Office Depot

RETURN TO ARBITRAGE
DEPT. FILES

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

THE COURT: All right. Ready to resume, sir?

MR. KEMPF: I am, Your Honor.

THE COURT: Thank you.

MR. KEMPF: We were talking about competitors and their impact before we broke for lunch, Your Honor. I would like to return to that subject, and specifically I would like to return to Wal-Mart.

THE COURT: When you do that, you included in the discussion the evidence that Mr. Cary has been arguing about, and that is that if you consider some of these, and he talks about the clubs as being competitors, and we consider the whole gamut, assuming they are competitors, do they operate still or not to constrain the prices of Staples and Office Depot?

MR. KEMPF: I was going to actually close on that point, Your Honor.

THE COURT: As long as we get to that point.

MR. KEMPF: I won't forget it.

THE COURT: Go back to Wal-Mart.

MR. KEMPF: Okay, back to Wal-Mart. I will be inferentially addressing it all of the way through, Your Honor. I will address it head on, if it is the last thing I do.

Now, let's take a look at Wal-Mart. Silent killer, Mr. Cary referred to them as. That is not something litigation-driven we made up. If you go back to Mr. Mandel's speech of 1990, he called them the silent killer and the first witness that used this term was their witness, Mr. Atkinson from BJ's.

Mr. Assaf said, Have you referred to them as the silent killer? He said what does it mean? They think they don't compete with you. And the next thing you know, they steal away your business. So, that is recognized in industry. Nothing litigation-driven about that, Your Honor, as their own witness testified to.

Now, there was this big dispute while the FTC's · declaration and our declaration, and I think we explained those were two FTC declarations. Did we put the second one in evidence? You bet we did, Your Honor. And the reason we did, is because Wal-Mart gave a second declaration before they would ever say hello to us.

When I talked to Ms. Stroud on the phone, she said, I don't want to feel uncomfortable talking to you. You are a competitor. In any event, let -- what you get when you look at the Wal-Mart story, Your Honor, you get not only the Wal-Mart story, you get an instructive insight into the whole process of the so-called impartial investigation that the FTC does that is neither impartial nor investigation. It is a preconceived witch hunt. And what they do, they go out to people and they say, in all of the declarations, it starts with in lieu of a subpoena, they go out and say to these folks, we are from the Government. We have this subpoena power we can use on you. But it is an investigation we are doing. And if you will just give us a declaration here, why, we won't have to exercise our subpoena power. And so they do. And it is just an investigation, so they get what is the PX 174. And in that one, Wal-Mart's primary competitors are not the office supply superstores. And I believe that the superstores, Staples, Depot, and Max, are each other's primary competitors and not firms like Wal-Mart.

Then, all of a sudden, it becomes a public proceeding and the Wal-Mart folks, say, Gee, if this is public, we better go back and look at what we said here. It will be out for God and everyone to see now. They go back and on their own motion, not falls by the wayside, and all of a sudden, Wal-Mart's competitors in specific categories like office supplies, would include specialty retailers, like OfficeMax and Office Depot.

Before you go to the next one, do you have the Helford thing here? It is another insight into the whole declaration process. Let me put that up there in a second.

They go out and talk to these folks. And, they would ask them, the one side of the story -- didn't ask them the full factual picture. And if some of the people stepped up to the plate and volunteered and said, Well, let me tell you, let me send you back your draft declaration. And Mr. Helford's was particularly instructive. He took the time to go through and make a line-by-line edit. At one point he said, he edited out something from the declaration. He was very careful. He didn't just edit out though, he put in some language that is powerful that he didn't overlook. When he edited theirs, he sent them back and said here are all of my line edits, and here is something that really captures everything, and I would like you to add this in here. You can find this at DX 855 and also at DX 960, Your Honor.

Finally, I believe that a merger of Staples and . Office Depot will intensify competition for office product sales. The merger may also pressure and harm manufacturers of office products as they lose business due to consolidated lines by the merged company and/or exceed to greater allowances to gain the businesses.

That is actually like that one letter you circulated to us last week where the one supplier said, Whoa, this will pinch me something fierce. Then, as he continues on, focusing on precisely that fact that he alludes to here, but the actual customer will likely benefit with even lower prices and greater services due to intense competition. This is one of the ones I referred to in the opening that found its way to the waste basket. We have no FTC declaration from

Mr. Helford because when they found out what the facts were from him, they said no need for a declaration from you.

We don't want those facts. So his time spent with them never gets reflected, other than we found it later. But we got Tinkers to Evers, we said let's go for Chance here. We said, we are going to mark this as a DX. But this is not something that we benefited from our discussion with them. And if they won't talk to us, fine; we will depose them. And so we did. We deposed four people at Wal-Mart. Two from Wal-Mart, two from Sam's. And all of a sudden the story ripens a little further. We do get Tinkers to Evers to Chance, or as we used to say when I was a kid growing up, . Micksis to Smalley to Addison Avenue.

But when we took Long's deposition, all of a sudden we get the testimony, and the reason Wal-Mart price-checks Staples, and Depot, and Max is because Wal-Mart views Staples, Depot, and OfficeMax as competitors in the sale of office supplies? Answer, yes. And then we took Mr. Glass, the CEO of Wal-Mart's deposition, the same thing. Do you consider Staples to be a competitor of Wal-Mart in the sale of office supplies. Yes. Same thing for Depot and same thing for Max. That is their view of competition. As it ripens from FTC drafted language to actual witnesses talking when you ask them questions point-blank.

Same thing on expansion. The first one, the first

Long declaration, it says, If prices were to rise at Staples, Wal-Mart would not add additional office supplies. The second one becomes, well, Wal-Mart would not necessarily add additional supplies. Then, we get into the picture and we say, okay, let's ask the guy. And so we sit here and we say, "As we sit here today, you can't say one way or the other whether Wal-Mart would consider expanding the number of SKUs for office supplies in response to any market forces over the next few years?" Now, you get the full answer from Mr. Long. "Any time we would see an opportunity, we are going to be considering every aspect. I can't tell you that definitively, definitely over the next five years we wouldn't do anything; we are constantly changing." That is the fuller picture.

When you go to Mr. Glass, it says, "Mr. Glass, based on your understanding of Wal-Mart, is Wal-Mart able, next year, to add even more office supplies to its customer place, if the sales justify it? And is Wal-Mart able to expand space that is now dedicated to office supplies?" "Yes."

And now this is part of the competition between them, Your Honor. This issue on the number of SKUs. When it comes to the key SKUs, not the odd items, but the key SKUs, when you turn to the key SKUs, first of all, everybody on the shop list carries the key SKUs. The old 80/20 rule of operation. When you go there, you find 34 kinds of file folders at this particular Wal-Mart SKU. 33 kind of Post-it notes.

Actually, Mr. Smith and I did a count last night of the Post-it notes at the Wal-Mart. There were more than 60 SKUs of Post-it notes at that Wal-Mart. There was some with hearts on them, every kind of SKU of Post-it notes hanging there. Twelve rows across and six rows down.

Now, if you are looking for, as Matt Scanlan put it, if you are looking for polka-dot ones, maybe ours isn't the place to go. But if you are looking for file folders and you say to yourself, I don't need 60 SKUs to look at. If . they have 34 different kinds of file folders, that is plenty for me. So, we may carry more SKUs, but the issue is, do they carry ample SKUs to provide vigorous competition; and the answer is yes, Your Honor.

In any event, let's go to pricing next, and we will start off with the declarations. Here it is the dog that doesn't bark, the Sherlock Holmes thing. Something starts to disappear. The first one says, Wal-Mart's pricing policies attempt to match the superstores on the same items that are carried at Wal-Mart. Wal-Mart, however, does not attempt to price below the office supply superstores.

Version number two. The second half falls out of there. That is on their own notion, before we talk to them, so it is gone. We said, Well, I think we see something that maybe is a little bit more to the story than that. And so we go full circle on it, and we asked them about it at deposition. Mr. Assaf says, Based on Wal-Mart's pricing philosophy and the view that Staples, Depot and Max are Wal-Mart's competitors, Wal-Mart tries to beat Staples, Depot and Max for office supplies, doesn't it? Answer, yes.

Now, what is over here on the far left, when you ask him, straight out, yes, we have a sign on the outskirts of our building, we sell for less. Actually the one on the driveby says, "We will not be undersold." That is the one that you will see over on the Wal-Mart there.

And then Mr. Glass, Sir, I want to show you what has been marked as DX 582. That is an in-store item from Wal-Mart that has their price, ours on it, and it shows that they are selling their thing cheaper than Staples in this instance. So he was shown that. He was asked,.

"Q: What is your reaction in fact that Wal-Mart has lower prices on a printer than Staples?

"A: I would expect us to have as low or lower prices than our competitors." That is the Wal-Mart declaration.

Now, let's turn to constraints for a minute. Both of them say the same. They made a big deal out of this. Wal-Mart cannot prevent the merged firm from raising prices.

Same thing in the second version of the FTC declaration.

Now, what I think of here is one of the witnesses you asked about this morning, Mr. Segall. They said to him, Now, they can't prevent him, can they? And he said, No, of course not, it is a free country. People can do whatever they want to do. And he said, a lot of people have tried it. This goes back to the silent killer point. I think his words were something like, and the graveyard is full of people that tried it. That is the silent point, Your Honor, coming full circle.

And in their papers they have a disingenuous quote from Mr. Segall. I think they say something like, he grudgingly conceded they couldn't prevent it. I think he did more than that. I think he explained and went on to explain what happens to people that tried that. The silent killer kills them and they end up in the graveyard.

Now, not content with that, we said, let's go forward with these depositions and let's ask these folks. So we said, Is there any doubt in your mind -- this is Mr. Long -- that if Staples, or Depot, or Max raise their prices, that Wal-Mart would try to take customers away from them? Answer, yes, we do. They can't prevent it, carefully phrased language over here; but ask them what happens if they try it, remarkably consistent with what Mr. Segall said he would anticipate. We would go after their business. You would want to take customers away from Depot, Staples and Max, wouldn't you? Answer, yes.

Mr. Glass, one of the questions raised by the FTC in this merger case is, What would happen if Staples and Depot raised prices after the merger? What would Wal-Mart do in reaction to Staples and Depot raising prices? We tend to view those things more as an opportunity to gain market share than additional profitability. Remarkably consistent on this side as well, and it tells a full story of the Wal-Mart situation.

Let me turn just briefly to entry, Your Honor. And I will try to respond to several points Mr. Cary made this morning.

Mr. Ledecky was proud of his immigrant heritage when he was in the courtroom. He talked about how he -- not unlike Mr. Stemberg's story. He was another young go-getter -- and nobody that saw him in the courtroom has any doubt about that -- who was looking and trying to enter this business, the selling of office products to people. And he came up with an idea, ran into a lot of brick walls, stuck at it; and now he is the fastest growing company in the District with over 3 billion dollars in sales.

And in fact, he lucked out; he made the acquisition of Mailboxes, Etc., because we couldn't get to them that afternoon. And the next day when he came in, he told us a little bit about that. He is very excited about it. And he views it as yet another opportunity to compete, another vehicle to get those customers in there. And they said -- in their briefs they say, well, they will have catalogs there. We have catalogs in our store too. And is he going after those customers? You betcha. They have this thing, they say, this is an industry nobody can enter, although everybody has in 10 years, the way they define the industry under their goofy definition of it. Then, they say, Oh, you need to have scale. Yeah, scale, that's it. And there are a lot of companies with big scale. If the opportunity was there and the pricing was attractive, certainly companies that have three billion dollars in sales of office supplies already. And this is only one of them. There is a whole boat load of them all competing in different channels. They have that volume. They have that scale. They can open up if the opportunity is there. It is the old saying, why buy a cow when milk is so cheap?

If the reason they don't enter is because prices are so rock bottom, that is not a sign that it is hard to enter, that is a sign that the companies who are serving it now are doing a hell of a good job of it. And the only thing that is deterring entry is vigorous competition, which is what the antitrust laws are all about.

Okay. Cherry picking? You betcha. Now, I won't go through the ones I did in my opening. I just want to go back to the one, and the reason I do, Mr. Cary talked about Kokomo, Indiana. And the reason I want to go back to this, you can find cherry picking right from every document they use virtually in the case. You don't have to scurry around. We produced more than a million documents. You don't have to go through all million of them to find counter examples. Usually you can find them in the very documents they have.

I looked over the lunch hour at the stuff he had up here. It doesn't refute this at all. The word for it is, if I use a single word, it predates it.

If you look at his two examples, they don't do anything to counter the thrust of what I caught them on at all. One of them deals with 1995, and both of them deal with May of 1996. These are both from November of 1996. This is not an apples and oranges comparison; he is comparing other things. And if we are having an administrative hearing, am I going to take a close look at those? You bet I am, Your Honor. But this is clear cherry picking, and it is from November of 1996, not some stuff from the prior year or May of that year.

Litigation-driven documents Your Honor? I will show you the most litigation-driven document I have ever seen. Right up here, you saw it in the opening statement. See if you can't get it up there a little better. PX 139.

