are testifying as an accountant expert; is that
 10 right, an expert in accounting?
 11 A. I don't know. I am certainly testifying as an expert in
 12 analyzing efficiency defences. I believe I am an expert in
 13 accounting.
 14 Q. You are not sure about that?
 15 A. If you could -- if there was something drafted showing
 16 what I am being offered as -- I may have seen it. I don't
 17 recall.
 18 Q. Mr. Painter, take a look at your monitor for a moment,
 19 will you, please.
 20 (Videotape played)
 21 Q. Do you recall that from your deposition in this case,
 22 Mr. Painter?
 23 A. I recall it now. Yes. Again, you know, Mr. Curran, I
 24 don't mean to -- you asked if I was considered being offered
 25 as an expert in accounting. I mean, I am clearly here to

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1 offer opinions with respect to the claimed cost savings.
 2 Clearly I -- my profession, I am an accountant. And clearly
 3 a lot of what the analysis was does involve accounting. Lots
 4 of accounting records, certainly.
 5 I mean -- and again, I don't mean to play
 6 semantics. The question had to do with whether I was being
 7 offered as an expert in accounting, and I don't have the
 8 answer to that.
 9 Q. Does your expertise in accounting enable you to have
 10 superior judgment of the credibility of other people who are
 11 testifying under oath?
 12 A. That is a very broad question.
 13 Q. I think it is a yes-or-no question.
 14 A. I believe that with respect to analyzing the efficiency
 15 claims in a merger context, in the antitrust context, that
 16 have been asserted to this Court, I believe that I have --
 17 that I have expertise.
 18 Q. You got your accounting degree at the University of
 19 Maryland?
 20 A. Yes, I did.
 21 Q. Did you take any special courses in assessing the
 22 credibility of other people?
 23 A. No, I didn't.
 24 Q. It wasn't part of the standard curriculum in that area?
 25 A. No, it wasn't. Still isn't, I would have to assume. I

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1 think they do that in law school. (Laughter)

2 Q. Well, they teach us how to make an assessment of

3 credibility, that's true.

4 Now, when you say -- I want to make sure I

5 understand your testimony here. Do you dispute Shira

6 Goodman's testimony as to the effort and commitment and

7 energy and time and expense that went into these task forces?

8 A. Absolutely not.

9 Q. Over 200 people participated on these task forces;

10 right?

11 A. Yes.

12 Q. You don't dispute that?

13 A. No.

14 Q. You spent about a thousand hours by yourself; is that

15 right?

16 A. About a thousand hours.

17 Q. Without any prior work experience in the office products

18 business; right?

19 A. That is correct.

20 Q. Now, since that B.A.T. case where Judge Needleman made

21 his findings and today, you have not developed any expertise

22 in the office supplies area or consumable office supplies

23 area, have you?

24 A. No, I have not.

25 Q. Mr. Painter, do you recall the various categories of

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1 efficiencies that were identified at Staples and Office

2 Depot?

3 A. Yes, I do.

4 Q. Do you see that chart there on the screen on the

5 overhead?

6 A. Yes.

7 Q. Does that identify the various categories?

8 A. Yes, it does.

9 Q. Let's start at the bottom and go up on these six

10 categories, Mr. Painter. You take an issue with certain

11 savings identified in the traditional vendor savings

12 category; is that right?

13 A. Yes, I have.

14 Q. And that relates to purchasing goods; right? From

15 vendors?

16 A. Yes, it does.

17 Q. Do you ever work as a purchaser of goods from vendors?

18 A. No, I haven't.

19 Q. Have you ever negotiated large volume purchases for a

20 company?

21 A. No, I haven't. I think this will be a whole series of

22 nos, at least if it is the same list of questions asked at my

23 deposition. (Laughter)

24 Q. Well, I could pretty much go through all of those

25 categories. I could talk about Global Product Sourcing,

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1 where people arrange for items to be manufactured or

2 purchased overseas, and I could ask you a series of questions

3 about your personal work experience in that area. You would

4 answer no to all of those questions, wouldn't you?

5 A. Yes, I would.

6 Q. If I asked you about distribution costs?

7 A. I would answer no. I have no experience in distribution

8 costs, in terms of being part of a private company that is

9 involved in understanding the distribution system in the

10 company.

11 Q. And the same with marketing; right?

12 A. Right. These are -- yes. With the exception of these

13 are categories of savings that are -- often make up a cost

14 savings claim or cost savings assertion in a merger context.

15 Beyond that, absolutely not.

16 Q. Now, what I want to know is whether you have personal

17 work experience since you got out of college, working in any

18 of these areas. Okay, we have covered the vendor savings.

19 We have covered Global Product Sourcing. We have covered

20 marketing and distribution. And I don't know if we covered

21 about marketing, but it applies to marketing as well?

22 A. Yes.

23 Q. And goods and services savings and GNA?

24 A. That is correct.

25 Q. No work experience whatsoever in those areas?

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1 A. No.

2 Q. Thank you for your cooperation. I think that will help

3 to speed things along. In fact, Mr. Painter, since you

4 graduated from the University of Maryland with your -- is it

5 a BS in Accounting?

6 A. I think so.

7 Q. You have not worked anywhere full-time other than the

8 FTC; right?

9 A. I worked full-time for about three or four months for

10 Woodward & Lothrop. I mean full-time in the sense of 40

11 hours a week. (Laughter) I work a lot more full time here

12 at the Commission.

13 Q. But not for much longer; right? You are retiring?

14 A. In four months. I will be retiring in September.

15 Q. Tell me what you did over at Woodward & Lothrop.

16 A. I was part of -- it was actually -- I dropped out of

17 college and I took a job. I was working at Woodward &

18 Lothrop and then working another job. And I was in the

19 management training program, and I went through a variety of

20 week-here, week-there, working in various departments with

21 Woodward & Lothrop.

22 Ultimately worked the final phase of that period

23 with the buyer for electronics. I think it was actually

24 called radios and televisions and electronics. And they

25 offered me a position as assistant buyer and I declined, and

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1 they put me in the stock room for my last two weeks.
 2 Q. You lasted in the management training program about
 3 three months there?
 4 A. I think it was about three months.
 5 Q. Mr. Painter, you are not a CPA?
 6 A. No, I'm not.
 7 Q. You have not completed any post-graduate work?
 8 A. No, I haven't.
 9 Q. You are not published in any professional journals or
 10 anything?
 11 A. No, I haven't.
 12 MR. CURRAN: Your Honor, if it would please you, I
 13 would be happy to address the specific points in
 14 Mr. Painter --
 15 THE COURT: You can ask him whatever you would
 16 like. You have your time and you can use your 15 hours as
 17 you want. It is up to you.
 18 BY MR. CURRAN:
 19 Q. Mr. Painter, I would like to direct your attention to
 20 your report again.
 21 A. All right.
 22 Q. Mr. Painter, I would like to direct your attention
 23 specifically to paragraph 15 on page 8 of your report.
 24 A. I have it here in front of me now.
 25 Q. It's Plaintiff's Exhibit 282. Page 8, paragraph 15.

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1 And we also have highlighted a sentence in that paragraph.
 2 "The aggressive case cost savings appear to be
 3 totally unsubstantiated."
 4 That is what it says in your report?
 5 A. That is what it says, yes.
 6 Q. That is not right, is it?
 7 A. This came up at the deposition, and I indicated that
 8 with the exception of the Hausman analysis that it was
 9 totally unsubstantiated. After a series of questions that
 10 brought that out.
 11 Q. But you hadn't even read the Hausman analysis; is that
 12 right?
 13 A. No, I haven't.
 14 Q. And you are not qualified to read or review or to
 15 scrutinize the Hausman analysis, are you?
 16 A. I am not. I am glad I'm not. (Laughter)
 17 Q. So, when you say the aggressive case cost savings appear
 18 to be totally unsubstantiated, you are comfortable making
 19 that statement, having not read underlying analyses performed
 20 by MIT professors?
 21 A. The analysis itself, as I understood it at that point,
 22 is that the analysis did not distinguish between -- it
 23 distinguished between best prices and scale. Best prices
 24 being about 1.2 percent of the 1.8 percent.
 25 Now, I have to tell you that I have learned that