If you look at their Findings of Fact, Proposed Findings of Fact, what they call this, they call this our Pricing Manual, Office Depot's Pricing Manual, capital P, capital M. This is a litigation-driven document. This is a document that is not even a real document. It is a phoney. It is a fraud. What this document actually is, PX 139, if you look at it in the record, is a draft possible price manual that a fellow did. This is the prior page to it, handwritten. And this is the document itself. Put the other one back over here, and put this one up over here.

Let me show you what they did to make a litigation-driven document. They changed the logo. See, there is no ink on it over there; they did it in red. They cleaned it up. And if you look at the paragraphs, the end of the first line on this one is "we." That comes in the middle of the second line here. This is completely retypeset to make it look fancier, more like it is a Pricing Manual, instead of a draft document. Then, what they do, is they blowup one paragraph, bring it down here, and cover over the paragraph below it so they can feature a few things.

Now, the one of the things -- do you have the testimony? Nobody ever saw this. Nobody read this document except the guy that wrote it. Mr. White was deposed about it and he says,.

"Q: Was this document ever approved in any way by superiors to you?

"A: No, it was not. I did turn it over to Tom Smith for initial review and to the best of my knowledge Tom never got a chance to review it before he fell ill and later passed away. The only guy that ever got this other than the author died before he read it.

"Q: Was it circulated to anybody other than Tom Smith?

A: No, no one." Draft of a possible retail pricing memorandum, handwritten cover. All of it becomes -- it becomes the company's official Pricing Manual. And the way -- no. No. The way they get it to look like the official Pricing Manual, they change the type face. Talk about litigation-driven documents. It is an outrage, Judge. Let's take a look at what the drafter had there that they conveniently covered up there when they prepared this litigation-driven document. If you take the actual one, it says the main competition -- it is consistent with the paragraph that is blew up -- it says the main competition that we as a company recognize officially are those that we call the superstore competition. Next sentence -- very interesting, at this time we recognize Staples, Max, and Best Buy as office superstore competition. On the lesser scale, we also recognize PriceCostco and Sam's Wholesale Club. Those all of a sudden are the superstore competition in his draft manual in the part that you can't see. Then it goes on and says, We do not shop the clubs for the pricing of catalogs, but we compete against them for on weekly-shopped items. It goes on and talks about Canada. And then he says, In both the United States and Canada we also face a host of national and regional competition. We compete against, and he has a long laundry list, and he sees these competitors influence our pricing. Don't constrain? Right in this document that they made a big deal out of and elevated into our pricing manual, these competitors influence our pricing, and we react to their advertised retails and any price matches under the low-price-guarantee program. That is something that I talked about earlier on the Staples side. Here is an example of its impact in the marketplace in operation over at Depot.

Okay. I said earlier, Judge, the most important document in my view in this case is DX 1909. It is not litigation-driven. It was the first document that ever existed in this industry. Mr. Stemberg wrote it back in 1985, when there were zero superstores in the United States, not in any market, but zero in the United States.

If you compare it, Your Honor, what you will find is it reads remarkably like the Findings of Fact that we submitted to you. Nothing litigation-driven about our story at all. It is the way the company was founded, the way they operated for 10 years; and the way they will operate in the future. Not a faith; a proven track record. I don't have to rely on our promises or anything like that. And you go all of the way through, Your Honor, and you start off with the lower prices on the screen on the right.

Staples, the office superstore, everything will be cheap. Our Findings of Fact, the low price approach revolutionized the selling and pricing of office products throughout the industry and across all formats.

If you look at some of the Viking and Quill exhibits, for example, their own documents, Jack Miller who is the head of Quill does an annual industry report, some of which are in the record and those have statements about how it drove down the prices of the mail-order firms as well.

Prices at 37 to 50 percent off, conception in his mind are finding what they have done, savings 30 to 60 percent. Over on this side, lower shifting from pricing to cost. Most serious threat would come from an inability to generate sufficient volume; we have to do that. And the Findings of Fact is, how do we do that? We purchase to try to get our costs down low.

Again looking to the right screen again. Volume. We have to drive volume. Our greatest challenge, to change the behavior of consumers. The magnitude of savings which range from 30 percent will be the principle tool. That is how we will get that volume. Our Findings of Fact. The office products business is driven by sales volume to make up for low margins. The name of the game in this business is to increase one's volume of business.

Our story is consistent now with what it always has been. Strong competition. These people don't really compete; this is all litigation-driven. He saw the same competitive landscape when he was going around to his investors in 1985, as we are telling you, Your Honor. It is the same exact story. The advantage of the discount stores is one-stop shopping for someone buying other goods. I think I said that earlier today, and you will find it in our findings as well.

Lower prices than mail-order houses. We will be at a disadvantage regarding delivery and credit. Something in our findings, and again something I covered earlier today.

Wholesale clubs. Competition to be reckoned with. Our finding, wholesale clubs would respond to superstore price increases and would welcome the opportunity to take away customers. And the same throughout the whole exhibit, Your Honor. That is why I spent so much time with it. It is not litigation-driven; it is bedrock. It is where the whole industry is founded. It is wholly consistent with our story. It is, indeed, it is our story. The PX 3 is their story. The realities in the marketplace driven by that are ours.

Let me turn to our old friend PX 3, Your Honor. Let me start with the obvious. If this was the world, there would be four price zones. Everybody would have four price zones. The reality is, Depot has 55, Max has 70, and Staples has about 40. And that, what that reflects, is there is a lot more going on in the world than just these four competitors.

Now, we have never said and do not say now that the Staples, Depot, and Max companies are irrelevant to each other. That has never been our position, and it never has been, and in our findings that is confirmed.

I will direct your attention to 331, and 332; it sets forth our position on that. What we say is, it is one of a host of factors. In fact, if you open a second Staples store in an area, it impacts your pricing. It is the old quantity, price interplay. If you increase the quantity, the only way you can sell it is by having an impact on your price. All additions to quantity, from whatever source, impact the pricing, by definition.

Now, one thing Mr. Cary said this morning, he said -- and I want to get his quote this morning and from his opening. He said, if you look at all of the backup behind the one on the right there -- this is behind tab B, the one for Staples or the one behind tab B. He said in his opening, over time, again from each of the time periods where they gave us information, the picture remains constant. This morning what he said to you is, they are remarkably consistent. I am not going to go through the ones I did during my opening, Your Honor. But I kept looking at this thing and the longer I look at it the squirrelier it becomes. They use different ones to show different things.

They had one up here this morning, Mr. Cary did, where he said look at this. Max's pricing is always higher. You can flip back a few pages further and say here is one -- the Depot/Max area is the yellow one. Look, the yellow bars are always high compared to the green and the blue. That is the one he showed you, and you can find that in the book of exhibits that he gave you. You can say remarkably consistent. You can flip over to the page and find exactly the opposite. You can find a spot where Max pricing is lower than three players, and lower than Staples/Depot.

And you can also -- stay on the one on the left for a second there. The other thing you look at when you look at this one, is Los Angeles, where there is only two players. Let's take two California markets. San Francisco has six percent higher prices than Los Angeles, although there are three superstores in San Francisco, and only two in Los Angeles. That tells you there are market dynamics at work that are not captured by their phenomenon.

Let me guide -- you know what I have got, I have one of those fancy laser things. Let me try it out. See, if you look over Los Angeles on the far right, where there is only two, Staples and Depot, prices are lower by six percent than if you look at another California city, San Francisco over here where there are three players, instead of two. There is obviously a lot more at work here. And while Mr. Cary highlighted a particular chart, he said, look at this, the yellow ones where Max is around are not constraining, they are all higher. You go a few pages later and you say here is one where the yellow ones are all lower.

Let's go to the next one on the right there. Now, this proves another point. If you look at New York here, a three-player market, and compare it to what is called non-Champaign, one of the non-competition areas over here, you find that the prices in the three-player area are higher than in the only one-player area. Now, instinctively you have a sense that everybody knows New York is a high cost area. So what this at least tells me instinctively is that, sure, these other factors are at work. Obviously cost is at work here.

Now, again, if you look at this, again the Max zones, Depot and Max, the yellow, are lower than a great many of the three-player markets and a great many of the green Staples/Depot markets only.

Flip over to the next one over here. A couple of things are kind of interesting to me when I look at this and look for the remarkable consistency over time. I looked at Orlando on the far left and Cincinnati. And I said, Gee, look at this, Cincinnati is 6 percent higher than Orlando. Both are three-player markets is the phrase they use here. And then I also notice that the Max zones, again on this one, are lower than the Staples/Depot one and the superstores here. Many of the Max zones. So then I said, look at this over here. You shift over to another chart and you find suddenly, instead of Orlando being the low one, Cincinnati is the low one. It drops from here down to here, and Orlando goes up. One, Cincinnati six percent higher than Orlando, and the other one, Orlando is two percent higher than Cincinnati. I find a lot of inconsistencies in the charts in short, Your Honor.

This is another one. I don't remember why I picked this one, Your Honor. And given the clock is going, I will junk that one.

Obviously I found some squirrely in that one as well. I just don't remember what it was. The nonsense correlation, spurious correlations. Did I make that point? Yes, I did. It is not something I made up, it is established literature. And I will not take the time to go through it here, but this chart is there for your availability at this time. It explains precisely what I meant.

When you try to relate things that all statistics show are related, you can do that in two ways. You can say there is a relationship where none exists, or you can use an old expression. You can try to make a mountain out of a molehill. You can take something that is a minor correlation, and all of a sudden, voila, it is the explanatory explanation for everything.

And let me compare a couple of -- Jim, do you have the old Depot one? The Staples from the PX 3, tab B? This is one I made fun of during my opening. We did gather some evidence and the evidence shows that the price that Wal-Mart charges for Coca-Cola varies as to whether it is a three-superstore town, like Los Angeles, a two office superstore town like Washington, D.C., or an one-office superstore town like Bangor, Maine. This is a pricing of Coca-Cola at Wal-Mart. A similar correlation as how we price office supplies and how they price Coca-Cola, depending upon whether there is one, two, or three office superstore towns. They say, look at this. Go back to the other one. They say, look at this stairstep. We said, look at this. This is a nonsense correlation. When you put the two together, what it tells you is, it is a different correlation. What it tells you is, Bangor, Maine is not Washington; and Washington is not Los Angeles. Each is its own individual town, and I will get to that in a minute. What it tells you is that there may be a correlation here, but maybe what is correlating is a host of demographic and cost factors, other than the existence of office superstores.

I don't think the reason Wal-Mart charges more for Coke in Bangor, Maine is because there is only one office superstore there. I think the reason is there are demographic factors that influence their pricing there that make a lot of sense to them. Just like the factors that influence our pricing in some of these towns make sense to us. And is the superstore one? Sure. But are there a host of them, and is the superstore blown all out of kilter in their stuff? Absolutely, and we will come back to that.

Now, what are some of those factors? Dr. Hausman said, I will tell you what some of them are, and I will run some models to see whether I am right. First of all, you can check the number of Best Buys. And there are not many Best Buys in these markets, not many computer stores in these small markets. Not many warehouse clubs in these small markets, and that is why the pricing is different there. They are smaller, more remote. There is a whole host of factors that lead to this. And here are three of them, and these are the kinds of things when you take, when you take and put a model together that tries scientifically to take these into account, the numbers fall from these high numbers that they had in PX 3 to ones that reflect reality a little bit better.

And let us not forget that when Dr. Ashenfelter was asked during his direct examination by Mr. Cary, Did you look at the cross-sectional and these kind of models? Yes, I did. I concluded what Dr. Hausman did was the right approach to do.

Now, in my opening one of the things I had, I had a series of charts that are in the record that took for each city and colored in the line. And said, we will use blue lines for three players; green lines for two players; red lines -- same color scheme they used. Red for one player, and sort of a goldish color for no players. And I said to you, then, I want to emphasize again, Your Honor, that it is analytically more helpful not to think of this in terms of pricing in two-player markets v. pricing in one-player markets. The way that it is helpful to analytically look at it is say, I wonder how the pricing in Washington compares with the pricing in Anchorage, Alaska. Yuba City, California; Hattiesburg, Mississippi; Dover, Delaware; Muncie, Indiana. That is more instructive. You are not saying two player, one player; that has no meat on it. You are looking at real towns with real names, and you can say to yourself, of course, things are different in Anchorage than they are in Washington. I don't need Dr. Ashenfelter to tell me that. My kids know that. All right.

Now, let me cover one other point, Your Honor. Let me jump forward for a minute to the next slide, and I will come back to this one. Leave that one up on that side and leave the other one up there. Put the other one over to the other side. Let me tell you one of the good things about the merger if it goes forward, Your Honor. It will do two things. In fact, they talk about potential competition. Here is potential competition, work in the marketplace translating into actual competition.