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1 since this was written. I had some -- I will leave it at
 2 that. I had -- I'm sorry Mr. Curran. Maybe I didn't answer
 3 that question. Was the question had I looked at the -- had I
 4 analyzed the Hausman analysis in forming that statement?
 5 Q. You are not capable of analyzing the Hausman analysis,
 6 are you?
 7 A. No, I am not.
 8 Q. But you are comfortable making that statement?
 9 A. I'm comfortable --
 10 Q. It is a yes-or-no statement. Are you comfortable making
 11 that statement, not having read the Hausman analysis?
 12 A. If I could explain. As I sit here today, I am somewhat
 13 comfortable with it, but I need to explain why.
 14 Q. Today, do you have an understanding of the Hausman
 15 analysis?
 16 A. I have more of an understanding of the Hausman analysis
 17 than I had before.
 18 Q. Mr. Painter, all of your knowledge about the achievable
 19 efficiencies in this case comes straight out of your review
 20 of documents that have been provided to you from this case;
 21 right?
 22 A. They come out of my analysis of documents that have been
 23 submitted by both parties. They come out of my analysis of
 24 vendor declarations. They come out of my analysis of
 25 testimony. They come out of my analysis of documents

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1 submitted by third parties, and so forth. Yes.
 2 Q. If I recall correctly on your direct examination, you
 3 stated -- I tried to keep a little list of things where you
 4 acknowledged you didn't know what the words meant. And at
 5 least there are a couple that I would like to confirm with
 6 you.
 7 At the time that you wrote your report and appeared
 8 for your deposition in this case, you didn't know what the
 9 word "opportune" meant in connection with these; is that
 10 right?
 11 A. No. I did not. I had to review documents related to
 12 the Global Product Sourcing program. I had reviewed
 13 underlying documents that were either identified or I
 14 uncovered with respect to the Global Product Sourcing
 15 program. I believe it actually -- I think they were
 16 contained -- they were contained in the actual underlying
 17 analysis, the January the 14th analysis that was the basis
 18 for the efficiency book. That is, it took those savings and
 19 then reformatted them into basis points and so on.
 20 And in the underlying documents in there, the word
 21 "opportune" appeared. It was used. And I had no
 22 understanding of the word "opportune." I believe Ms. Goodman
 23 was asked about the word "opportune." And my recollection,
 24 and you correct me if I am wrong, is that she didn't know
 25 what the word "opportune" meant either.

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1 And I made an assumption which I spelled out very
 2 clearly in my report that, assuming that it meant those SKUs
 3 with the greatest savings, then I reached some conclusions.
 4 And again, I don't want to point to that paragraph in
 5 isolation, because that paragraph was part of a whole series
 6 of paragraphs that sort of discussed GPS, and they are very
 7 much integrated with one another. One supports the other,
 8 and so forth.
 9 Q. At the time that you prepared your report and the time
 10 of the deposition, you didn't know what "opportune" meant in
 11 this context; is that right?
 12 A. That is correct.
 13 Q. You didn't know what the word "reach" meant either, did
 14 you?
 15 A. I still don't know what the word "reach" means. I
 16 thought I indicated in my report, assuming "reach" means
 17 something that -- a cost savings that was obtained that was
 18 greater than the budgeted savings. The budgeted savings
 19 appearing to be 22 million and the reach being something like
 20 27 million, then this would mean that the savings were 27
 21 million of the 55 million that were being derived as a result
 22 of the sample.
 23 Q. You were -- you were adding some words or some new
 24 meanings to your vocabulary in this process; right?
 25 A. Yes. I was making judgments on what they might mean

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1 with respect to trying to draw conclusions about the
 2 analysis.
 3 Q. Because you did not have a background in the industry
 4 and with these companies; right?
 5 A. That is correct. But again, I point you to testimony
 6 from Ms. Goodman, who didn't know what the word "opportune"
 7 meant either. At least that is my recollection.
 8 Q. Can you give me a cite for that?
 9 A. I can't.
 10 Q. You testified on direct, I believe, that you first
 11 became suspicious or cynical or --
 12 A. Skeptical.
 13 Q. -- skeptical. Thank you. About the level of
 14 efficiencies, because the company's estimate was higher than
 15 the Goldman Sachs estimate. Right?
 16 A. Because the estimates that were presented in the
 17 efficiency book premised on a January 14th study were
 18 represented to be the -- based on known facts and the most
 19 realistic projections. And they were, in order of magnitude,
 20 much, much higher than what I had seen in the board
 21 analysis.
 22 And actually, even if they had not been described
 23 as the best estimates or the most realistic estimates, I
 24 would have been skeptical, given the order of magnitude and
 25 difference in comparison.

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1 Q. What was the purpose of the efficiencies analysis at
 2 Goldman Sachs for the board and for the prospectus?
 3 A. The efficiencies, as I understand them in Goldman Sachs,
 4 was to determine what the benefits -- financial benefits or
 5 the strategic benefits were of recommending this merger to
 6 the shareholders. Of determining whether or not to recommend
 7 the merger to the shareholders.
 8 Q. So the purpose of the analysis was to support a fairness
 9 opinion; right?
 10 A. No, that's not my understanding. The fairness opinion
 11 is something that would effectively try to assess the
 12 consideration being given for the transaction. In this
 13 instance, the exchange ratio, for example, I think was 1.14
 14 shares of Staples stock for Office Depot stock. And whether
 15 that represented, based on current market values of the
 16 companies, that represented a fair consideration as part of
 17 the fairness opinion. It doesn't mean that it was the best
 18 -- the best offer that the shareholders could get or the
 19 worst offer. It was within a range of reasonable offers, of
 20 reasonable consideration for the shareholders.
 21 Q. Do you know what a fairness opinion is?
 22 A. I know it in the context that it is a generally sort of
 23 a short letter that is prepared by the investment bankers to
 24 assess the consideration that is being given to the
 25 individuals -- to the shareholders to companies, and to draw

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1 some conclusions with respect to whether that is a fair
 2 consideration being given.
 3 Q. Do you know what an accretion analysis is?
 4 A. It is an analysis of what the added benefits are to the
 5 earnings per share; generally in terms of earnings per share
 6 to the shareholders as a result of the merger, over what was
 7 anticipated without the merger.
 8 Q. What exactly was Goldman Sachs project? Was it to
 9 project total synergies, or was it to project earning per
 10 share accretion that would result from the synergies?
 11 A. Well, they probably go hand and hand. Goldman Sachs
 12 prepared two assessments of cost savings. They determined a
 13 base case set of cost savings and then they prepared an
 14 aggressive set of cost savings. And from that the projected
 15 earnings per share were -- actually, they were -- they
 16 ultimately, in the proxy statement, they resorted to the base
 17 case set of cost savings.
 18 And based on those cost savings, they determined
 19 what the accretive effect was on the earnings per share of
 20 the post-NEWCO companies relative to the projected earnings
 21 per share of the two companies. That is, Merrill Lynch did
 22 it. I mean, Goldman Sachs did it for Staples. Merrill Lynch
 23 did it for -- I think it was Merrill Lynch did it for Office
 24 Depot.
 25 Q. I would like to direct your attention to the excerpts

1 that are up on the wall here --
 2 A. All right.
 3 Q. -- from the proxy statement. Do you see the first one?
 4 The following is a summary of certain of the
 5 financial analyses used by Goldman Sachs in connection with
 6 providing its oral opinion to the Staples board of directors
 7 on September 3, 1996?
 8 A. That is correct. I see it.
 9 Q. This is from the proxy statement of several months
 10 later; right?
 11 A. Yes. I am assuming it is from the -- I don't recall the
 12 proxy, and I am sure it is the January 23rd proxy statement.
 13 I'm not aware of any other one.
 14 Q. The second bullet point, "Goldman Sachs opinion
 15 necessarily was based on the economic, market and other
 16 conditions as an effect on, and the information made
 17 available to it as of the date of its opinion."
 18 Do you see that?
 19 A. Yes.
 20 Q. The third bullet point, "The analyses were prepared
 21 solely for the purposes of Goldman Sachs providing its
 22 opinion to the Staples board of directors as to the fairness
 23 of the exchange ratio to Staples, and do not purport to be
 24 appraisals or to necessarily reflect prices at which
 25 businesses or securities actually may be sold or may track in

1 "The projections of EPS for Staples was provided by
 2 Staples management, and projections of EPS for Office Depot
 3 were provided by Office Depot management and modified by
 4 Staples management. Such analysis indicated that the merger
 5 is projected to be accretive to Staples' stand-alone EPS by
 6 6.4 percent in fiscal 1997, 7.9 percent in fiscal 1998, and
 7 10.3 percent in fiscal 1999."
 8 Did I read that right?
 9 A. Yes, you did.
 10 Q. Mr. Painter, isn't the purpose of an accretion analysis
 11 to determine what is going to shareholders and necessarily
 12 what is -- not what is going to consumers?
 13 A. It certainly doesn't assess what is going to consumers.
 14 You are absolutely right.
 15 Q. I am putting on the monitor another visual that I pulled
 16 out of the notebook that Mr. Cary gave me before you
 17 testified. Can you read it on the screen?
 18 A. Yes, I can see it here.
 19 Q. Up top, it says, "An entire distribution claim of 883
 20 million cannot be verified."
 21 Can you see that?
 22 A. Yes.
 23 Q. On direct examination you were describing the inquiry
 24 you made to determine, or in order to conclude that the
 25 entire distribution claim of 883 million cannot be verified.