OfficeMax's response to the merger. We will double the number of store openings. Our plans for the merger -- we are going to increase the number of store openings. And here is what we will do when we do that. We will go to Max towns where there is one player, and we will enter and it will become two players. We will go to towns where there is no player, and they will become one-player markets. And Max is actually implementing that plan, rolling it out, even as we are sitting in the courtroom. When that happens, what happens is the prime in these towns -- they made a big deal how this is our own exhibit. All of the left side exhibit is PX 3 tab B, I just reprinted it on there. That is PX 3, tab B. I added a column to it and this is the line they are missing, the zero player markets. Places like Sharon, Georgia; Anniston, Alabama; Bismarck, North Dakota. The merger will accelerate the opening of superstores there. If you were to come back in six months, you know what you will find, Your Honor? You will find this discrepancy between the two-player and one-player markets probably will be larger. And that is a good thing. The reason it will be larger, these places are more remote, higher still, and when we go to town and drop the prices there, those people are going to be happy, not upset.

You know, I remember when we had Dr. Warren-Boulton up there. And I was asking him, what is the market in places like Greenfield, Massachusetts, or these towns on the right here? And he said there is no market there. I had this picture of it is like Berlin. They have to fly in office supplies. You don't airlift supplies in there; of course there is a market for office supplies in that town. When you recognize that, you say to yourself their whole market definition doesn't make sense. What happens to round out my testimony from him, I said, it starts off until we get there all of these towns over here, there is no market there. There is no market. Where do these people get their office supplies? They get in some other market.

In any event, what happens when they come to town? They become a monopolist. I asked him, he said, Yeah, that's right. The day they open up, they are a monopolist. What is the first thing they do as a monopolist? They drop the prices. They are not a monopolists, Your Honor. They are doing two things. They are reserving powerful competition in the marketplace. And they are proving the ongoing efficiency stories, that they can drive efficiencies and well serve the marketplace by lowering prices. So, as I look at this merger, I say to myself, one of the good things about it is this pricespread they say may well increase, because what will happen is, it will accelerate more places becoming more remote, isolated, high-cost towns at least getting a superstore. That is a good thing.

Now, what has happened over time? Prices have fallen, fallen, fallen everywhere, from coast to coast, in all markets. Mr. Cary's papers and again this morning he says, you know what they respond to, is competition only from each other. He is doing the flip side of what he thought I would do at this trial. I think he thought I would come in and say, there is no competition between the superstores. We never said that. But what he is doing is going the opposite extreme and saying these other things have no impact. Obviously, something is going on that in the one-firm towns, when they lower prices year after year and there is no Depot, and there is no Max, they have to be doing -- they have to be lowering it for some reason. And we submit there are two reasons. One, is vigorous competition that they ignore, but exists in the real world; and two, the reality that the efficiency story is true. And as the company increases its volume, it drives prices down year-in, year-out in every market in America, whether or not there is an Office Depot there. And we have -- I got a couple of slides here with some examples, Your Honor.

You can go from Jackson, Michigan; Kokomo, Indiana; Elkhart -- Dover, Delaware; Altoona, Pennsylvania. And whether there is no Office Depot there or no OfficeMax there, they are driving prices down in market after market, specific markets instead of in the aggregate. I won't try to redraw the pricing chart on the board, but I did get an old slide Mr. Smith and I used before. And this marries to some testimony that I took from professor or Dr. Warren-Boulton.

The only way you can raise price is if you are willing to accept fewer sales. The two are inexplicably intertwined. I walked Dr. Warren-Boulton through that, and I used a couple quotes from an old mentor of mine, Professor Stigler, now deceased. And he said, consumers invariably obey one law as universal as any in social life, they buy less of a thing when its price rises. What their theory implies, is what these companies will do upon merging is reverse history. They will shift from companies that are constantly trying to lower price, to increase the quantity of sales. And they will do what the chart has, they will go back from the competition price, the C price and the PC price and quantity with competition, they will raise the price and reduce their output, and thus, losing the benefits of increased volume. Makes no sense, Your Honor.

Let's take a moment to look at the other side and what our position is. And this is again from Professor Stigler. The oldest and most basic -- the flip side of the first one. The oldest and most basic rule of demand theory is that people will not buy less, but usually buy more of a commodity when its price falls.

I asked Dr. Warren-Boulton about these things. And he said, of course, this is Econ 101; not something in dispute. This is rock solid. When you do that and translate into the draft I was trying to draw over there, when you get your cost curve down from what you will supply at the competitive market, instead of going up the scale, you try and push it down by getting lower costs, a supply that you would provide with increased efficiency; that is the way that you do it. You drive your costs down and it enables you to sell more at a lower price benefiting the marketplace. All of this is, to turn to another old friend, the productivity loop in operation, Your Honor. That is all that it is.

Mr. Smith reminds me to emphasize and I think I do later, but this is a good point to do it. Merger guidelines -- not merger guidelines, merger case law is concerned with a dynamic marketplace. What is going forward? What will happen in the future? And these kinds of things are powerfully instructive. It is saying, What lies ahead in a dynamic marketplace where it impacts not only ourselves, but other people as well? When others respond by increasing their own competition, by using, gaining the efficiencies of Wal-Mart? And Mr. Edwards from Kmart said, if we get lower prices -- and Mr. Stoudt said he saw them coming at him too -- everybody would be after me for those and they in turn would pass them onto their customers as well. It is a dynamic marketplace, not a static one. And many of their examples are static ones, not dynamic ones, Your Honor.

So they retreat to their concentration statistics. This is another one I talked about in my opening. They have two things. In their brief they say, post-trial brief, courts usually rely on market share and market concentration to measure the likely anti-competitive effects of the merger. They go even further, this is one of their conclusions of law. Post-merger market shares and large increases in concentration create a presumption that the transaction is illegal. You don't need to do anything. It is real easy. In fact, let me get the exact words this morning. Beyond dispute, is what Mr. Cary said, the market concentrate is beyond the dispute. If there is anything that is beyond dispute, Boris Steffen in the video, the Sergeant

Schultz' videotape, he says I know nothing, I just carry-out orders. Dispute. Those things are a joke is what they are.

And in fact I have some references here. I am running a little long on the clock, and I am headed to a break in a minute, Your Honor. But there are some good case law folks in here on not so fast red rider. I don't think the statistics necessarily carry the day, especially when they are shoddy statistics.

Here I asked Dr. Warren-Boulton, it turns out Mr. Cary did as well. Concentration data are only useful if you define the market correctly. That is what this market is all about, drive high numbers, so they can hide behind, they can say we don't have to prove our case, you can presume our case. That is what the whole exercise is all about, Your Honor.

Now, what did he say during Mr. Cary's direct examination? He is talking about how the merger changes the two player to one player, and three player to two player. By the way, one thing that is interesting that was consistent is that there is not a big pricing difference between the two-player and three-player markets. Their brief says maybe one percent. When Mr. Cary, if you look at one of the exhibits he gave you, had four charts on it. Actually all four of them, the price is lower where -- if you look at the green bar and the blue bar, you see that the two-player green bar is lower than the three-player blue bar.

Now, so he says, the immediate effects are in a group of markets. We will go from two to one; and another group will go three to two. That is a large structural change. And here is the key, and one which you would generally be expected to result in a significant price increase. Here is the hooker: If you define the market correctly. So I went back on cross and I said, You would expect, wouldn't you, that if the market is correctly defined in this industry, as in other industries, that the more concentrated the market, at least after a certain level, the higher the prices? He said, Yeah, all else being equal, yes. And you would expect the price, all else being considered equal, to be lower in places where there is lower concentration, wouldn't you? Answer, yes.

In my opening I had these done differently -- here I married both charts on the same chart. This marries two things. It marries their concentration with the pricing. They want to just presume all that. And I said, Okay, we will go back to our old friend Mr. Steffen. And we will say to him from his declaration, I have 35 markets spread out here, and I looked at the concentration. And you know what? Grand Rapids is the least concentrated of all, and Washington, D.C., is the most concentrated of all. If you define the market correctly, that tells you that the prices should be higher in Washington than they are in Green Bay. We went over to their pricing charts, and what do you find? You find exactly the opposite. Instead of the prices being way higher in Washington than Grand Rapids; prices are higher in Grand Rapids than in Washington. Even when you take the extremes, the ones that if prices were apt to be high anywhere, it would be -- if you have defined the market correctly, it would be in Washington. And if there is anyplace they ought to fall below, if you defined the market correctly, it is in Grand Rapids. Instead you find exactly the opposite. What this tells you is they have not defined the market correctly. So does their brief they filed yesterday. This is from page 2, not this exhibit. I did this exhibit. They say, you know, we are concerned here because you have got three-player markets going to two-player markets; and if you do a concentration, obviously individual markets will vary in their things, but let's make an assumption. It is a 50/50 market in one case, and one-third market in the other. What the change in concentration is, is 50 percent when you do that. And on the same page of their brief, they say what is the impact on prices? About one percent. Again, it tells you that on a huge jump like that, if the most they can find -- this is their number, I am not using my number. Theirs. It is a one percent differential, they defined the market wrong. You will also see, I need the

DX number in the lower-hand corner. 760. The market as they see it, and this is sort of done on a national level, they keep bemoaning all of these companies are disappearing. Their disappearance is good. They have consolidated and become more efficient and they have driven prices down as they have consolidated. It tells you they are looking at the wrong landscape. They should be looking at the bigger picture for out there in the marketplace. Everybody is selling.

The ten pitfalls. I had those up when Dr. Warren-Boulton was up there. I asked him about all ten in his deposition. He said, Oh, these ten pitfalls, no, no, no, these are not pitfalls. Three in particular that bear on our case. High Herfindahl's falls to competitor problems. Herfindahl's statistics are only useful in finding safe harbors. Anti-competitive effects may not occur even when the Herfindahl is very high. Number one he disagrees with. Number two, dismissing efficiency is speculative. Is that a pitfall you should avoid? No, no. Absolutely not. It is important to realize that anti-competitive effects are often equally speculative. And all potential efficiencies should be measured and balanced against potential adverse effects to predict the likely net effect of the transaction.

Frankly, he thinks it is not a pitfall to focus on a 5 percent test. I said, I didn't make these things up. I got them from a book that came out just a couple of months ago. Citations in the lower corner there. Turns out one of the co-authors is a fellow named Malcom Coate, who is the deputy director of the FTC's own Bureau of Economics. So they recognize these are pitfalls to avoid. He fill into all of the pitfalls, that is why his analysis is in the pits, Your Honor.

I am now turning to the simulations. What is the next one? Real merger requirements v. black box hypothetical merger simulations.

One of the things in looking at Dr. Warren-Boulton's writings, and this is the first time we have cited this. I was looking at it over the weekend last week. He says, you know, one thing you can look at is, can the merging firms document any cost increases after previous mergers? Let's take a look at their company documents. Mr. Cary talks about, I want to talk about hypothetical increases in connection with hypothetical mergers that they never did. Dr. Warren-Boulton said, no, no. Here is what is maybe more instructive. Actual pricing patterns, after actual mergers, that actually did occur; so we have an abundance on that.

By the way, a great quote from the Polaroid/Eastman Kodak case. Although I cannot paint a perfect picture of the market from the testimony of fact witnesses, contemporaneous documents, and market research, I find that evidence much more reliable than even the best econometric model. Direct evidence is, after all, the factual basis of the case. Not some approximation built on facts. In any event, he tells us, look at the actual mergers, not the hypothetical ones. Where we have done that, and we have one for each company, when Staples that acquired HQ in Los Angeles, the result was prices went down.

Same story when Office Depot acquired Office Club down in Dallas; afterwards prices went down, after the merger. In fact, there is record evidence that one of the reasons they went down, not only in Dallas, but elsewhere -- well, let's keep these two up and I will put Florida up in a minute -- is because of the efficiencies generated by that merger. And that impacted downward pressure on prices, not only in Dallas, but elsewhere as well. Prices went down after the merger, and they went down across the country. And if you do the comparisons, they are all in the same zone. One might be a little bit lower one year, a little bit higher the next, because there are a lot of individual factors that vary from Florida to Texas. But they are all down in the same direction and all down in the same general order of magnitude.

This is a good time for a break, Your Honor.

THE COURT: All right. Ladies and gentlemen, we will take a break for ten minutes. Be back at about 20 minutes of 3:00. We will continue with the Defendants' closing argument.

THE DEPUTY CLERK: All rise.

(Brief recess)

THE COURT: Are you ready to proceed?

MR. KEMPF: I am, Your Honor.

THE COURT: Thank you.

MR. KEMPF: Let me begin. My colleagues pointed out when I was discussing entry, I skipped over something I should have done at that time. I would like to go backwards and cure the record on that, Your Honor. It covers -- I discussed entry, and then I had meant to hand up to the Court a piece on powerful new entry on the horizon, something I mentioned in my motion.

THE COURT: A sealed matter?

MR. KEMPF: A sealed matter. Something we did in sealed evidence during the case. I handed up an under-seal piece during my opening, and I would like to do the same at this juncture, Your Honor. It goes to entry and constraint that the Court raised, and I will address it at the end also. If I can hand this up to the Court.

THE COURT: That's fine. All right. (pause)

MR. KEMPF: Thank you, Your Honor. At the break I was about to move into the econometics and saying they looked at carefully, we believe even their own econometric models show that the transaction will lead to lower prices.

This is something from Dr. Ashenfelter, and I have a couple of things from his that I also want to reference, Your Honor, if I could hand those up to the Court and to Mr. Cary.

THE COURT: Thank you.