1 the future."
 2 Do you see that?
 3 A. Yes, I do.
 4 Q. And the fourth one, "The preparation of a fairness
 5 opinion is a complex process. Selecting portions of the
 6 analysis or of the summary set forth above, without
 7 considering Goldman Sachs analyses as a whole, would create
 8 an incomplete view of the processes underlying Goldman Sachs'
 9 opinion."
 10 Do you see that?
 11 A. Yes, I do.
 12 Q. Now, one of the slides that you reviewed on your direct
 13 examination quoted an excerpt from the prospectus -- from the
 14 proxy statement; right?
 15 A. The proxy statement/prospectus. It is a combination.
 16 Q. I would like to put on the Elmo a paragraph beginning on
 17 the same page of the excerpt that you read from before. Let
 18 me read that.
 19 "Projected earnings per share and accretion
 20 analysis. Goldman Sachs analyzed the projected earnings per
 21 share EPS and projected EPS accretion of the combined company
 22 following the merger, using the synergies for the combined
 23 company projected by Staples management, of 91 million in
 24 fiscal 1997, 146 million in fiscal 1998, and 211 million in
 25 fiscal 1999.

1 Do you remember that?
 2 A. Pretty much.
 3 Q. You did it twice, didn't you? You talked about all the
 4 A.T. Kearney documents you looked at?
 5 A. Yes. I looked -- I did it twice. Did I say it twice?
 6 Q. Tell me what documents you looked at and what inquiry
 7 you undertook in order to reach this conclusion?
 8 A. I looked at the documents that were provided in the
 9 efficiency book. I believe there were underlying documents
 10 -- there were documents that we had received that were
 11 Kearney documents from the parties -- from Staples
 12 themselves. And there were 21 boxes of documents that were
 13 submitted to a copy center as a result of a subpoena from the
 14 Commission. Actually, I wanted to make this 21 boxes. And I
 15 went through all of the boxes, to the best of my ability.
 16 And that's the basis.
 17 Q. And you concluded, based on your review of those
 18 documents, that the entire distribution claim cannot be
 19 verified?
 20 A. I should have added "by me." I could certainly not
 21 verify them. I tried to explain some of the documents that
 22 in fact suggested to the contrary of what is being asserted
 23 and these are specific to this merger. By mentioning that, I
 24 saw documents used as the base from which to measure savings.
 25 at least on their face, 1996. And one actually for retail

1 was 1996, August actual, one month. Or that -- and the other
 2 was budgeted 1996 figure for the BSD. I might have it
 3 flip-flopped.
 4 Q. The fact that you can't verify these distribution
 5 claims, these savings, it doesn't mean that other people can
 6 verify them, does it?
 7 A. You are absolutely right. We have asked, but you are
 8 right. That I can't verify them, doesn't mean that there
 9 isn't somebody out there, probably with Kearney.
 10 Q. I think I stuttered in making the question. Let me say
 11 it again.
 12 The fact that you cannot verify these savings
 13 doesn't mean that someone else cannot; right?
 14 A. No, it doesn't.
 15 Q. And in fact, given that you do not have experience in
 16 this industry and have not worked at these companies, you are
 17 at a significant handicap in verifying these distribution
 18 savings; is that right?
 19 A. I am certainly at a significant handicap in
 20 understanding a lot of the documents that I went through, and
 21 I have a significant handicap with respect to the people that
 22 were literally compiling the savings. Again, with respect to
 23 being at a handicap, if the documentation was all there as to
 24 determining what was the merger's specific portion or what
 25 was not, I may not be at a handicap. I don't know.

1 Q. And the third you call remaining possible efficiencies?
 2 A. Yes.
 3 Q. You are an accountant. What is the 1.66 percent, plus
 4 the 1.43 percent? What does that total up to?
 5 A. 3.09 percent. 3.09 percent.
 6 Q. And that is a percent of what?
 7 A. That is a percent of sales.
 8 Q. In the year 1998?
 9 A. Yes.
 10 Q. Do you know what the estimated sales are for the
 11 combined company in 1998?
 12 A. Give me just a minute. (Pause, referring) I really
 13 think I might have it. Close, anyway. For some reason,
 14 15,629 -- 15,629,000,000 is standing out in my mind. Correct
 15 me if I am wrong.
 16 Q. Let's take that figure and multiply it by 3.09 percent.
 17 What does that come to? (Laughter)
 18 A. Tell me again. I may need a calculator.
 19 Q. I just want you multiply the percentage that you
 20 calculated times the sales volume that you calculated, that
 21 you recall?
 22 A. Okay. Assuming it is 15.629 billion and the percentage
 23 is 3.09 percent -- you won't help me out with a calculator?
 24 Q. Mr. Smith will.
 25 A. Thanks.

1 Q. You're not disputing there are in fact distribution
 2 claims, are you? That there are in fact distribution savings
 3 to be achieved here?
 4 A. No. I believe that there probably are some distribution
 5 savings. I believe that if you took -- even companies the
 6 size of Staples and Office Depot that have fairly elaborate
 7 distribution systems in place, that even after they would
 8 rationalize or optimize the distribution systems, I believe
 9 that you could take those two systems stand-alone, optimize
 10 those, and achieve savings.
 11 And I do believe that in fact there would be
 12 savings in that respect attributable to the merger, from
 13 distribution. I just don't know how much.
 14 Q. One final document, Mr. Painter, from what Mr. Cary
 15 showed you before. Do you recognize that one?
 16 A. I do.
 17 Q. I believe it was the last document Mr. Cary showed you?
 18 A. I think so, yes.
 19 Q. And down at the bottom you have broken out the 5.03
 20 percent into three separate categories; is that right?
 21 A. Yes.
 22 Q. And the first category you call erroneous; right?
 23 A. That is the terminology attached to it, yes.
 24 Q. And the second category you call unsubstantiated?
 25 A. That's right.

1 Q. May I, Your Honor?
 2 THE COURT: Yes, sir.
 3 A. Is this a Staples product? Is this a GPS product?
 4 Q. It is a Staples product, but I have no idea if it is a
 5 consumable office supply.
 6 A. I get 483 million dollars, rounded. 483 million
 7 dollars, when I do the calculation.
 8 MR. CURRAN: No further questions, Your Honor.
 9 THE COURT: Thank you, sir. Let's see if there is
 10 any redirect.
 11 REDIRECT EXAMINATION
 12 BY MR. CARY:
 13 Q. Mr. Painter, is there a relationship between accretion
 14 to shareholders and possible cost savings from a merger?
 15 A. There is.
 16 Q. What is that?
 17 A. There is potential. There is certainly a potential
 18 relationship.
 19 Q. What is that relationship?
 20 A. I mean, to the extent that you have cost savings that
 21 are -- effectively translate to the bottom line; that they
 22 are not passed through, for example, to consumers in the form
 23 of lower prices, they have the potential for -- to the extent
 24 they are realized, they would improve the projected earnings
 25 per share.

3 rights
 Feb 24

1 Q. Why would a company pass through cost savings to
 2 consumers?
 3 A. To -- it would be a profit maximizing objective to in
 4 fact increase in terms of dollars the bottom-line dollar
 5 profits.
 6 Q. So, efficiencies that are passed through to consumers
 7 should also result in an accretion to shareholder value; is
 8 that right?

9 MR. CURRAN: Objection, Your Honor, leading.

10 THE COURT: Why don't you just reask it to him.

11 BY MR. CARY:

12 Q. Would savings that are passed on consumers in the form
 13 of lower prices potentially have an impact on shareholder
 14 value?

15 A. To the extent that savings passed through to the
 16 consumer in the form of lower prices create great -- for
 17 example, create greater sales, that then create greater gross
 18 profit dollars, that then create greater bottom-line dollars
 19 for the company, then it would have an accreteive effect. It
 20 would improve earnings per share.

21 MR. CARY: No further questions, Your Honor.

22 THE COURT: Thank you, sir. Thank you very much,
23 sir.

24 MR. KEMPF: Mr. Cary said he was going to call
25 someone else, and I said that I would concede my time so he

1 A. Yes.

2 Q. And have you also heard testimony about the possible
3 price impact, anti-competitive price impact as a result of
4 this transaction?

5 A. Yes.

6 Q. Could you please explain how, as an economist, you would
7 evaluate those two forces arising out of this transaction?

8 A. It would be -- would it be possible for me to use the
9 board?

10 THE COURT: Certainly.

11 THE WITNESS: In looking at the effect of both of
12 these influences together on prices, there are really two
13 things going on here that have been talked about continuously
14 over the last two days.

15 One is the competition effect, and the second is
16 the cost effects. Cost or efficiencies almost always are
17 scaled effects. And the combined effect of these two gives
18 you the price effect.

19 THE COURT: Let me give you a mike, if you don't
20 mind. I don't think a lot of people here can hear you, and
21 they need to hear you. There should be 40 feet of cord
22 there.

23 If you would hold that with your other hand when
24 you talk. Thank you, sir. That's on.

25 THE WITNESS: Now, the competition effect is the

1 can finish today. There may be some dispute as to the time.
 2 My only question, Mr. Cary, I don't want to raise this, but I
 3 think you have about half an hour left, 20 minutes or so.

4 MR. CARY: I can finish in half an hour, Mr. Kempf.

5 MR. KEMPF: I can name that tune in four notes.

6 MR. CARY: Plus I think that means that you have no
7 time left which means there is no cross-exam; right?

8 MR. KEMPF: No, I have a little time left.

9 MR. CARY: Your Honor, the Government calls
10 Professor Warren-Boulton.

11 THE COURT: Good.

12 FREDERICK WARREN-BOLLTON, GOVERNMENT'S WITNESS, SWORN

13 THE COURT: Good afternoon, or evening.

14 DIRECT EXAMINATION

15 BY MR. CARY:

16 Q. Professor Warren-Boulton, welcome back. As you have
 17 heard, we are extremely limited in time, so I would request
 18 that you answer my questions as concisely as possible so we
 19 can get through this very quickly.

20 A. Yes.

21 Q. You have been sitting in the courtroom during the
22 defense case, have you not?

23 A. Yes.

24 Q. You have heard testimony alleging that there are
25 efficiencies that arise from this transaction; correct?

1 effect of the merger if there were no efficiencies at all.
 2 We've estimated this from a number of different sources,
 3 including documents and elsewhere. But what I would like to
 4 do in going through here is really go through almost like a
 5 numerical example with reasonable numbers, so we can get a
 6 feel as to how we combine these things and some idea of the
 7 sensitivity, shall we say, of the results. The kind of
 8 assumptions, or whatever numbers you decide are the right
 9 numbers, how one would go about combining them to get to the
 10 answer.

11 And the answers which I want to get, or at least I
 12 am assuming we want to get to, is what will be the effect of
 13 the merger on prices. And my particular concern is the -- on
 14 the price of office supplies in the regions where Staples and
 15 Office Depot compete. So that is where I am going.
 16 In doing that, we would start with an estimation of
 17 what would be the effect of the merger, absent efficiencies.
 18 at least at the national level. I will make that point
 19 later. Because this is the only question that we can truly
 20 answer using the experience of the past. We have an enormous
 21 amount of data which has been put together in admittedly very
 22 complex econometric models, but in trying to learn what it is
 23 that we can tell from the past that would help us in the
 24 future, the one question we can answer there is, what would
 25 be the effect of the merger before looking at nationwide

1 efficiencies.
 2 And to begin with, there is no dispute amongst
 3 anybody that this is positive. We -- absent efficiencies, it
 4 is my understanding from listening to everybody here, that
 5 everybody agrees the prices would go up in these markets
 6 after the merger. The FTC certainly believes it. Professor
 7 Hausman believes it. Mr. Stenberg believes it. So it is not
 8 a question of whether this is positive or not, it is a
 9 question of how big it is.

10 The best estimate from Professor Ashenfelter is
 11 something in the order of 7 and a half percent. He is a
 12 statistician, and so he won't tell me exactly what the right
 13 number is to 12 significant digits, which is what I would
 14 like. But what he will say to me is, Look, it is somewhere
 15 between 5 and 10. I mean, I am confident that it is
 16 somewhere between 5 and 10.

17 So from my point of view, as a matter of fact, I
 18 will start with my own number. I know of course that perhaps
 19 Staples would like to start with different numbers, but let
 20 me just start with what I think is, for example, what
 21 Professor Ashenfelter would argue and which I find consistent
 22 with the documents, by the way, as the right number for the
 23 percentage price increase if we had no efficiencies.

24 And the second question is then to ask how large
 25 efficiencies are we going to have. And as we have been

1 Now, in this particular case, while this will be
 2 disputed, I would argue that virtually all of these
 3 efficiencies are specific to the firm. Certainly all of the
 4 non-procurement ones, and as an economist I would also argue
 5 even the procurement ones are specific to the firm.

6 We have -- or rather Dr. Ashenfelter has been able
 7 to look to the question of how and what percentage of
 8 efficiencies get passed through, depending on whether they
 9 are specific to the firm or whether they are across the
 10 industry. And the answer is, as economic theory would lead

11 you to expect, the percentage is much smaller if it is
 12 specific to the firm. If I get a cost increase and it is
 13 only to me, I am under no pressure to pass that on. But if
 14 that cost increase also goes to my competitors and he cuts
 15 his prices I will find that I am cutting my prices, not just
 16 because my costs have gone down, but because my competitors
 17 have cut their price.

18 THE COURT: You said cost decrease; right?

19 THE WITNESS: We get a cost decrease.

20 So what kind of pass-through rate would be
 21 reasonable? Professor Ashenfelter's estimate is 17 percent.
 22 I am not nearly as good with numbers as Mr. Painter, so I
 23 would like to round that up to 20 percent so I can multiply,
 24 you know, in my head. So I have 20 percent of 1 and a half
 25 percentage points that are going through, and so what I have

1 listening to here for some time, that too is under a great
 2 deal of dispute. The parties appear to be alleging
 3 efficiencies something in the order of 6 percent. I
 4 have listened for the last hour, two hours, two and a half
 5 hours to Mr. Painter on the cross, and I have read his
 6 report. And anybody can decide whatever number they want to
 7 decide. My feeling about what you should do or one should do
 8 is one should err on the conservative side. You want to make
 9 sure you don't let a merger through unless it will be
 10 efficient.

11 I am going to put up a number that I think is a big
 12 number. I would probably, if pressed, say it was much
 13 smaller, but I am sure the other parties would disagree. And
 14 it would be something like the order of one and a half
 15 percent, if I take Mr. Painter's results out of the 6
 16 percent. And I asked, what is left after we look at
 17 substantiated efficiencies that are specific to this merger,
 18 that would not happen otherwise. Because if they would
 19 happen otherwise they are not really relevant, because we are
 20 looking at a price effect that would have happened
 21 otherwise.

22 So we have about a one and a half percent. But
 23 that unfortunately is not the end of the story. Because the
 24 next question is, how much of this will be passed on to
 25 consumers, and that is the pass-through rate.

1 is the equation here, is I have a 7 and a half percent price
 2 increase, absent efficiencies. I have one and a half percent
 3 of revenue which are cost efficiencies; which, by the way, is
 4 in dollar terms a very, very large number. That is a big
 5 amount. 20 percent of which are passed on. Okay.

6 And what I have is, since this is .3, I have an
 7 estimate of what is the price effect of the merger in those
 8 markets where Staples and Office Depot compete for office
 9 supplies. At this point that would be my best estimate if I
 10 had to look into a crystal ball and see what was going to
 11 happen.

12 Faster?

13 Q. No. I was going to ask you a question. I was going to
 14 slow you down a little bit. Can you walk through the
 15 calculation that got you to 7.4? You went too fast for me.
 16 A. Went too fast for me too. Is that better?