MR. KEMPF: This is the so-called column 8. You know, Mr. Cary is critical. He says, you know, we didn't get Dr. Hausman's stuff until shortly before trial. You know, they had a chance to depose him twice after they got his stuff. They were handing us, as the Court will recall -- I know it was 3:15 one afternoon; we get stuff the next day -- it was coming so fast, even though they kept changing the table, they couldn't get it on the table fast enough. This was column 8. The chart was ending with column 7.

Let's walk through the black box study. We have this is -- this started 157 was one that we got at least in advance of trial. Dr. Ashenfelter, who was a little bit like Mr. Steffen, in the sense that he is relying on data he gets from the staff. He is not doing a lot of judgmental exercise of what the data is.

The first thing he does is say, Let me try Dr. Hausman's thing. He comes up and doesn't quite get it. Dr. Hausman had 0.9 and he says, Let me make the corrections

I think it ought to be made. He heads south on him. He gets to 0.8 and he starts running some models of his own. He says, suppose we try this; suppose we try that. And he is generating in each case numbers that don't even make their own 5 percent test. He goes along, 2.09, oh, shoot. Let me try again, 3.7, 4.0. And all of a sudden, column 7, eureka , I have hit the mother lode; I am now north of 5 percent.

And then Professor Hausman took a look at his stuff and we got back and said, you know, actually you guys are doing these wrong. So that is when we got PX 400, which drove the numbers down even lower. By the way, the interesting thing is the 7th column, when he was talking about that, Dr. Ashenfelter made a point of saying look at that t statistic, at 15. That is one-in-a-million chance that would be random.

Let's share some other information, Your Honor. Column 3, where one calculation he did yielded 2.5 percent. There is an one-in-a-million chance that is random and chance also, Your Honor. The same for all of the -- wait. Let me see. Yes, that is -- column 3, 4, 5, and 6 are all less than one in a million, based on those t statistics. And we have an affidavit that went in yesterday from Dr. Hausman that makes that point. All of those t statistics with the exception of column 2 are over one-in-a-million, and column 2 is like one-in-a-half-million.

The second one. So he keeps chugging along here. And then one of the things that the Court asked him, Gee, I noticed if you look down there at observations, Dr. Hausman has like merely 7,000 over here, and you have a thousand to 3,000 in some of these others. And that is when he said, Yes, I ran a monthly one, rather than a weekly one. I don't know what was in Your Honor's mind. I was saying to myself, why would anyone shift from using more observations to using less observations?

And let's talk about the group here. We had the FTC. We have a group of lawyers. The Bureau of Competition, folks, is the second bureau. The Bureau of Economics and Mr. Roberts, down at the end of the table from the Bureau of Economics, for example, and Dr. Ashenfelter is taking the data from them. And I don't know whether -- what all they ran, but what I assume that it is no accident that they said let's run it with less, less observations and see what happens here.

The Court asked Dr. Ashenfelter, Well, gee, what would happen if you ran it using the weekly data, instead of the monthly data? And we got this thing, this declaration, supplemental one from Dr. Ashenfelter a week after the trial was over. It says, Well, I went back and I ran Mr. Hausman's one in column 2, I guess it was, using monthly, instead of weekly. I don't think that is a significant change. I said margin analysis, which provided even more observations for a longer period of time. And again, both went in the same direction. I think we have that as the next one up there. Showing that even without considering entry or efficiencies, you get a modest increase nowhere near like they are talking about, and that immediately drops down when you start to add in the efficiencies and broadening the scope of it to a huge net decrease.

One other thing, I don't have any handups on these Your Honor; I will try to do these on the screen. These are things that Mr. Cary talked about this morning. He said, Well, gee, what about Cincinnati? Do we have company documents that address that? And the answer is yes, Your Honor. And this one is in the record as DX 588. It talks about what is impacting the pricing in Cincinnati. And as you see from the text I have highlighted at the bottom the remaining strong locals are setting the price for locals, making Cincinnati more competitive for prices.

When OfficeMax opened was there a big impact? Look at the second column, see the plus 15? This is like a Richter scale for measuring the impact. Yes, when there is a new restaurant that opens, does everybody go there right away? Yes. If you take a look what is influencing pricing over time, that is what you find.

Similarly, and I think Mr. Cary might have been trying to anticipate this -- if you look at consumers -- this is DX 588, contemporaneous business document. Who do the consumers think are the main competitors? This is Staples interview, Staples at the top of the list; second, Wal-Mart; third, Depot; fourth, Kmart; fifth, Sam's Club; and last, OfficeMax. There is vigorous dynamic competitors, even in Cincinnati.

Let me turn to the two other markets he mentioned. Again, I apologize. These are the only overheads we were able to make. If you look at the impact, and you say what is the impact here? Let me start with one that he had up there. It was Miami. And what is most noticeable about it is the impact when you net it out is 2 percent. Not anywhere near the 5 percent test they talked about. One, they made a big excitement about is the 2 percent. If you then take and look at Long Island, the other one he mentioned, again look at a contemporaneous business document, it shows the impact in Long Island is 1.69 percent. These are both in the range that Dr. Hausman talked about and what Mr. Stemberg talked about. They are not anywhere near consistent with the kind of numbers they were using, Your Honor.

Let me go back to my presentation. Predicting. I talked earlier about how it is a prediction. This is a quote from their memorandum at page 3. It says, in evaluating the legality of a merger, the antitrust laws essentially require a prediction as to whether the deal is likely to lead to less competition, and consequently higher prices for consumers. They have three things they talk about, the cross-sectional analysis, that is the PX 3 type exhibits. 6 percent to 13 percent. Dr. Warren-Boulton did the stock market study. And that is the one that he used 6.68. And I then asked for his stuff that he had up there, because I saw some handwriting on it. And turns out one of the people that worked for him did it on a more realistic 10 percent cost to capital number. And said if you do that, you fall under the 5 percent test again; and there's no magic to the 5 percent test again.

Dr. Ashenfelter, he is all over the lot, 0.8 percent to 8.6 percent. Dr. Warren-Boulton, page 23 of their post-trial brief says, you put all three together and they spell 5 to 6 percent. Borderline case, under his, when you put it all together.

I contrast this hypothetical modelling to predictions that I think come from real people in the real world. Again I carry us back to DX 1909 as to what is going to happen after the merger. What is going to happen is a continuation of the charter that Mr. Stemberg set for this company from day one. What it is going to comport with is a ten-year track record and a history of falling prices. What it is going to -- they can poor mouth the banner all they want to. When we announce this merger, the commitment that was made to the public was this merger would enable consumers to save even more. When they started questioning that, the companies ran joint ads from coast to coast, a series of them. We had one in our opening. Mr. Smith has it over there now. There are a bunch of these at DX 24, Your Honor, a whole series that are half a dozen or so. That when we join forces, our greater efficiency means even lower prices for you. This is something that they have taken and gone from a prediction to making a public commitment in the marketplace.

And I will show you something from Mr. Feuer in a minute, but they are not going to live up to that commitment. That is what they told the marketplace. They would get annihilated if they didn't live up to that. The final question I asked Mr. Stemberg,.

"Q: Now, on the pricing front, what will you do as CEO of the new combined company following the merger, if the merger goes forward?

"A: We will lower prices. That is the testimony, Your Honor, not coming from models. It is coming from business people and it is reflected over an unbroken string of ten years. And competitors, suppliers and customers all recognize and agree that is what the likely result of this will be, Your Honor. And they have said if it is not, constraint will bring you in a big hurry. We, the customers, will look elsewhere. We, the competitors, we will meet that looking and force those prices down in a big hurry, or you will go out of business. And there is a powerful incentive that leads them to want to do this, Your Honor, because this is the real marketplace. Not this trumped up three people where you Berlin airlift stuff into towns where there is no superstore. This is the real world where they have a small slice of the pie. And the reason, the powerful reason -- they talk about altruism and generosity, it is nothing to do with those things, Your Honor. It is common sense. A profit maximizing business strategy. It doesn't have anything to do with benevolence. It doesn't have anything to do with any of those. It has to do with common sense, sound business practices.

There is a huge blue circle there. We have a small slice of it, and the way to get a big slice of it, instead of going out of business, is to stay on the productivity loop, get those cost savings, and drive down prices and increase sales.

Now, they talk about unilateral effects. One of the things I looked at over the weekend, I don't think we highlighted this until our brief we filed yesterday, Your Honor. They cited Section 0.1 in their brief, and so I went back and I read Section 0.1. They cited it for something else. When I was there, I said, Look at this, their own guidelines say you could find a unilateral effects case, unilateral conduct. And by that we mean conduct, the success of which doesn't rely on concurrence of other firms in the marketplace.

Well, we know what OfficeMax says. They say No way, Jose, is what they say. Are we going to go along with this? Forget it. Mr. Feuer says, I don't believe that they will raise prices, but if they did, OfficeMax would eat their lunch from coast to coast. Nothing would provide a greater competitive opportunity for us than if they raise their prices, especially by some large margin like 5 to 10 percent.

He goes on to say, that would tarnish their image; the word would be out. We would not be bashful about telling the marketplace, these consumers, who say in survey and declaration, we would look around. He says, they don't need to look very far, because ourselves and all of these other people, these constraining dynamic people, we will tell them that is what they have done, and we will say come and visit us.

In fact, Mr. Ledecky on the stand addressed that specifically in his testimony. We would view it as an opportunity to stay lower, cut our prices deeper and steal their customers. Powerful constraint. And under their own guidelines it blows the unilateral theory out of the water, I think.

I want to shift to the efficiencies, Your Honor. I already covered -- this is not a people who are doing an evaluation of efficiencies after the fact. These are people who are driving the analysis of the efficiencies. And let me shift over here.

The main focus has been on the base case. I think it is instructive on this wonderful job that Mr. Painter did, when they asked him, How much of the aggressive case do you think they can get? His answer is, not a nickel, not a nickel. I have been dealing with these people for a long time now. I know how hard they make me work at night. What they are going to do, is they are going to have the aggressive case as a target to exceed, not to match. That is going to be their target. And the reason they are is because they want to get those costs down. They want to pass them along and grow on the productivity chart.

Now, they have said before and they say again, they can grow on their own. It is true we can grow on our own. What you do, you get on a new glide path and it is captured here. Dr. Hausman captured it very nicely when they were questioning. Why would you wait five years to get these efficiencies and pass them onto the consumer? The merger provides it to them today. You can lower prices now. Not only that, the merged company, it doesn't stand still, it grows. They get on this steeper volume, new efficiencies, and they grow like crazy.

So, Mr. Painter, let's go back over to him again. Mr. Curran at my request -- because I said I would get us out of here on Friday afternoon -- did an abbreviated discussion with Mr. Painter of his analysis, much like Mr. Cary abbreviated his against the clock this morning. I said to you I would tell you and I will do so now, that the place that you can find the detailed analysis of this. It is at our proposed findings 598 through 646, and those run from pages 238 to 251. Respond to those, and we responded to those in detail, Your Honor, at every turn, including everything he mentioned this morning. Including the subject of Hewlett-Packard that he made so much a big deal of. That is all covered in there, Your Honor.

Let me say this, they can quibble around the edges all they want to. And might they do some things differently, sure. My own view is, they will beat many or most of those projections. The important thing is, that the shear magnitude of them, and not losing the forest through the trees, what he does when he finds a nit he throws out an entire category.

Remember, for example, he said, what happened is, they didn't use '96 against '97, they used '95. He said no they had a story for that. What they said was, that's because some of those suppliers were saying to themselves, we are serving Depot with lower prices right now, and if we hope to compete for the new company's business, we better at least lower our prices to Staples, to what Depot is now. If they find out afterwards, we might be in deep trouble. So he said, what the rationale the business people gave them was no, 1996 is not really what we would be achieving as a stand-alone company. There is creep in there from people making anticipated price reductions to us, figuring the merge will go through and they want to get at a good place in the line.

Now, you can quibble around the edges how much of that, maybe you should give all of it; but the important thing is they are real substantial and powerfully supported. And that is set forth in detail in the places I gave you, Your Honor.

Now, what Mr. Curran did that is most instructive, is he said, now, these are the efficiencies claimed. This comes from PX 3(b), the last thing on that chart Mr. Cary reviewed with Mr. Painter. He broke it into three lines, and I have added a fourth. I have added a subtotal in the middle. He said the total efficiencies claimed against revenue would be 5.03 percent. I, Mr. Painter, think that about 2 percent, 1.94 is erroneous. And I find another 1.66 percent that are unsubstantiated, which gives us a range of

1.43 to 3.09. Those are all his numbers, Your Honor. And I am going to come back and talk about the unsubstantiated a little bit, both in terms of the efficiencies analysis, and in terms of the equities, Your Honor. Because the burden of proof in this case, notwithstanding everything he keeps saying, is on them. I think that is the first thing you said when we came out. And in this case, they have to meet that burden. And it is not enough for them to say, Mr. Joseffer's word when he was cross-examining Shira Goodman, we have not been able to verify those yet. Mr. Painter's word was then it is unsubstantiated. As far as I am concerned, those are unsubstantiated. Mr. Curran says, is it possible to substantiate them? Yeah. I think what that means, to use a different word from verify and substantiate, they were not able to prove that they are not there. That means that they cannot prove that they are not there. So what they do, they call them unverified, unsubstantiated and say we failed. But in any event, you get this bracket. We then went back and said, Let's run that bracket against the revenues that nobody questioned on their side in the room. Base case and aggressive case. On the sales side, what do we think the sales will be? And we will multiply it by the two numbers of Mr. Painter. And on the low end, it is a billion four and on the high end it is three billion two. Those are huge and powerful efficiencies, Your Honor. Driving fabulous cost savings that get passed onto consumers in the form of lower prices.