17 Q. It is the .2 times 1.5. I got it.

18 A. Minus .3 should be 7.2. Sorry. That is why we have
 19 calculators.

20 Now, the question next is, how sensitive is this to
 21 any kind of reasonable change?

22 Q. On this scale then, if you still have a positive price
 23 effect, the merger would be anti-competitive?

24 A. The merger would be anti-competitive. I will put a plus
 25 7.2 there. We now have 7.2 percent price. And the next

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1 question is, how sensitive is this to the kind of things that
 2 could happen. I mean, you know, what are the numbers
 3 alternatively that you might want to plug in?
 4 The first thing you could say is, how sensitive is
 5 it to the amount of efficiencies? You could ask, suppose we
 6 simply doubled the amount of efficiency above what
 7 Mr. Painter would give them. At that point we have 7.5 minus
 8 our 20 percent pass-through, times 3 percent efficiencies.
 9 Okay.
 10 And so what we would get here, if I am good at
 11 this, is I now have a plus 6.9 percent. So if I doubled the
 12 amount of efficiencies that are involved, holding the
 13 pass-through rate the same, I still get 6.9 percent price
 14 increase, which is a very large price increase.
 15 Now, I could say well, maybe I am not just wrong
 16 about the efficiencies. Maybe I am wrong about the
 17 pass-through rate. Perhaps Professor Asbenfelter has missed
 18 and we should double his pass-through rate.
 19 Now we go 7.5 and double this pass-through rate as
 20 well, we get 40 percent of the 3 percent efficiency rate, and
 21 I have now got a plus 6.2. So, the thing is that no matter
 22 how large the efficiencies are -- not no matter how large,
 23 but any reasonable range of efficiencies and pass-through,
 24 even when they are twice what the data appear to be the
 25 pattern in the past. What we are getting is very large price

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1 increases.
 2 THE COURT: How did you get the 6.2? And the .2
 3 part of that 6?
 4 THE WITNESS: Yes. And again. All right.
 5 So however one does it, one basically has to go
 6 through this same little formula. And you know, without sort
 7 of prejudging which number should be where, it just is an
 8 easy way to sort of say, what are the reasonable numbers that
 9 I find for this price increase. This happens to be Professor
 10 Ashenfelter's number, but anybody can plug in relative
 11 numbers and come to a result.
 12 And the point essentially that I see here is that
 13 these results in terms of the bottom line you, if you like;
 14 which is, do you expect to see a large price increase after
 15 this merger for office supplies in overlap areas, the answer
 16 is yes, and it is not very sensitive to the kinds of
 17 assumptions that you need to make here.
 18 BY MR. CARY:
 19 Q. Very good. Do you mind pressing the Xerox button before
 20 you return to the witness stand.
 21 A. It wasn't on.
 22 Q. It wasn't on? I am sorry, I thought I turned it on.
 23 (Pause, diagram copy made)
 24 Q. Professor Warren-Boulton, one other thing I would like
 25 you to address. We have heard a lot in the defense case

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1 about Wal-Mart, and I would like you to address the extent to
 2 which Wal-Mart can be expected to significantly constrain or
 3 even eliminate the price increase after the merger?
 4 A. Okay. Once again, I would like to approach it in terms
 5 of what I have heard is the facts of the case, but also
 6 mainly in terms of how you put it in perspective. I guess,
 7 if I can, I have to get back over here again.
 8 Q. All right.
 9 A. Can I erase this? Let's erase the productivity loop. I
 10 think I just reduced your productivity.
 11 So it is a scenario with respect to how you might
 12 look at the role of Wal-Mart in this process. And let me
 13 just start with what seems to be consistent with what I have
 14 heard the Wal-Mart people saying to me when I listen to them
 15 and when I read the depositions.
 16 And let me begin with here, let me just draw
 17 something that would be what is essentially sort of a picture
 18 how the FTC sees the relationship between exception and
 19 prices in -- for Staples. And essentially the way the FTC
 20 has thought of this and the way I have thought of this is the
 21 price of Staples.
 22 We can think of that being in several competitive
 23 zones. The lowest price zone is the one where all three
 24 are. Staples and Office Depot and OfficeMax. Okay.
 25 And then there is second group in which there are

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1 two competitors. Two competitors, Staples, plus OfficeMax.
 2 And there is a third group in which there is
 3 another group of two, which is Staples plus Office Depot.
 4 And finally there is a final group, which is the
 5 Staples only. The one competitive superstore.
 6 I think what the data says, and what everybody
 7 agrees, is that the highest price is in the Staples-only
 8 zone. The next is in a Staples plus OfficeMax, since
 9 OfficeMax clearly seems to be much less forceful competitor
 10 here than Office Depot. The next lowest is Staples plus
 11 Office Depot. And very close behind it, not far away, is all
 12 three firms.
 13 Now, if we think about what Wal-Mart said in the
 14 depositions -- or at least what I hear them saying. Wal-Mart
 15 says -- and let me draw a sort of a run underneath there --
 16 they have basically nationwide prices. National pricing.
 17 Everyday low pricing. So if we have the price of Wal-Mart
 18 here, and we look across these zones, what they say is they
 19 begin with a single set of nationwide pricing. So we'd
 20 expect it to look something like that.
 21 The only thing is, they then go on to say, where
 22 they face competition in particular areas, particularly low
 23 prices, either from Kmart or Target or from category killers,
 24 in those particular products where they face particularly
 25 intense competition, where prices are lower, they will lower

1 their prices. They will discount off their already low
 2 everyday national prices.
 3 So if I kind of like draw these little zones down
 4 here, unfortunately I don't have a data set that consists of
 5 Wal-Mart prices to test this, because that would clearly be
 6 the next step. As I understand what Mr. Glass and Mr. Long
 7 said, what they have said is when they see particularly
 8 strong competition from category killers, what they do is
 9 they discount. A little bit. Some, I don't know how much,
 10 off the price.

11 Now, since what we find is that there is
 12 particularly strong competition when Office Depot is present,
 13 I would expect to see that in markets where Wal-Mart competes
 14 with Staples, Office Depot and OfficeMax, what they will tend
 15 to do is they will tend to discount off the national price.
 16 And in markets of here and here, they will tend to get a
 17 relatively large discount, and here they won't discount at
 18 all. Okay. And there maybe, you know, maybe not at all.

19 So now we ask the question, what happens when there
 20 is a merger here? Now, one story we will get to in a moment
 21 is a story that says Wal-Mart will stop this merger from
 22 being profitable, at least in terms of its increased price
 23 and increased monopoly profits story. Another story is what
 24 I hear here. That is, if we have a merger, what will
 25 happen?

1 at individual stores, holding constant of time, holding
 2 constant for presence of competitors, holding constant -- I
 3 am sorry, for the number of competitors, holding constant for
 4 everything we are physically capable of holding constant for,
 5 what happens is you get numbers in the order of maybe a 5
 6 percent price increase here; maybe a 9 percent price increase
 7 there. And overall, across the board, it is somewhere like 7
 8 to 7 and a half percent. Professor Ashenfelter said
 9 somewhere between 5 and 7 percent is what we expect.

10 So now what is the relationship between this and
 11 Wal-Mart? Well, as I understand the story that I am hearing,
 12 what Wal-Mart does is they would say after this merger, We
 13 have seen an increase in prices here. Competition from the
 14 categories is less intense. That does not say they will turn
 15 around and say whoopie, I will raise my prices today. But in
 16 the same way as these prices drift up, we expect to see those
 17 discounts drifting up too.

18 So what I would expect to see in terms of the
 19 relationship between Wal-Mart's prices and the office
 20 superstores prices over time is not one story. It is not
 21 that the presence of Wal-Mart makes the merger unprofitable
 22 or it doesn't result in price increase, but that there are
 23 ripple effects that go outside. That we expect to see
 24 perhaps a little lessening of the discounts there in terms of
 25 Wal-Mart.

1 What the FTC is alleging, and what I believe, is
 2 that what we are going to see if this merger goes through is
 3 a perhaps gradual, may take days or months or a year, but
 4 what will happen is that these -- this price level will begin
 5 to approach this price. They will probably move down and
 6 converge, so that over a period of time what they will see is
 7 -- by the way, all of these prices are drifting down.
 8 Prices are constantly declining in this industry, and they
 9 will probably continue to decline no matter what we do here
 10 today, the same way as prices decline in the computer
 11 industry even if there were a monopoly.

12 But looking at it, as somebody says, caeteris
 13 paribus -- all else being equal -- what we expect to see is
 14 that -- what the FTC would expect to see, and I would too,
 15 over time this will drift up. So the price effect that we
 16 will see is here, that these three-firm markets, Staples,
 17 Office Depot and OfficeMax will begin to look like Staples
 18 and OfficeMax markets. These markets that are Staples/Office
 19 Depot markets, will begin over time to look like Staples
 20 markets.

21 Now, when you estimate this in the past and you ask
 22 the question, looking at the past, the last 20 months, in the
 23 data and saying, how big a price increase, how big a
 24 difference is there a year, holding constant for everything
 25 we can think of holding constant. Holding constant for costs

1 And I think, you know, whenever you define markets,
 2 markets are not watertight. The idea is to define a market
 3 so you have a market that is at least one worth
 4 monopolizing.

5 It is like you take a rock and you throw it in a
 6 pond, and here is Staples and Office Depot. That is where
 7 the biggest impact is. And then the ripples head out from
 8 there. And you say, where is the next? Where are you going
 9 to be anchored to get the next biggest sort of bump? I think
 10 it is OfficeMax sitting out here. That sort of goes out.
 11 And when we look at the data in terms of the ripple effect of
 12 the merger, you know, maybe you get into Best Buys. At the
 13 moment, at any rate, Wal-Mart is really out here.

14 Now, why don't we think -- you know, could it go
 15 both ways? The answer is yes. Wal-Mart could be
 16 constraining the office superstore pricing and the office
 17 superstores could also be constraining to some extent
 18 Wal-Mart's pricing. And we have been able to test for that:
 19 that at least looking in the past for the past 20 months,
 20 saying, how much of a difference has Wal-Mart made? We can
 21 answer the question, what would happen if Wal-Mart
 22 disappeared? What would happen to the prices here? And the
 23 answer is, it is a very small number for the Wal-Mart of the
 24 past 20 months.
 25 Q. How small?

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1 year or so would be enough so as to drive that number down to
 2 a relatively low point? Because you have to get it down to a
 3 relatively low point if you are going to -- I guess we have
 4 left it, but if you are going to get a number for the price
 5 effect absent efficiencies which is sufficiently low so it
 6 can be offset by the cost effects times their pass-through.
 7 And all I can say is, looking at the past, it
 8 doesn't -- you know, I can't see any way I could reliably
 9 feel any sense of confidence that Wal-Mart is going to change
 10 in such a way as to make this a credible alternative.
 11 MR. CARY: Thank you. No further questions, Your
 12 Honor.
 13 MR. KEMPF: My count, they are over 15. And I
 14 won't use my full 15, but I do have a little bit of cross. I
 15 will try to be very brief.
 16 THE COURT: That's fine.
 17 (Pause, diagram copy made)
 18 MR. CARY: Just for the ease of the record, I will
 19 take the Xerox of this and have it prepared in an exhibit
 20 form that is a little more manageable than the printout that
 21 comes out of the machine.
 22 THE COURT: All right. Just take exactly that as
 23 it looks.
 24 MR. CARY: Exactly how that looks and put it on a
 25 real piece of paper instead of the shiny stuff.

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1 THE COURT: All right.
 2 CROSS-EXAMINATION
 3 BY MR. KEMPF:
 4 Q. Professor Warren-Boulton, let me hand you up something I
 5 have identified as 9012. And I will give the Court a couple
 6 of copies.
 7 MR. CARY: Your Honor, I will object to the ground
 8 this subject was not touched upon in the rebuttal case, and
 9 therefore it is beyond the scope of direct.
 10 MR. KEMPF: It is beyond the scope of direct.
 11 You asked me the first day we were together if we would be
 12 sticky about holding people to direct, and I assured you I
 13 wouldn't. I thought we had a sauce rule.
 14 And what this is is something that I picked up from
 15 Mr. -- or Dr. Warren-Boulton the other day at the end of his
 16 examination, when I said, Let me take a peek at your notes.
 17 If I can cover this.
 18 THE COURT: I will let him do it for a couple of
 19 minutes in this area. Go ahead.
 20 BY MR. KEMPF:
 21 Q. These are some notes I saw you making on the witness
 22 stand the other day when you were testifying. Do you recall
 23 these?
 24 A. I certainly recall this piece of paper, yes.
 25 Q. And if I take a look at the first page and I go over to

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1 where you had, where you had testified about 6.68 expected
 2 price increase -- do you see that on the bottom column, the
 3 last number? I am sorry, middle column, last number?
 4 A. Yes. I see 6.68, yes.
 5 Q. And then when you were recalculating up there you came
 6 up with something less than 5 percent. It looked like 4.45
 7 percent to me; is that correct?
 8 A. No. Actually, that is not even my handwriting.
 9 Q. Whose is that?
 10 A. Sergar Delkar.
 11 Q. Who is he?
 12 A. He is an economist at Micra.
 13 Q. And he came up with the 4.45?
 14 A. No. He was looking to see what result you would get if
 15 you assumed a 10 percent discount rate.
 16 Q. If you're assuming a 10 percent discount rate, you get
 17 4.45?
 18 A. That is correct. As I said, between 10 and 20.
 19 Q. Let's go over to the chart over there. See the first
 20 column?
 21 A. Yes.
 22 Q. I believe that you testified --
 23 MR. CARY: Your Honor, I would object to the
 24 introduction into evidence of this document, with a cover
 25 sheet prepared by Mr. Kempf that doesn't look like

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1 Dr. Warren-Boulton's handwriting.
 2 MR. KEMPF: I am happy to change that sticker and
 3 put it on the second page.
 4 THE COURT: Thank you.
 5 BY MR. CARY:
 6 Q. The first column, competition effect?
 7 A. Yes.
 8 Q. That is in the overlap markets, I believe you said?
 9 A. That is correct.
 10 Q. Now, the second column, the efficiencies, those are in
 11 all markets; isn't that correct?
 12 A. That is correct. I tried to make that very clear.
 13 Q. So that if you were to redo that chart and say, let's
 14 look at the overlap markets -- excuse me, the non-overlap
 15 markets, what you would have is you would have no Column 1:
 16 is that correct?
 17 A. That is correct. But I think Column 2 would be
 18 different as well.
 19 Q. Well, my point is there would not be a Column 1: is that
 20 correct?
 21 A. That is correct.
 22 Q. All right.
 23 A. At least not now.
 24 Q. I understand.
 25 A. I mean, next year -- as I think we sort of pointed out,

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1 these markets --
 2 Q. The answer is no, I take it?
 3 A. I am sorry. Was the answer tomorrow no? The answer is
 4 no, tomorrow. That is correct.
 5 Q. I take it the commercial you are trying to give is if
 6 there is more overlap stores in the future, there would be
 7 more Column 1s. Is that the gist of what you are trying to
 8 sneak in?
 9 A. I am trying to give you an accurate answer, sir.
 10 Q. Mr. Cary will pick those things out.
 11 You said during your direct testimony that everyone
 12 said that prices would go up. Why, even Mr. Stenberg said
 13 that. Do you recall that?
 14 A. That is my recollection.
 15 Q. He didn't say anything like that, did he?
 16 A. I think he said that --
 17 Q. No. No. Answer my question first. He didn't say
 18 anything like that, did he?
 19 A. I don't have a quote from him, no.
 20 Q. Were you here when he testified?
 21 A. Yes.
 22 Q. Do you remember the last thing I asked him is what would
 23 happen to prices, and he said they would go down?
 24 A. But you are not talking about the number.
 25 Q. No. I am talking about what you said he said. Don't

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1 you remember my last question is what would happen to prices,
 2 and he said they would go down, and they would go down in
 3 every single market in the country?
 4 A. Yes.
 5 Q. All right. When you are talking about the pass-through
 6 analysis, that was on the 30 SKU out of 7,000 analysis,
 7 wasn't it?
 8 A. That is correct.
 9 Q. Now, let's take your column over here and let me sort
 10 of -- do you see that? Look at the top line there. This is
 11 one that we don't have a 7.5 on it. But I think what your
 12 testimony is, is that there were -- you know, late-changing
 13 news from Dr. Ashenfelter said that the final column ought to
 14 be about 7 and a half. Do you remember that?
 15 A. Again, my previous exhibit said 7.6. But we could make
 16 it 7.5.
 17 Q. It is changing all the time. All I am saying is the
 18 chart doesn't have a 7.5, so I will work with these numbers.
 19 And I gather what your testimony is, what you show
 20 over there, is if you took any of the other columns and
 21 applied the second column to it, why, the price change would
 22 be even lower than the small price change shown on here.
 23 Isn't that the implication of what you drew up there?
 24 A. I am sorry. You lost me there.
 25 Q. In other words, if we took Column 6, which is now --