Let's go to the next one. Their attack on the pass through, let me pause on the pass through even before we put that point up there. They say, you have to prove pass through. There is a lot of people that think that is nonsense and is not good law, including the chairman of the FTC. he has written several things on this and he said, come on; and Dr. Gould covers this in his declaration as well, Your Honor. If these efficiencies are real, there are a number of things they can do with them. Let's study those. One thing, they can pay them out in the form of dividends.. If you pay stuff out in the form of dividends, guess what another name for shareholders is, consumers. Another thing you can do with them, and Chairman Pitofsky covers this, he says you can make this a more efficient factory, improve their distribution system. A lot of things they can do internally to put that money to work, and that benefits consumers especially as others in the industry respond. That is the chairman's view on pass through.

So, it is by no means clear you have to pass them through at all. Our whole history is passed on building them through; that is precisely what we will do. Even if that were not the record in this case, that doesn't get them home. Far from it. But then they say to prove we won't pass them through, they come up with this most bizarre study of all. This is the one they picked out of the 7,000 SKUs, they picked 41 of them. And for some reason, I don't know what it is, they struck them, and this goes back to my point. The Bureau of Economics people and the Bureau of Competition people. And before they give anything to Dr. Ashenfelter, they can do what they want to do, see where it comes out, and tell them here is what we want to do. They said run 30 of the 41. And we took a look at it, and what it turns out is, it is a Bic pen pass through is what it is. The most bizarre thing I have seen. A lot of bizarre things they have given us.

They made some reference, Mr. Cary did, about a quote Alliant case where he said Judge Bork said you know, you shouldn't do stuff on untried theories. You can shift the contest a little bit. And the untried theories here are all their untried theories. And it was not Judge Bork, it was Judge Oberdorfer, is my recollection.

Now, this is a chart I prepared. I apologize. This looks like an ad for the Turkish Government, I think. It is the reprint of the chart that Dr. Warren-Boulton did. And we just highlighted it in three columns of a red, green, and the price effect. His being competition effect, cost efficiency scale, and price effect. And it has -- it is a reprint of the one he did on the board, and then I just added a few things to it. And you recall during my cross-examination I abbreviated a little bit, and I said, we have a little bit of an apples and oranges problem, don't we, Doctor? The competition effect, that is only at retail. It is only in overlap areas. And it is only for consumable office supplies. The efficiencies, that is everything. He said, yes. And so, what I said is, you know, consumers don't spend percentages, they spend dollars. Let's take his math and run it using the 10 billion dollars in sales, and the billion four of overlap for retail and see what you get. When you do the three calculations, what you get is, one is a competition impact of 78 million; efficiencies at 30 million; 48 to the red. Use his second one you get 18 to the red; and if you do his third one, it is 42 million for the good for consumers. That is using his model and changing it over. Obviously, we think the pass through is much greater. We think the efficiencies are much greater. This is not our model, it just shows you, when you take a look at his old model, it just shows you, when you take a look at his old one -- one other thing that ought to be emphasized about all of their models, remember I talked earlier about dynamic? Their models are not dynamic at all. Quite the contrary. They are one shot price effects, and this is what both their experts said on that.

Dr. Ashenfelter, your simulations of price effects only predict the one-shot price effects of the merger; isn't that correct? Yes.

Me questioning Dr. Warren-Boulton. You talked about the competition effect. Didn't Dr. Ashenfelter testify that he didn't know whether that was sustainable, that it might be a one-shot event under his analysis. Answer, that would seem reasonable. These efficiencies are dynamic and they continue year in and year out. The dynamic marketplace on his price effect, if you start factoring in entry, constraint exercised by other people who start doing a response of the kind we have been focusing on, and I will come back to in a minute, if that does constrain, any price effect immediately disintegrates. That is the one-shot nature of it. If there are other things not captured in a non-dynamic model start to play out in the marketplace, they extrapolate and Dr. Ashenfelter testified about that.

What I then did was try to do another version using what I think is a more reasonable approach to it, using Dr. Warren-Boulton's model and it generates anything from a 15 million dollars in one year to 3.7 billion spread over five. And I am running against the clock, and I won't take the time to go through this but it is in there. And then you say to yourself, we covered this in the opening, why, why on earth would somebody that has a successful business format that they have been using for a long time, mess around with what is as Mr. Cary at one point called it the core of our business. The core of our business is of office supplies. Office supplies is a shrinking part of the business, and that is all. That include business machines, all of the things that he wants to cut out to get their high numbers. They have to not only get rid of furniture and computers, they have to narrow in and have only consumable office supplies, and that includes some non-consumables as well. That is a business. If you look at the 10K's -- both the companies are in the record. You will see that is a shrinking part of their business. It is way over 50 percent, and now under 50 percent. You say, why would you take these people and jack up the prices to them, and jeopardize they walk out of the store? And not only don't buy office supplies, they don't buy anything else in your store. By offering a broad -- our hook to get furniture and computer and other sales is this carrying the odd item. When we are there, we hope to carry not only the 20/80 stuff; we carry other stuff too. That is the way we compete in the marketplace.

Mr. Lapinski, one of their declarants is a good example. He uses the copy center and buys equipment. The least thing he does is office supplies. If you look at what Mr. Lapinski buys, those are exactly the kind of things Mr. Cary mentioned, the 80/20 rule. If you go out of Sam's Club and walk over to the CVS drug store and you turn to your left and look at that wall, you'll see they have a lot of the

SKUs, exactly the stuff that Mr. Lapinski buys. There is an image issue here as well, Your Honor. People go to the drug store a lot, and if they see our stuff is out of line on the pricing, it will kill us in the marketplace. There is a powerful constraint, even from CVS, because they carry most of those common items.

All right, let's marry them. Let's go from here over to when you combine them all and you say, we have this small percentage. Do we have a large version of this, Mr. Smith? It might be easier to see. We start with a small percentage of the business. And we start carving that down, and we go to 2.7; and we go to the overlap, and it is down to a billion four, and then Dr. Ashenfelter uses 8.6. This is a little different from his other model with 89 million. And then he says, is that sustainable? I don't know. I don't know whether that is sustainable. My model doesn't address that. It is not a dynamic model, it is a static model. To be sure, the big chunk of that is going to the shareholders. That is the portion that's accretive. That is the part they will get. The rest of it is going to go back to consumers in the form of lower prices. Somewhere in here, a huge chunk of that goes to consumers in the form of lower prices. And do we hope over time to drive the value of the stock up? You bet your life we do, Your Honor. That is the whole purpose of it.

Finally, Your Honor, let me close out with the equities, and I will try to pull some of this together. The statute -- actually the statute starts with the equities. He didn't mention the equities at all. They say, upon a proper showing of weighing the equities and considering the likelihood of the submission's likely success, such an action would be in the public interest. Preliminary injunction can be granted. Here there are powerful equities, Your Honor, both public and private.

I said I would come back to this ignoring proposition. It is not just the efficiencies they say ignore. There is another part in their brief they filed yesterday that says Dr. Hausman's analysis, because we got it late, not as late as we got theirs, but we got it late they say, so we were not able to recreate his analysis, so you ignore it. We were -- the Defendants were not able to verify or substantiate these things at least to our satisfaction; therefore, you ignore all of those things.

When you turn to the equities, Your Honor, first of all, you don't ignore them under any circumstance. But if there is one thing that is crystal clear, when it comes to the second half or actually the first half of the 13(b) test, you don't ignore them in the case. Dead on on that, is the Weyerhaeuser case. Judge Ginsburg expressly rejected the notion that you ignore those things. And the reason she did, she said, Look, what we are doing here at a 13(b) proceeding, it is not a Section 7 proceeding. She said, I don't need to address the issue here as to whether or not you could or couldn't take account of these in the Section 7 proceeding, but for sure you take account of them in this kind of a proceeding, because this doesn't make a final determination on the merits as to Section 7. It is a preliminary forecast. It is done under time constraint they themselves have complained about more than anyone. It is done on an incomplete record.

We have tried to make that less incomplete, and they chide us for that, but it is not as complete as it ought to be. Some of these things he raises today. Will I go back and look at Kocomo, Indiana? You bet, Your Honor. And Judge Ginsburg wisely said there, No, no, no, we are not going to sacrifice these things and ignore them because the preliminary forecast could be wrong.

Now, the powerful lesson from Weyerhaeuser is exactly on the money. In that case the Commission voted 5/0 not 3/2 like they did here. They voted 5/0 to challenge that transaction. And Judge John Pratt said, that transaction I think the Commission will win its case. And Judge Ginsburg said, Yeah, but they might not. I will let them have a chance. And when we had that chance -- Mr. Smith tried the case -- 5/0 they voted. They said, never mind, no problem after all. And so the efficiencies in that case, the pro-competitive benefits there were realized and not sacrificed on the grounds we will just ignore those for the time being.

Judge Pratt had the wisdom and Judge Ginsburg saw that wisdom to say, Let's give them that chance, because I could be wrong and there are powerful equities.

Here, not only do we have a strong case on the merits, but we have this overwhelming public equities. The 3 to 5 billion dollars in consumer savings. And if we are right, there is no need to sacrifice those consumer savings.

Now, they try to attack <u>Weyerhaeuser</u>. The brief they filed yesterday, they have a new attack on. They say, that was a whole separate order, and there is no separate order here. Is it is a blurring of two distinct issues in that case, Your Honor. They say you can take account of his equities. At the time of the <u>Weyerhaeuser</u> case, their position was, No, the only equity you can take account of is vigorous enforcement of the antitrust laws. That's the only public equity involved. You can't even look at private equities. That is the position that we are talking about Judge Ginsburg rejected.

There was a separate issue in the <u>Weyerhaeuser</u> case. Okay, if you take account of them what sort of remedy? And they try to blur those two and make it look like the opinion is talking about a whole separate order. It is not; it is talking about a separate issue. If you have a clean opinion with nothing like that in it, you can look at FTC v. Great Lakes Chemical by Judge Frank LaGarr, in Chicago. And it is 328 F. Supp 84. And the discussion of this point with no issue of a hold separate or anything else, parallels Judge Ginsburg's discussion exactly; and that is at pages 98 and 99 of that decision, Your Honor.

The dynamic nature of the efficiencies, Your Honor. It is not just the efficiencies that we will generate as suppliers realize those efficiencies internally and give them to others, so that all suppliers and all consumers, even those that don't shop at our store benefit from them.

We talked about various kinds of enhanced competition. We talked about increased foreign competition. Those are all important public equities. I will rest on our papers on those.

Private equities. Let me turn to those, and there is only one I really want to emphasize. Probably two. It's the loss of the Office Depot shareholders. An astounding finding they propose. Their proposed finding 325. They say Office Depot shareholders have not seen any significant diminution of the stock's value over the past year. Here is the real world. The stock was trading at 32 on September 8th, of 1995. The day prior to the merger, it had fallen to

16; more than half of the market, the per share, the number of shares increased; so it is a 48 percent loss in market capitalization. 2.6 billion dollars. Where do they get the notion? I call that significant diminution.

If I lost 2.6 billion dollars in value, I would be upset about it. I don't think they are comporting with the real world.

Now, let's talk about the transaction and its impact. That would be the next one. The merger agreement basis for the value is 22 dollars a share. The analysis, the analysts have estimated that the stock might trade-in the 10 to 12 dollar a share range, if the deal is not permitted to go forward. That is a huge loss. That is why all of these people with the cell phones are hanging around the back of the room that are here for the arbitrage community. They will take a big hit if this transaction doesn't go through. They are right that, you know, an illegal transaction can't be justified to somebody's private gains.

But the courts have made clear this is a preliminary forecast only. And when you are making that preliminary forecast, recognizing you have only seven weeks as they've emphasized, and recognizing that you could be wrong, as Judge Pratt was in the Weyerhaeuser case as to his forecast, that is the time when you for sure take account of these, because you don't put people in a 2.6 billion dollar penalty box lightly. Especially in a case like this, where you can have adequate -- if they proceed with their case, there is adequate post-divestiture relief.

Finally, Your Honor, I want to circle back to something they said and close the loop on the constraint issue. I tried to hit constraints throughout here, but let me come back to something. It really picks up on a question that you asked, Mr. Cary, too.

Here is where we are competitively right now. We are down at the intersection. And the question is, What happens if we raise prices? And there are two constraints that interplay in the marketplace. We have touched on them going along. Consumers say, Hey, the price has gone up, what should I do? Now, here we know what they will do. Survey tells us what to do. They will look around elsewhere. Declarants tell us what they do, including many of their own declarants. They say, They do that, I will look around elsewhere.