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1 A. I am sorry. I was looking at.
 2 Q. If you look at Column 6 on the monitor, 3.7?
 3 A. Yes.
 4 Q. And what I gather your testimony is, if you took this
 5 column of Dr. Ashenfelter's and applied the efficiencies
 6 analysis, you would come up with 3.4 instead of 3.7. It
 7 would be lower; right?
 8 A. It would certainly be lower.
 9 Q. That would be true of every column on here, wouldn't it?
 10 A. That's true.
 11 Q. Now, there was a comment here -- I think it was by
 12 Dr. Ashenfelter -- that a number like 11 that Mr. Hausman had
 13 on the first column or 14 like he had on the final column,
 14 that is a pretty good T square. If you will back up a little
 15 bit, you will see that that is a T square number.
 16 Can you un-zoom me a little bit? Keep going. We
 17 are getting there.
 18 A. T statistic.
 19 Q. See, it is a T square?
 20 A. Yes.
 21 Q. And he said that you know, 14 number -- anything over
 22 two means that it is statistically significant. Do you
 23 recall that testimony?
 24 A. At the 5 percent level, yes.
 25 Q. And when you get these high numbers like 14 or 11, those

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1 are like million and one shots. Do you remember that
 2 testimony?
 3 A. That is correct.
 4 Q. Okay. Let's go to column 3. You can zoom in a little
 5 closer Mr. Gidley.
 6 I take it what the implication of that is, if these
 7 numbers like the 3.7 figure in Dr. Ashenfelter's sixth
 8 column, or the 3.6 in his fifth column, or the 3.3 in the
 9 fourth column, or all -- or the 2.5 in the third column,
 10 those all have pretty hefty T square numbers, don't they?
 11 A. They are T statistics. But what that is saying is that
 12 they --
 13 Q. Do they have large T statistics, is my question?
 14 A. They have very large T statistics.
 15 Q. That is the only question I am asking you. Thank you.
 16 Now, the other thing is you had said that everybody
 17 said that this competition effect would occur, but for
 18 efficiencies. They testified a little more than that.
 19 Didn't Dr. Hausman say actually there were two things?
 20 A. Can you refresh my memory?
 21 Q. Well, I'm asking you. Don't you remember he said there
 22 were two things?
 23 A. Two things?
 24 Q. You said there were two things that would impact that,
 25 one being efficiency. Didn't Mr. Hausman say there would be

1 two things that would impact it, one being efficiency and the
 2 other being --
 3 A. Pass-through?
 4 Q. No. How about try "entry"?
 5 A. Yes.
 6 Q. Didn't he say that?
 7 A. And that is what I have tried to deal with in the
 8 Wal-Mart issue.
 9 Q. When you put that up there, you said everything except
 10 efficiencies. And the actual testimony is everything except
 11 efficiency and entry. Isn't that correct?
 12 A. I'm sorry. I was trying to be very clear. When I was
 13 talking about the Wal-Mart, what I was saying is that the one
 14 thing not taken into account there is an issue such as
 15 Wal-Mart changing the nature of what it is doing. That is
 16 why I discussed Wal-Mart.
 17 Q. But entry by anyone is important, isn't it?
 18 A. Entry is always important.
 19 Q. And it doesn't matter who it's by, does it?
 20 A. It could matter who it was by.
 21 Q. Well?
 22 A. For example, if I entered the office super supply
 23 business, I don't think it would --
 24 Q. You're correct on that.
 25 A. Thank you. Once again we reached agreement.

1 year after year. And not only that, they increase over time.
 2 as Mr. Painter's analysis has shown?
 3 A. The question is whether the price effects would --
 4 Q. No. The question is whether the efficiencies are one
 5 shot or continue on over time, and indeed get bigger over
 6 time?
 7 A. I really don't have any particular view as to whether or
 8 not those efficiencies are likely to grow or not.
 9 Q. Let me carry you back. Let me put this up here. This
 10 is the last thing we looked at this part right here. This is
 11 Mr. Painter's exhibit, do you recall? I think you were in
 12 the courtroom?
 13 A. Yes.
 14 Q. And it talks about a percentage as against sales. Do
 15 you remember Mr. Curran walked him through 3 percent times 15
 16 billion dollars as 483 million, I think was his number?
 17 A. Yes.
 18 Q. Sort of a robust number?
 19 A. Large.
 20 Q. And the sales won't be 15 billion. This year they are
 21 up from 10 billion to 15. Isn't it anticipated, and don't
 22 you expect that the combined company sales will be, instead
 23 of 15 next year, maybe 17, maybe 20. And then maybe 25. So
 24 that we apply 3 percent efficiencies against the number over
 25 time, the amount of the efficiencies in terms of -- may stay

1 Q. But entry that is real by someone that knows what they
 2 are doing is significant as long as there -- it may be more
 3 significant if General Motors or IBM decides to enter it, but
 4 entry that is real and provides pressure is always a welcome
 5 thing and always has an impact, doesn't it?
 6 A. In general, yes.
 7 Q. You talked about the competition effect. Didn't
 8 Dr. Ashenfelter testify that he didn't know whether that was
 9 sustainable; that it might be a one-shot event under his
 10 analysis?
 11 A. That would seem reasonable.
 12 Q. All right. Now the efficiencies. You know there is
 13 evidence that the efficiencies will go on year after year
 14 after year, and indeed increase over time, even under
 15 Mr. Painter's analysis?
 16 A. I am sorry. When you meant a one-shot on the prices,
 17 you meant they would go up and come back down again?
 18 Q. I said that he said that he didn't know beyond that.
 19 There would be an immediate one-shot one, and he didn't know
 20 if it would be sustainable or not.
 21 A. I think in terms of -- it seems reasonable to me they
 22 would -- in fact, my testimony has been.
 23 Q. I am asking you -- I have moved beyond that. You
 24 already testified to that.
 25 I am now asking you on efficiencies. Those go on

1 the same percentage year to year, but in terms of dollars it
 2 increases year to year. Is that fair?
 3 A. These are all in percentage terms.
 4 Q. But the efficiencies are not only what they are, but
 5 they increase over time?
 6 A. I think that --
 7 Q. Is that correct?
 8 A. I have no idea if the increase --
 9 Q. Is that the implication of Mr. Painter's chart here?
 10 A. I think you would have to ask Mr. Painter.
 11 Q. When you look at it, let me ask you this, is 3 percent
 12 of 200 higher than 3 percent of 100?
 13 A. Yes.
 14 Q. And if the 3 percent figure is correct and the sales
 15 increase, won't the amount of the efficiencies increase from
 16 year to year?
 17 A. The dollar value would, necessarily. Yes.
 18 Q. All right. Now, let's go back to this for a minute. In
 19 looking at a merger you care about all consumers and the
 20 impact on them, don't you?
 21 A. Personally?
 22 Q. Yes.
 23 A. Yes.
 24 Q. Now, let me jump forward to the next one. Let me see if
 25 I have any questions on this, and then I will jump forward to

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1 the next one and we will be done.
 2 Now, you see your first three charts there? I
 3 mean, your first three bars there; the three and then the two
 4 two-firm markets?
 5 A. Yes.
 6 Q. And you see how you have the two two-firm markets above
 7 the three-firm market?
 8 A. Yes.
 9 Q. And in fact, if you look and compare the first bar with
 10 the third bar, you see how you have the Staples, Office Depot
 11 bar higher than the markets where there is Staples, Office
 12 Depot and OfficeMax, according to your drawing?
 13 A. Yes.
 14 Q. Actually you concluded at one point in your work on this
 15 case that that bar is actually in the wrong place, didn't
 16 you?
 17 A. I think you will have to explain.
 18 Q. Didn't you conclude that the average prices appear to be
 19 somewhat higher in markets where Staples and Office Depot and
 20 OfficeMax are present, than markets where only Staples and
 21 Office Depot are present?
 22 A. I think those are the simple averages, yes.
 23 Q. Based on your conclusion that you reached, that chart is
 24 drawn wrong, isn't it?
 25 A. No. As I tried to be careful when I explained this,

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1 that that chart is an attempt to ask all -- holding all else
 2 constant: Holding constant local cost conditions, holding
 3 constant the level of competition from the other firms, it is
 4 the caeteris paribus. It is holding all else constant. What
 5 you do with an econometric model, you know, what are the
 6 price differences between three-firm, two-firm and one-firm
 7 zones? If you look at the simple averages, not holding
 8 constant for those, you can get variation there.
 9 Q. You have the Staples/Office Depot line. In fact, you
 10 can see it above the red line here; right?
 11 A. That's right.
 12 Q. And that is way above the blue line over in the
 13 three-firm market; right?
 14 A. Yeah. The econometric results are that it is above.
 15 Not a great deal above, but yes.
 16 Q. And the conclusion you reached is that the average
 17 prices appear to be somewhat higher in the markets where
 18 Staples, Office Depot and OfficeMax are present than in
 19 markets where only Staples and Office Depot are present?
 20 A. Those conclusions are based on, as I stressed, simple --
 21 just simply comparing zone averages from the documents. But
 22 that is what you criticized. That is why we wanted to do an
 23 econometric model was to handle that sort of problem.
 24 Q. Let me turn to the efficiencies, and that is the last
 25 thing I want to cover.

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1 Now, the reason that Wal-Mart checks Staples and
 2 Office Depot and OfficeMax is because Wal-Mart views Staples
 3 and Depot and OfficeMax as competitors in the sale of office
 4 products. Isn't that right?
 5 A. That is correct.
 6 Q. Now, wouldn't you agree that where companies monitor the
 7 prices of each other and react to changes in each other's
 8 prices, that that is an indication they are significant
 9 competitors?
 10 A. It certainly would be consistent with their being
 11 competitors. How significant is an empirical question.
 12 Q. Now, in comparing SKUs, and in comparing companies that
 13 are selling office products, if you want to compare the
 14 number of SKUs each are carrying so you can say how many SKUs
 15 does this one have than the other one, you want to do an
 16 apples-to apples comparison, don't you?
 17 A. I assume, yes.
 18 Q. And if one person has some of the things that the other
 19 one counts as office products, parked over somewhere else,
 20 whether it is in the electronics department, a battery
 21 department or computer department, whatever, if you were
 22 doing a company-to-company comparison, you would want to move
 23 those over and add them to the tote, so you get an
 24 apples-to-apples comparison, wouldn't you?
 25 A. Not necessarily, but you can do that.

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1 Q. Why would you not necessarily want to do that?
 2 A. I think, as I have said in my direct testimony, trying
 3 to mine a great deal of information by looking at SKU counts,
 4 it is difficult and not all that rewarding process. We can
 5 all think of examples in which you can count SKUs, in your
 6 term, to apples to apples, and come up with all kinds of
 7 strange SKU counts. I think the purpose of counting SKUs or
 8 identifying things like what people consider to be their
 9 competitors is to establish a provisional market. Who is
 10 likely to be -- who should you look at? Who should you
 11 expect that are good candidates for being in a provisional
 12 market if you want to expand to arrive at your market
 13 definition.
 14 And the more different firms look, the more
 15 different the products look, you know. The less likely you
 16 are to say those are firms that are similar.
 17 Q. Let me just ask you in terms of three simple things.
 18 A. Yes.
 19 Q. Suppose over at Office Depot and Staples, they count as
 20 office supply, consumable office supply SKUs, toner,
 21 batteries, and disks. Okay?
 22 A. Yes.
 23 Q. Now, if you are comparing them to somebody else in terms
 24 of their SKU count of consumable office supplies, and that
 25 other person has those three other, those same three products

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1 but in a different department, you want to move those over
 2 and count them in their SKU count to get a fair comparison,
 3 don't you?
 4 A. You can do that.
 5 Q. No, no. Don't you want to do that to get a fair
 6 comparison?
 7 A. I don't think that would be unreasonable.
 8 Q. I didn't ask you whether it would be unreasonable. I
 9 said if you want to do it fair, isn't that the way you do it?
 10 A. Fairness is not an economics concept. (Laughter)
 11 MR. KEMPF: Your Honor, I will take that answer and
 12 move on. Three last questions.
 13 BY MR. KEMPF:
 14 Q. Evidence that larger firms have lower unit costs would
 15 help corroborate specific efficiency claims, wouldn't it?
 16 A. Yes.
 17 Q. All right. Second, the past merger experience of the
 18 merging firms or other firms in the industry can be a source
 19 of evidence indicating the validity of claimed efficiencies,
 20 can't they?
 21 A. The past measure of experiences with respect to
 22 efficiencies? It could be. If you believe that you were in
 23 a similar position to where you had been in the past, yes.
 24 Q. And evidence the past mergers reduced unit cost would
 25 support a claim of efficiencies; isn't that correct?

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1 A. Yes.
 2 MR. KEMPF: I have no further questions, Your
 3 Honor.
 4 THE COURT: Redirect, Mr. Cary.
 5 REDIRECT EXAMINATION
 6 BY MR. CARY:
 7 Q. Mr. Kempf characterized some testimony by Professor
 8 Ashenfelter. You didn't take Professor Ashenfelter to be
 9 saying the price effects on this transaction would go up and
 10 then back down, did you?
 11 A. No.
 12 Q. Would you expect the price effects to be sustained for
 13 some period of time?
 14 A. In fact, as I think I have testified, I would expect
 15 them to be intensified. That 7 and a half percent or
 16 whatever number would come out of this model basically
 17 assumes that the future is -- can be predicted by the past.
 18 And as I think I said on my direct, there are a
 19 couple of things copying up on the horizon which would seem
 20 to me to indicate that the effects of this merger are likely
 21 to be more severe if you compare the world with merger and
 22 the world without the merger, and you say that difference
 23 will be 7 and a half percent based on the experience over the
 24 past 20 months. If you project what you think is happening
 25 in this industry and where it is going, and you ask how big a

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1 difference will the merger have made in two to three years, I
 2 would say that the difference is likely to be greater than 7
 3 and a half percent for the reasons that I outlined. Which
 4 is, first of all, facility overlap amongst these stores is
 5 increasing. Indeed, there is some evidence that impact is
 6 the impetus of this merger.
 7 And secondly is the finding both in the documents,
 8 in the financial reports; and most interesting, even has been
 9 confirmed in the econometrics analysis. As markets approach
 10 saturation, that competition amongst the office superstores
 11 intensifies. So that at the moment, you know, there is a 7
 12 and a half percent difference depending on the level of
 13 competition. Once they eat all of the little fish in the
 14 pool and turn on each other, that 7 and a half percent is
 15 likely to be -- you know, competition among the superstores
 16 is likely to become more important.
 17 If I am asked the question if I am looking forward
 18 into some sort of "but for" world, what is the effect of
 19 merger and no merger in terms of the price of office
 20 supplies, I would say that while the immediate estimate might
 21 be 7 and a half percent increase, if we look forward into the
 22 year 2000 and comparing those two rules, that number is
 23 likely to grow rather than shrink. But then there is the
 24 possibility of Wal-Mart, and these are balancing factors that
 25 you have to take into account.

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1 Q. Mr. Kempf also asked you about the expected growth in
 2 the efficiencies over time. Were you in the courtroom when
 3 Ms. Shira Goodman testified?
 4 A. Yes.
 5 Q. And Ms. Shira Goodman was the Defendants' witness on
 6 behalf of efficiencies; is that right?
 7 A. Yes.
 8 Q. Isn't it true that Ms. Shira Goodman has written that
 9 the relevant advantage of NEWCO's sale versus Staples or
 10 Office Depot would only decrease rather than increase over
 11 time? Do you see that on the diagram for defendants?
 12 A. That is what is on this document, yes. In other words,
 13 in a sense that's what you expect to see. Most industries
 14 have scale economies up to a certain level. As you increase
 15 the scale of output, your average costs fall for a host of
 16 reasons. For most industries they then flatten out. And
 17 indeed, in the vast majority of industries you start getting
 18 diseconomies of scale. In other words, costs first fall with
 19 output, and they remain constant with output for a while, and
 20 then they start to increase with output. And that is why we
 21 have businesses of all sizes.
 22 There is only one situation that I know of that is
 23 described in economics that is a situation in which scale
 24 economies continue indefinitely, and those are called natural
 25 monopolies. They are industries in which scale economies are

1 that don't deserve it. So we thank you all for the work.
 2 We will be back for the closing arguments on June
 3 5th, I believe. Thursday at 9:30. Two hours apiece. If you
 4 want to reduce that or add to that, you give me a call and we
 5 will talk that over. Right now we will leave it at that.

6 Thank you.

7 THE DEPUTY CLERK: All rise.

8 (Which were all proceedings
 9 had at this time.)

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CERTIFICATE

14
 15 I, PATRICIA J. YERKES, RMR-CRR, do hereby certify that
 16 the foregoing transcript constitutes a full, true, and
 17 correct report of the proceedings which then and there took
 18 place.

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PATRICIA YERKES, RMR-CRR

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