We also get to the other side of the equation. What will the Wal-Marts and those people do to constrain them and keep them from doing this? We will consider increasing our SKUs. When these people come around, we can lower prices. Some of these people are already lower prices than we are. Sam's, and BJ's, and PriceCostco, on many of these items not only match our prices; they are lower.

I would go back to what Dr. Warren-Boulton conceded from the witness stand. There is a lot more to it than that, it is value, price, service, convenience; all of those kinds of factors. Those are all constraining. And you don't need a price identity to have them very constraining on each other. Because, they do provide other things that are important to consumers and they all impact, just as automobile prices impact each other, even when they are not identical, and the like.

So, there is a powerful, in the dynamic world rather than a static one, if somebody tries to raise price, the two issues are, will consumers look around, and will competitors respond. And here, we know from all of the evidence that we have seen, consumers already look around. They are constantly checking these things.

Those letters Mr. Helford got, people look at all of these things all of the time, so they are very really constraining.

Let me give you a few other examples of constraints. Price-checking. There is a wealth of information in the evidence of the price-checking that we do against them and that they do against us. And the reason that they price-check is to compete vigorously with each other and to constrain each other. Basically, look in their eyes to capture more of the business from themselves. And the interplay of all of those things is what provides a competitive marketplace that well serves consumers. We check them; they check us.

Consumers cross shop. That is the 150 percent guarantee. They look around. That constrains us. When they come in and cash those in, that constrains us.

When Mr. Stemberg was on the stand, I showed you an example of hundreds of situations where Staples/Depot -- they had this facade that Depot constrains Staples, and Staples only responds to Depot. I gave you examples of many, many hundreds of examples where Staples' prices were below Depot's. If the only thing they were responding to was Depot, what in the heck were they responding to? They were responding to real world constraints coming from a host of other suppliers, Your Honor.

And the 40 price zones. The 40 price zones reflect the reality that there is a lot more constraint than the three competitors. There would be four price zones, if that were the only thing that existed out there in the real world. The reality is that there is massive price constraints.

I would close, Your Honor, by focusing on a question that you put to Mr. Cary. When you said to him, you know, you have been talking about prices going up, prices going up, isn't it really -- isn't the real gist here of your though the prices have declined from the general market?

MR. KEMPF: I'm not sure I follow the question, Your Honor.

THE COURT: If you take your chart that you have up there with the blue with the three party.

MR. KEMPF: PX 3, the first one, you mean?

THE COURT: You take your two-player, three-player and one-player market. The red is the one they used. Those generally have been higher across the board.

MR. KEMPF: It is not consistent. If you look at the backup you will see that. Is it true where there is only one, prices have been higher? The answer to that question is yes, Your Honor.

THE COURT: Have you shown, or do you attempt to show in your papers that the Bangor example, that is because it is other factors, or is it because there is not the same kind of competition as the other superstores, perhaps naturally the prices don't get as low as they do where there is Office Depot and OfficeMax?

MR. KEMPF: Your Honor, we try and do both. What Dr. Hausman tried to do -- and we found other examples in the evidence; people testified about it as well -- is to highlight some of those factors. And I have one chart up there that shows the presence, for example, of Best Buy, wholesale clubs, et cetera. And he said, those are different in those towns as well. And one way to look at it is to come back over here.

Remember, I said even when we open a store that has an impact. The reason for that is, if you increase the quantity, if you don't lower the price, you can't sell it. That is what the supply-demand curve tells you. So if we add a store in an area and increase output, that itself has an impact on pricing. So whoever comes into the marketplace, and whether it is an Office Depot, a Price Club, a wholesale club, everybody who adds output to the marketplace does have a constraining impact. And specifically, do we expressly acknowledge the fact that when Office Depot adds capacity to a market where we are, whether it is one, two, or three, that has an influence? The answer is yes. We have -- I think they thought that we would try the case on some other theory; we have not. We acknowledge that. What we say is, they make a mountain out of a molehill. It is one of a lot of factors; not one of one factor.

To understand it, you look at, for example, the ones I did on the fly, which I didn't have in my book, that show -- even the ones that they trumpet, it is 2 percent, 1.69 percent. Those are two of the three examples that he gave.

THE COURT: Mr. Cary likes the Bangor, Maine. He seems to prefer Maine. What about Maine? Bangor, Maine showing, as they define consumable office supplies being when you look at the prices are higher there than where else you have competition, where there is no other superstore competition in Bangor, Maine.

One argument I thought that you had been making earlier, and you showed it with your Coke example at Wal-Mart, was perhaps other factors. And I don't know whether it is transportation or whatever that would cause a higher cost for those products to be produced and sold. Have you gone that route or are you just --

MR. KEMPF: I have. That is certainly part of it. Let me give you some cites. In our Findings of Fact, 268 to 282 is where we discuss various other variables in PX 3. But it is costs to other competitors. And there are marketing costs. When we talk about Bangor, for example, the newspaper ad costs less in Bangor, than it does in Boston. You have a lot more stores in Boston, than you do in Bangor; so when you look at it your costs are higher in Bangor for that one, for example.

THE COURT: Let me get to one other. Just a couple of questions before I pass on to Mr. Cary, because it is my last chance to talk to the parties.

Dr. Hausman's analysis and the inclusion by Dr. Ashenfelter, the California and some Pennsylvania, I think, and some odds and ends stores -- Dr. Hausman said he was told that these are rural stores and they would skew the results. Is that the basis of his testimony? Or is that the argument Mr. Cary makes?

MR. KEMPF: No. That is what he said here today. But what the full testimony is, was, Dr. Ashenfelter said I think those are rural stores. And then he said, No, I remember now. I had four computer superstores. If there were four computer superstores in the area, I didn't do that. And the reason he didn't is because when he took a look at some earlier results in California, it got all of these crazy predictions. It said, prices will go up 76 percent in Los Angeles. And nobody in their right mind would think that would happen. He said it would be a mistake. It fails every test there is. It would be a mistake to lump that in and screw up the results. You would have to do it. He didn't ignore it. He took a separate model that took account of that. Both Los Angeles, and these -- the other ones. But he looked to California with something like 17 percent, if he did it that way; and no one in their right mind would think it would have any impact like that. You would have tumbleweeds blowing down the aisles of your superstores if you raised prices 17 percent. There would be nobody there. It would be like a ghost town.

THE COURT: Finally, what about Mr. Cary's argument about Goldman Sachs and the analysis they used? And it was not related really to efficiencies. It would be a different story today.

MR. KEMPF: That is -- I think I have it here with me. It is page 32. It is the proxy statement. This is the one that I marked up and passed over to Mr. Curran. 31 and 32. It is on page 31 and 32 of DX. I don't have the DX, I have the original here, but I will get you the DX number, Your Honor.

But what Goldman Sachs did is what is called and specifically identified as an accretion analysis. An accretion analysis says, basically, it starts off for the purpose of providing a fairness opinion to the shareholders. In each case, both of us. They are concerned, its not diluted. And in fact, what they are concerned about is the transaction covers itself as it were, so its shareholders are not worse of.

The questions, in other words, is can we generate a sufficient number of efficiencies that the transaction will be accretive, rather than dilutive? As Mr. Painter expressly acknowledged on the stand, an accretion analysis only measures efficiencies that are not passed onto consumers. Those are by definition excluded from an accretion analysis. But accretions analysis says, do we have a sufficient number of efficiencies here? If those are given entirely to shareholders, the deal pays for itself. And they did an accretion analysis and the answer to that question is yes. When they do that, they then have a basis to provide a financial fairness opinion to say so the shareholders, from a financial point of view, from a financial perspective, this is a fair transaction.

Then, when the Board says, Okay, we know that the deal will pay for itself as it were; we now go about and set about a very different exercise. And that is to see how many efficiencies we can find to drive the productivity loop. They're essentially apples and oranges. You are taking on the one hand -- let me just read you the quote somebody handed up to me from Mr. Painter.

And this is transcript page 286, beginning at line 10, Your Honor.

"Q: Mr. Painter, isn't the purpose of an accretion analysis to determine what is going to the shareholders and necessarily not what is going to consumers?

"A: It certainly doesn't assess what is going to consumers; you are absolutely right."

So the purpose of accretion analysis, it doesn't measure what is going to consumers at all. It is outside of the scope of an accretion analysis. The accretion analysis is how much do we give to the shareholders? To go over here, this is not that amount of it. Do we have enough of this down here that makes sense to go forward with the deal? And if it does, then we will form a task force and see if we can take a look at this thing more broadly and find out how many of these things we can find altogether.

In other words, before you sign onto the deal, you have to make sure that in the accretion analysis, show that the deal makes sense. Once the Board says, Yeah, it does make sense, that is when you put together your task force and say, Okay, let's go get them. Let's see how big these efficiencies really are. That is an exercise not for litigation. You do that in every merger as they have done and as time has shown -- In fact, the record is good on this. They have consistently underestimated the efficiencies in the past?

And when they have actually done the mergers, they have found time and again -- and this is in our findings I believe, also -- yes. They just gave me the numbers on it. This is at 603 to 607 of our findings, Your Honor.

When they have done prior mergers, they have found that their estimates, not the accretion analysis estimates, but their own estimates going in, were understated. They have more efficiencies than anticipated. That is why my own belief, and this is just my own belief, it doesn't count as evidence obviously, but there is evidence in the record. It does support the notion, that an aggressive case analysis is not something that, oh, gee, we have accomplished the aggressive case. Let's rest easy on the oars. That is a target that they want to beat. So, their past track record is they have beaten what their estimates were. So the Government says, Oh, my gosh, these things have grown like topsy. They start off with the accretion analysis nowhere big as near as this, and now looks what it has become.

The answer is, once you decide to go forward with the deal, you do put together a team. It is not a question of MBAs to justify everything. MBAs working with talented business people. You saw Ms. Goodman on the stand, trying to work very hard to find out -- let me go back to something that I said.

THE COURT: I just really had one question. I don't want to redo the argument.

MR. KEMPF: The only thing I was going to add, Your Honor, these are people who scramble like crazy over basis points, which is a hundredth of a percent. That is how intensely they look at this thing all of the time.

THE COURT: All right. Thank you. Appreciate it, Mr. Kempf.

Mr. Cary, you have some time and I have a couple of questions to ask you after you get through.

MR. CARY: Thank you, Your Honor. As you might imagine, I hardly know where to begin.

First, let's start with our famous Wal-Mart store, because we are back really to where we started. They have provided, and they put it up on that board, their consumer surveys, asking consumers, What would you do if Staples raised prices by 5 percent? And the consumer said, Well, we wouldn't shop at Staples anymore. Of course, most of those consumers might think about shopping at Office Depot if Staples raised prices 5 percent; and of course that is the choice these Defendants would take away from those consumers.

What do consumers do? Forget, the survey says. What do consumers do? Consumers have shown us how well they consider these to be substitutes. And consumers have told us they will pay the higher prices if they are required to because there is no competition among office superstores.

Mr. Kempf says, we are expecting these Defendants to act differently than they have always acted before. They keep lowering prices. We don't expect them to act differently than they have acted before. We expect them to act exactly the same. And the red zones that we talk about here are not all in rural communities; they are in urban communities as well. It doesn't matter whether it is urban or rural. It matters whether there is a superstore or there isn't a superstore. We expect them to act just like this. And we expect them to act just like they did when they put up on the board the three arrows going down and the red arrow.

They fixed it so it started at the same point; we know it doesn't start at the same point. It starts higher than the blue arrow. And as it proceeds, they get further and further apart. And the difference, the gap grows and grows, because they don't drop prices as quickly where they don't face competition as where they do.

Again, it is not a subtle point, not a difficult point. The question is, will prices be lower than they would have been if this merger doesn't go through? If the merger does go through, will prices be higher than they would have been, but for the merger? That is the question.

THE COURT: Let me ask you, when you mentioned Wal-Mart, I recall some testimony that on the silent killer theory that Toys "R" Us got into trouble because they sort of dominated the toy market for a few years. They raised their prices and Wal-Mart and Best Buy and others, Costco or something came in and said there is a market. And they brought in toys and competed and Toys "R" Us, got in severe financial difficulties apparently. At least that is what was mentioned.

Is that the scenario that the Defendants are putting up here, basically? If they go in and raise their prices, Wal-Mart and these others will see this niche and again to seriously compete against them more than you say they are now. Is that realistic?

MR. CARY: Your Honor, let's go back to the Toys "R" Us scenario, because my recollection of what was said about that was they stopped competing as aggressively and they did elevate prices. I didn't hear testimony to the effect they got into trouble, but I did hear testimony they lost marketshare. That's absolutely right.

But again the question is, what does the profit maximizing firm do? And that example, which Mr. Kempf has pointed out, is an example currently being litigated over at the FTC, is a very good one. Toys "R" Us is the so-called category killer. Unlike Staples, they don't face another category killer of the same magnitude; and therefore, they have slowly increased their profit margins and increased their prices to the point, that even though they advertise very low prices, they are not the same kind of low prices they were when they first started off. And yes, Wal-Mart has made encroachments in their marketshare, and yes the club stores have made encroachments. The interesting thing is they have not made sufficient encroachments to force them to lower their prices again.

THE COURT: The reason I said financial-- responsibility, is that to everybody's knowledge I used to own some Toys "R" Us stock and it went down a lot in the last few years. I don't think I have it anymore. I had at one time.

MR. CARY: The bottom line on this is a firm will do what is profit maximizing. And going back to Mr. Kempf's chart, if I could borrow it for a minute, it is very interesting what he puts up here. This is exactly right. Do you know what they called this block in this chart, where the firm raises prices? These are the extra profits that the firm makes by raising prices. This Economics 101 is very straightforward. You don't always lose money by raising prices. The question is, do you make more money from the people who stay with Staples and Depot, the combined entity, than you lose from those people that walk? You make more profit on those that stay, because your prices are higher. You make less money on those that walk. And the question is, how big is each group? And the evidence is very clear. Otherwise, the red bar would not be up that high. They would bring it down. They control the height of that bar. And they have decided that the profit-maximizing height of that bar is 15 percent higher than the most competitive market. They can make more money by keeping it there, than by dropping it to the same prices as Los Angeles, because people don't walk in enough quantities to Wal-Mart. Sure people leave, but they make more money on those that stay. That is Economics 101, and that is really what this is about. It is competition that increases the number of people that move when you raise prices. It is the fact that you have another very, very similar alternative in the form of Office Depot where a customer can say, I really like what Staples has to offer. If it were five or ten or 15 percent higher, I would swallow hard, but because I like what they offer, I would pay it. But if there is an Office Depot next door and Staples tries to raise prices, I don't have to make that difficult choice. I will just go across the street to the Office Depot, and that is why Staples' prices comes down where there is competition.

But if Staples buys Office Depot, you no longer have that choice. The consumer says, I'll go next door to Office Depot. We own that too. We will raise those prices as well. This is the very point missed by Mr. Kempf when he talked about expanding capacity. If you control all of the capacity, then you set the price at the profit-maximizing price, and you do it in what is in your best interest, not in what is the consumer's best interest.

Competition drives those prices down to a level that is competitive. That is what the merger laws are designed to prevent, is firms acquiring the alternative so consumers no longer have that choice.

THE COURT: And your secondary market that you talked about, in other words, the other office suppliers are not, quote, superstores, your mail-order people, et cetera, to give some examples, I guess Viking's advertisement of their annual statement saying they compete with them. Your premise is, that does not essentially affect their ability if they merge, or were to raise their prices, or not lower their prices much as they would in the past.

MR. CARY: Yes, Your Honor. That is what Mr. Helford testified to; that is what Mr. Miller testified to. That is exactly what they said. Our prices are already higher. There are some advantages that we offer to some customers, but there are disadvantages as well. And we would not expect to see our sales grow appreciably if the superstores raise their prices 10, 15 percent.

THE COURT: What about the value argument? It is not just a price, it is value. It is the service, it is the other factors so that they do compete, these type of companies with the Defendants.

MR. CARY: Your Honor, the value that they provide to the customer is the same in the blue bar areas as it is in the red bar areas. They don't say to people in Bangor, we will provide less value because you are paying higher price in superstores. The value is the value. What that shows is, since they are giving customers the same value, but Staples has the ability to raise their prices where they don't have competition, then Staples will not lose enough business by raising those prices to these folks, so as to make that price increase unprofitable.

And, you know, the chart that he put on here, or the annual report, '94 the report, it has two cities, Jacksonville and Cincinnati. Jacksonville is a Depot-only market where their prices are 12 percent higher than they are in Cincinnati. It is true that Viking serves both communities, but the fact that it serves both communities doesn't constrain the pricing of the superstores.

Now, it also is true Staples and Depot would like to get into that market, and they have gotten into that market. They have their own mail-order operations and they have their own contract-stationer operations. They do compete with Viking as a mail-order firm, and as a contract stationer. They do fight over customers in terms whether they will be a new store customer or not. But the bottom line is, Staples will find it profitable to raise prices, even though Viking it out there, because Viking's prices across the board are higher.

THE COURT: Viking thinks they compete with them. This article, the one you're holding up, for the record 1994 annual report says, in the introduction by President Helford, that it was not easy against low price superstore competition to increase their business in the United States to 297 million dollars.

MR. CARY: Yes, Your Honor. There is no question that all of these firms are fighting for the customers. No question about that. No question that Viking would love to have all of Staples' customers, but they are not going to get them. And they will not get them because they start out 20 to 40 percent higher priced than the top of the red zone, and the highest prices that Staples offers.

And in fact, Mr. Helford testified in this proceeding, he was asked, Isn't it true that the office supply superstore prices would have to increase by 10 percent or more before non-office supply superstore would see any significant increase in its sale volume? He answered, Well, I don't know the answer for non-superstore competitors, but in Viking's view, that is probably correct. And we have put into the record Viking's price-checking data which shows how much higher priced they are.

We also have testimony that the mail-order people would prefer not to deal with the small customer that goes into the retail store. The cost of shipping and handling to those folks are much too high for them to be competitive. And they have basically conceded that market to the superstores. There are many many customers who do not view Viking as an alternative, and that is what gives Staples the ability to raise prices, even though Viking is there and these other mail-order stores are there.

Another point that I think needs to be cleared up is this confusion about the 5 percent test. When Mr. Kempf puts the numbers on the board, he says this doesn't meet their 5 percent test on the econometics. The 5 percent test is not a tolerance level for anti-competitive price increases. The guidelines make that clear and the courts make that clear.

The 5 percent test is a guideline for defining the relevant market, and it assumes a hypothetical merger monopoly of all of the sellers in the market to get to that 5 percent test.

The guidelines say explicitly, it is not a tolerance level for price increases. In fact, the logic of the guidelines is, it is significantly smaller price increases re anti-competitive and illegal. The guidelines don't prohibit only mergers to monopoly, which is where you get the 5 percent price increase. They prohibit mergers at the 1800 Herfindahl threshold, as opposed to 10,000, which is merger to monopoly. The logic of that suggests you can have a price increase of less than one percent and it would be illegal, because the Clayton Act prohibits anti-competitive mergers in their incipiency. You don't have to monopolize a market before the Clayton Act kicks in, as the marketshare, statistics, and cases have held. So the suggestion that Mr. Kempf was making is just a totally inappropriate use of the 5 percent test.

The other totally inappropriate use of numbers was the t statistic numbers, Your Honor. He put up all of the charts of all the models that Professor Ashenfelter ran. And he said in most of these models the price effect is not even close to 5 percent. Again it is a fundamental misconception about what Dr. Ashenfelter was doing.

What Mr. Kempf in essence was saying is, if you correct only some of Mr. Hausman's mistakes, then you don't get the full price effect. We understand that. Each one of those was a separate mistake that was corrected to yield the correct result. It makes no sense to say, if you only correct one out of the nine mistakes, you don't get much of a price increase. Of course not. You have to correct all of the mistakes, include all of the data, and then you get the result.

I think Mr. Kempf just misspoke when he suggested that Dr. Hausman left out certain cities and ran the model separately. There were California cities that he did run separately, and he produced that data a couple of weeks after he produced the original data, a week or something.

There were other cities that he left out, that he never told anybody about, until we got into depositions here. And those other cities, while he remembered after the fact that there was this rule of decision that was made about four computer superstores, that rule of decision didn't come from him, did not come from any independent scientific basis. That rule of decision came from Staples, because Staples told him those markets were different. He didn't run a statistical test and decide they ought to be excluded. He kept them out and he didn't tell anybody that he kept them out. And he submitted a report that says this is all of the data and this is the effect, and he later admitted that wasn't the case.

Mr. Kempf made a big point about a couple of the charts that we put up. The one about Miami, and the one about Long Island. And he said, this doesn't even rise to the level of a 5 percent test. First, he misapplied the 5 percent test that showed actual price increases.

Second, those were markets where OfficeMax entered a formally non-competitive market. And we have already seen that OfficeMax is the high-priced competitor here. The idea of the OfficeMax is going to eat Office Depot's lunch if they don't lower prices as rapidly as a result of a anti-competitive merger, is absurd. They don't constrain these prices today very effectively. They bring them down somewhat.

As Mr. Kempf pointed out, they don't bring them down to the same level that head-to-head competition between Staples and Depot bring them down.

The merger law is very clear, if there is a particular competitive dynamic at work that drives prices down, that competitive dynamic is worthy of more protection than any other.

Let's talk about the aggressive case on the efficiencies. And again I apologize for jumping from topic to topic here. I am trying to get to the points as Mr. Kempf laid them out.

What Mr. Painter said about the aggressive case was that there was no basis for the aggressive case. Mr. Kempf mocks Mr. Painter for rejecting them, and suggests Mr. Painter was being arbitrary. Mr. Painter was exactly correct. We heard one witness from this witness stand, Ms. Goodman saying, Don't ask me about the aggressive case, you ought to check with Dr. Hausman. We then had Dr. Hausman come in, and we said, Dr. Hausman, what about the aggressive case? He said, I don't think anybody ought to base a decision on that work. He said that you ought to ask Ms. Goodman. Mr. Orlans at that point said, That's funny, she said, we ought to ask you. There is no basis for the aggressive case. It is one expert pointing to another, each of whom are hoping the other can support this fantasy of aggressive case.

We have heard repeatedly references to Mr. Pitofsky and his scholarly writings, Dean Pitofsky. They leave out one important qualifier to Mr. Pitofsky's statement on efficiencies that they have cited repeatedly. The qualifier was, that in that particular article, as I recall it, Mr. Pitofsky said, We ought not allow efficiencies at all after a certain concentration level. So, there were two sides to Mr. Pitofsky's suggestion about the appropriate policy for efficiencies analysis.

With regard to the pass through numbers that were recited, again, Professor Ashenfelter ran the same analysis on data provided by Professor Hausman. And if ours was the big analysis, theirs, I don't know what he would call it, but it is whatever Mr. Hausman shows that he got the same results on the pass through.

The reason for the selection of the items had nothing to do with any preselection or self-selection. What it had to do with was finding two items that matched. One from Depot, one from Staples. So you could compare what would happen if you had a firm specific cost decrease with a general across the board cost decrease, in terms of what would happen to prices. The idea was to match items. And all of the items that were matched, according to Professor Hausman was used, and the data was run, and it showed a 17 percent pass through rate.

No self-selection of data.

THE COURT: I'm not sure I understand that. The items that were on the board, the Bic pen items. Are those used by Professor Hausman in his analysis?

MR. CARY: Professor Ashenfelter did two analyses. First, he used the data provided by the FTC. Those are the ones he put on the board. He also testified, after being criticized on the basis of the sample, he went back and ran the same analysis on the sample that Professor Hausman had selected. And on that sample he got the same results, virtually the same requirements he described. I believe the difference was between 15 percent and 17 percent, was the difference using Professor Hausman's sample.

THE COURT: All right.

MR. CARY: One point of clarification on Bangor, Your Honor. Bangor was selected by Professor Hausman and by Staples as the example that they were trumpeting as the alternative explanation for high prices. It is not one that the FTC selected.

As in every other selected example, we went back and looked at it, and what we discovered was the truth. High profits drive the prices in Bangor, not high costs.

THE COURT: Do you want to mention when you have a chance, Mr. Kempf's review of the, quote, Office Depot Pricing Manual?

MR. CARY: Yes, Your Honor. I am glad that you mentioned that; I will do that right now.

Your Honor, the documents that we got are the documents from the parties. If there is a better pricing manual from Office Depot, the parties certainly know where it is and certainly could put it in the record. They put in 6,000 exhibits, about 100 of which are business records. We didn't find a better pricing manual in the hundred.

It is correct that the pricing manual they referred to was described as a draft, but various witnesses were questioned about that draft. Mr. White was questioned. He is the official that Mr. Kempf described as being responsible for having prepared that draft. And he was asked about that document and he was asked specifically, are the practices discussed in or described in the pricing manual in use today? Mr. Kovner made an objection. And he said, you mean the shops? I'm not sure exactly what that means. The witness answered, Yeah, I would say that they are fundamentally the same as this.

"Q: And have they significantly changed since you first drafted this in the summer of 1996?

"A: No. Dick Bennington, the man that was going to come up here and explain away all of the pricing information on behalf of Office Depot, who apparently never made it,

"Q: Have you made it clear to all of the people that work for you what your pricing policies are?

"A: I certainly have.

"Q: You think Mr. White understands your pricing policies?

"A: He certainly does.

"Q: Have you talked to him about your pricing policies?

"A: Of course.

"Q: Do you think he understands what your pricing policies are?

"A: I think he does."

This was a document that they were drafting in the summer of 1996. And as you all know, certain events came to play in the meantime. It was a draft, but according to the testimony, it was their pricing policy.

Now, with respect to the second part that Mr. Kempf referred to, of course, Office Depot competes with computer superstores. Half of their business is in the sale of computers. But is that document made clear their principal competitors are the office superstores? They did include Best Buy in that group, but as the evidence has been presented, Best Buy has since contracted their offerings and office supplies. They issued a press release to that effect, took a charge against their earnings, and said it didn't work for them. They tried to expand and they were unsuccessful, because of the barriers to entry in this market.

THE COURT: But the document was redrafted for an exhibit, or at least reorganized?

MR. CARY: It actually was not reorganized. What happened was, in order to create the graphic, what you have to do is scan the document into the computer and then generate that blowup portion.

So yes, that is a computer facsimile of the document. And I believe that in Mr. Vigdor's declaration it is described as such. The actual document is in the record and it is cited to specifically as a PX.

Again, what we have tried to do is attach the documents behind the demonstrative exhibit. But to use a fancy computer technology to make the highlight we had to scan the document in.

THE COURT: All right.

MR. CARY: In terms of the business records that Mr. Kempf relies on, and again, I think he said it himself, he is relying on one business record. The world has changed since 1986. The market is not the same place it was, and a start up firm trying to create a new market is not the same thing as the leading firm in its industry, competing head-to-head aggressively with the other leading firm in the industry. And yes, it might have been true that when they were carving out a new market, they were competing, just as the automobile competed with the horse when it started out. But with time, and with the successful creation of this format, they have succeeded in creating a new market. And the fact that they have done that by every definition in the case law does not now give them license to consolidate that market and create market power within that market, and thereby raise prices.

Mr. Kempf again misses the point when he cites the market share data between Grand Rapids and Washington, for example. The thrust of our case here, as we said repeatedly, is Staples and Depot head-to-head competition. We completely acknowledge that two-firm markets, where the two firms are Staples and Depot, and where they are fighting aggressively for that market, and where that market is saturated, are where prices will be the lowest.

OfficeMax markets are sometimes lower and sometimes higher; but OfficeMax is not driving competition in these markets. And therefore, to contrast three-firm markets that include OfficeMax and then show some two-firm markets with lower price, the two firm markets we are talking about are markets like Washington, D.C., and LA, where Staples and Depot are scrambling for market share by cutting prices against each other.

Professor Warren-Boulton summed it up the best. Grand Rapids. There is one store out here in Grand Rapids. There is two Depot stores up here, maybe 20 miles away, 15 miles away. The prices in Grand Rapids Staples' store are not non-competitive markets because they recognize the competition from these two Depot stores. That market is not saturated and they are not on each other's doorstep. So according to the Staples' pricing manual, Staples is in a position to elevate its prices, even though Depot is in the market relative to what they would be if they were really aggressively competing. Not to the level of non-competitive, but higher than they otherwise might be.

In Washington, D.C., and Los Angeles, these firms are at each other's throats. Mr. Kempf said it best, if you want to learn about saturation, three Staples within a few miles of each other out in Rockville Pike, one across the street from Depot; that is what will drive prices down. As these firms expand, and as they grow their shares in these markets, and they build new stores and come to hit against each other more and more, that is when the real price competition breaks out, which is why the prices are so low and why the Washington prices are low. It is that aggressive head-to-head competition in a saturated market that this merger eliminates, leaving no room for a new entrant, and allowing both firms combined to elevate their prices.

Let's look for a minute at prices in LA, because again, the suggestion was made that some of the econometics results are fundamentally implausible.

California is different. The reason California is different is because both of these companies have staked it out as territory. They are going after it. They are both in LA, both in San Diego, both in San Francisco. If you look at what that has done to prices in LA on price-sensitive items, below the non-competitive zone, LA prices are 20 percent below the non-competitive zones. You look at price-sensitive and non-price-sensitive, they are 14 percent below. And if you look at the general broad office supplies sample -- that's the one Mr. Stemberg said we ought to rely on -- they are 16 percent below.

A 17 percent price effect from these statistics is not at all implausible and certainly doesn't warrant throwing out the whole thing and not reporting the results.

Again, the fundamental point is that the 5 percent test is not a tolerance level for price increases. And a one or two or 5 percent price increase is enough to condemn this transaction.

Let's go back to the productivity loop for a minute. Mr. Kempf would have us all believe that the productivity loop is a self-sustaining cycle that works on its own, and that automatically drives prices down. We have seen it doesn't work in certain places where there isn't competition. But if you go back to Mr. Mandel's testimony, Mr. Mandel described Staples discovery of the productivity loop when OfficeMax entered the Boston market. It is competition that spurs these firms to lower prices in order to gain share from each other. If they can have the share without lowering prices, as they have demonstrated, they don't need to lower the prices.

Mr. Kempf talked about the price guarantees. And again this will not take long. He put up a chart that showed for a one-year period, there were roughly 3,000 claims on the price guarantee. If you take their 10 billion dollars in sales and divide it between an average sale of about $50 -- I am not much of a math genius, but I can conclude that 4,000 claims on price guarantee doesn't account for much of their business. So the Caldor 300 example, or 200 for Wal-Mart, is an infinitesimal portion of their business.

But even despite that, why would we not expect more of the ratio of the claims of price guarantee to come from Depot? The answer is in their pricing. As Mr. Stemberg testified, it is their policy to match Depot to the penny on a daily if not weekly basis. They match them consistently so people cannot make those claims, because they are so on top and obsessed with the prices Depot charges.

That is not the case with Caldor. They don't check and they don't match Caldor; so obviously there would be more examples where that would occur. The bottom line is that data is meaningless statistically, given it is such a small portion of their total sales.

The so-called hits analysis. Again, they are answering the wrong question. The hits analysis tells us what happens to sales when a new retailer moves into the neighborhood. The hits analysis they showed on the board is in fact what happens to sales if it is a Staples or Depot, the sales go down significantly; and if it is a Wal-Mart they go down about a third as much. But the issue is not how much their sales go down; the issue is what is happening to their prices. That is what we are concerned about, as Professor Warren-Boulton explained. The issue is price constraint. So the fact that their sales go down only matters from a competition point of view, an antitrust point of view, if it causes them to drop their prices. And the answer is it doesn't cause them to drop their prices. And the reason is, if Wal-Mart opens up and people start shopping at Wal-Mart, and they buy some of their office supplies at Wal-Mart, these companies can't lower their prices low enough to get those customers back. And the profit-maximizing strategy is to say those customers are gone, and now let's figure out what the most effective pricing strategy is with respect to our remaining customers. And the evidence is consistent. The evidence is, that the most cost-effective or profit-maximizing strategy is to keep the price high, if there is no other superstore.

That's why, despite the fact there is a Kmart in Fredericksberg, Virginia, the prices are higher than in

Charlottesville. And that's why the fact that there is a Wal-Mart in Leesburg doesn't cause Depot to drop the prices to the same level as Orlando. It is fundamentally addressing the wrong question. The pricing data we put in PX 3 is addresses the right question, as does the econometrics, which says that the price-effect of Staples and Depot is considerably larger than any of these other retailers.

Let's go to the equities, Your Honor. Congress has made a value judgment here. Congress amended the Clayton Act, in 1976, to provide for injunctive authority, to provide for the premerger notification program. And Congress did that because Congress understood that after the fact, unwinding of deals after the fact, and scrambling of eggs, does not effectively restore competition. And an injunction is necessary to preserve the status quo pending a full trial on the merits, so that in the event that the acquisition is found to be anti-competitive, there is an effective remedy at the end of the road.

Congress has made that judgment and the Courts have made it clear that the private equities do not cut against that standard. It is the public equities that favor competition that ought to predominate here.

And in fact, Judge Bork has made it clear in the <u>PPG</u> case. Once a substantial likelihood of success on the merits is shown, that there is a presumption in favor of a full-stop injunction.

Mr. Kempf can cite the Weyerhaeuser case, but the reality is, that the Court's last word on this was the PPG case which severely limited the reach of the Weyerhaeuser case. And it is very clear that a full-stop injunction is presumed once substantial questions have been raised about a transaction.

Now, the substantial question standard also is firmly established in the lot. It is established in the PPG case, the Alliant case, and the Ninth Circuit's Warner/Polygram case. And the reason is exactly what we have seen in this proceeding.

The question is, have you raised substantial questions so serious as to merit a full trial to the merits? And the reason is, because in the truncated proceeding, any Defendant can throw up a lot of material, can make a lot of arguments, which as I believe we have demonstrated. If you take each one of them and you address it, you have got answers for it. But if you can't address each one of them, because they raise so many, or they pepper the Court with so many different arguments and so many made-for-litigation exhibits, you are in a position where you can stop the whole process and you can allow for a transaction to go forward, which really does have substantial questions going to the merits that ought to be resolved. Congress has established the principal that those questions ought to be resolved. The reason they ought to be resolved is once the parties merge, once they combine their operations, taking them apart is extremely difficult, if not impossible.

And here we have an example of Mr. Kempf describing these in stores. What is the big deal? You can divest some stores. These are not just stores. These are stores tied together in a rational and organized network, metropolitan areas, tied to a distribution system that is rational and economically viable. All of these decisions were made in a calculated way -- where to put the distribution centers; how many stores it can feed off of; what are the ideal logistics given the store network. If you dismantle that as these parties plan to do, and if you eliminate all of the Office Depot distribution centers and consolidate into Staples, if you fire all of the employees of Office Depot in management positions, if you replace them with Staples employees, you have taken apart the business enterprise that is driving these prices down. An efficient operating machine has been taken apart and dismantled, and putting that back together is impossible, Your Honor. It is virtually impossible.

As Mr. Ledecky said, No one will come in here and buy 63 crummy stores. That is what they are if they are separated from this infrastructure. The infrastructure has to be preserved. These firms have to remain as viable competitors, because we know what happens where there is no competition; the prices will go up. And putting this together after the trial is going to be impossible.

THE COURT: Let me ask you a policy matter. This presumes that -- I mean FTC position presumes these two companies will stay as viable competitors with each other for the foreseeable future?

MR. CARY: Yes, sir.

THE COURT: One will not essentially outpace the other and one fades into insignificance. Is that historically -- can you show that is what happens if they compete so hard, one of them loses eventually, and you do have a dominant?

MR. CARY: Your Honor, there is no suggestion here, there has been no presentation of evidence to support such a suggestion that either one of these companies is in trouble, that either one is a failing firm.

THE COURT: It hasn't been a failing firm defense.

MR. CARY: There is not even a general dynamic defense in the sense of showing a declining firm.

What we have here is two aggressively growing firms. And in fact, what the evidence shows, the evidence that I pointed out in the opening statement, Staples is the one that is playing catchup here and they are doing a hell of a job at it, as I am sure Mr. Fuente would attest, but they are still playing catchup. Depot is still the low-priced leader, is still the bigger of the two firms.

What we have is competition in action. We have Staples aggressively lowering their costs and trying to compete. And OfficeMax is still very much in the race, although they are not as aggressive a price competitor. But there is no question whatsoever this market can't support the three firms. Quite the contrary, if you believe the Defendants, anybody can come into this market and thrive. There is no barriers to entry, there is no problem. We don't believe that, obviously; but there is no question that these three firms will survive.

THE COURT: I think what you are looking at then from the FTC point is something like a Barnes & Noble, and if the other big office bookstore wanted to merge, Borders want to merge, that would give you problems, I bet.

MR. CARY: I have not looked at that case, Your Honor, but if it looked like this one, it would give us problems, yes.

THE COURT: They don't serve coffee at their store like they do at Barnes & Noble; and Borders I like.

MR. CARY: That gets you back to the problem. They would have us believe that retailing is retailing, and none of these format differences matter. They matter to consumers. And if you look at the size of this market, there case. This is as powerful a case of pricing evidence as I have ever seen in 20 years of doing this kind of work. And if the pricing evidence doesn't matter, and if the pricing evidence can be obscured and obliterated in the face of people self-serving statements about who competes with whom, then we have to reevaluate the way we do these things. Because it is the inherited wisdom that price effects is what drives the antitrust analysis.

THE COURT: Any more you want to cover?

MR. CARY: I think I will leave it at that, Your Honor. Let me just make two small corrections.

I cited a document which showed that there were Wal-Marts and Sam's Club in Cincinnati prior to 1994. The correct cite on that is PX 73, at page 39. I think I might have said PX 39.

And I also quoted Mr. Glass for the proposition that he competes with convenience stores. Wal-Mart competes with convenience stores and gas stations. That is at page 42 and 43 of his deposition.

And finally, Mr. Kempf was correct, it was Judge Oberdorfer on the Alliant case. But the quote he was referring to was actually out of Coca-Cola.

THE COURT: Thank you.

MR. CARY: Thank you for your attention.

THE COURT: I want to thank all of the counsel again for their excellent work in this matter, their tremendous efforts on both sides. It is a pleasure for the Court to have such good counsel before them and see such good hard work.

I had said, I think maybe a little too quickly when the case first came in, I would decide this in two weeks. I didn't count 6,000 exhibits when I said that. It will be decided before the end of June. I hope substantially before the end of June. And I will advise counsel when the opinion is ready, and the opinion will be published after 3:30 whenever I finish it some day. But I will advise counsel when it will be ready, when it is finished.

I just don't want counsel to think it is coming exactly on June 15th. It may not make it by then, but it will not be a long delay. I want to go through the materials, the argument, and I'm fortunate enough to have the transcript. I want to review that as well as the briefs, so that will take me some time, but I will be back in touch with counsel as soon as I have finished the opinion.

Thank you all.

C E R T I F I C A T E

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

PATRICIA YERKES, RMR-CRR

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